CHAPTER 3
CHINA AND THE WORLD
SECTION 1: CHINA AND CENTRAL ASIA

Introduction

One of the most visible manifestations of China’s expanding global engagement has been its cultivation of close economic, political, and security ties with countries in Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan). Beijing sees Central Asia as a potential land bridge to markets in the Middle East and Europe, a source of much-needed oil and natural gas resources, and a dependable bastion of diplomatic support. But Central Asia is also a source of anxiety for Beijing, which fears Islamist groups in its economically and politically fraught western province of Xinjiang will find common cause with extremist or terrorist groups operating in the region. As the United States reshapes its own Central Asia policy in the wake of the drawdown in Afghanistan, it will have to take China’s growing presence there into careful consideration.

This section surveys China’s economic, energy, and security relations with Central Asia. In particular, it explores how China’s engagement with the region has evolved under Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping. China’s growing ties with the South Asian country of Afghanistan are also discussed. Additionally, this section examines how China’s interests in Central Asia both complement and compete with the interests of the United States as well as Russia, and considers the implications for the United States of China’s growing influence in the region. This section draws from the Commission’s March 2015 hearing on China-Central Asia relations; its July 2015 fact-finding trip to China (Beijing and Urumqi), Kazakhstan (Astana and Almaty), and Uzbekistan (Tashkent); consultations with experts on Chinese economic, foreign policy, and security affairs; and open source research and analysis.

China’s Central Asia Strategy

Since the establishment of the Silk Road during the Han dynasty (206 BC–AD 220), Central Asia has intermittently played an important role in China’s economic development and foreign relations. In modern times, Beijing’s view of Central Asia’s strategic value has waxed and waned. Fearing Soviet encirclement, Beijing viewed the region warily while it was part of the Union of Soviet Socialist Republics (USSR).1 After the fall of the Soviet Union in 1991, however, Beijing began the process of establishing diplomatic relations
with the new post-Soviet states, seeking to create favorable conditions for the economic development and security of its western frontier. During this time, Beijing cultivated ties with Central Asian governments, peacefully settled outstanding boundary disputes, and sought to take advantage of the region’s vast mineral wealth. When the U.S. War on Terror led Washington to establish bases and strengthen its strategic links in Central Asia in the 2000s, Beijing again became concerned about encirclement—this time by the United States—and sought to strengthen its ties with Central Asian capitals to sustain Chinese influence. Under President Xi, China’s longstanding efforts to cultivate influence in Central Asia became official policy in the form of the “Silk Road Economic Belt,” discussed later in this section.

Figure 1: Map of Central Asia

Decades before the Silk Road Economic Belt was announced, China approached relations with Central Asia with a clear set of interrelated objectives: (1) encouraging economic engagement between Central Asia and China’s westernmost province, Xinjiang, to bolster development and stability in that province; (2) eradicating what it calls the “three evils” of extremism, separatism, and terrorism from the region and preventing them from taking root in Xinjiang; and (3) expanding China’s economic and geostrategic in-


While the stated objective of Beijing’s immigration program was economic development, one observer cites political drivers as well, namely: “counteracting political pressure from Uyghurs … to import a loyal Han constituency.” Gardner Bovingdon, “Autonomy in Xinjiang: Han Nationalist Imperatives and Uyghur Discontent,” *East-West Center*, 2004, 23. See also Congressional-Executive Commission on China, 2007 *Annual Report to Congress*, 2007, 107.


How Xinjiang Informs China’s Central Asia Policy

Xinjiang, home to China’s Islamic Uyghur ethnic group, has experienced varying degrees of unrest in the past several decades. As in Tibet, many residents of Xinjiang do not culturally or politically identify with China, and some Uyghur groups advocate for greater autonomy or full independence for Xinjiang. Beijing views the existence of these groups as a threat to China’s sovereignty and security and has sought to silence them while simultaneously integrating Xinjiang into the social, economic, and political fabric of Greater China.

Chinese integration policies in Xinjiang are often violently repressive, alienating Uyghurs and fueling ethnic tensions. A decades-long government-led influx of majority Han Chinese into Xinjiang was meant to bring greater economic development to the region, but had the effect of disenfranchising local Uyghurs who found themselves excluded from economically productive sectors. This mass Han migration also led to the erosion of Uyghur cultural identity and language. Fearful of the “three evils,” Beijing has launched several “Strike Hard” campaigns to “root out places where criminals breed, and change the face of the public security situation” in Xinjiang. This has manifested in a heavy-handed security apparatus and led to the adoption of a repressive approach to Islam in Xinjiang. Human Rights Watch cataloged the range of China’s repression of religion in Xinjiang, referring to [a] multi-tiered system of surveillance, control, and suppression of religious activity aimed at Xinjiang’s Uyghurs.

... At its most extreme, peaceful activists who practice their religion in a manner deemed unacceptable by state authorities or CCP officials are arrested, tortured, and at times executed. At a more mundane and routine level, many Uighurs experience harassment in their daily lives. Celebrating religious holidays, studying religious texts, or showing one’s religion through personal appearance are
strictly forbidden at state schools. The Chinese government has instituted controls over who can be a cleric, what version of the Koran may be used, where religious gatherings may be held, and what may be said on religious occasions.\textsuperscript{10}

In recent years, the Chinese government has implemented a number of repressive measures, including banning Islamic veils and long beards, prohibiting some Muslims from celebrating Ramadan, and, although many Muslims do not drink alcohol, organizing a beer festival in a heavily Muslim-populated town in an effort to prevent "illegal religious promotion . . . and guarantee the village's harmony and stability," among other restrictions.\textsuperscript{8} 11

Predictably, these policies have fostered resentment that has frequently bubbled over into protests, unrest, and violence, which Beijing in turn often violently suppresses with police and paramilitary forces.\textsuperscript{12} This cycle of distrust, resentment, fear, and violence has been a prominent feature of Xinjiang's governance, particularly since 2009, when anti-Chinese protests and riots in Xinjiang's capital, Urumqi, caused the deaths of at least 197 people.\textsuperscript{13} A string of particularly violent incidents between 2013 and 2014 led to the deaths of hundreds more.\textsuperscript{14} China invariably refers to such incidents as acts of terrorism. Some undoubtedly are,\textsuperscript{2} but in many cases it is nearly impossible for outsiders to assess the veracity of the Chinese government's accounts of "terrorist" incidents, which likely exaggerate the "three evils" threat to justify crackdowns. According to Andrew Small, transatlantic fellow at the German Marshall Fund of the United States:

> Beijing's tendency to attribute almost any act of violence in Xinjiang to "separatists," to claim malevolent intent behind even the most peaceful of protests, and to criminalize political groups . . . leaves the line between the terrorist, the activist, and the aggrieved citizenry permanently blurred. However, this well-founded skepticism about Beijing's approach should not obscure the fact that there is, and has long been, organized militant opposition to Chinese rule in Xinjiang.\textsuperscript{15}

Beijing fears extremist groups outside China seek to spread their ideology and activities to Xinjiang, and Chinese officials often claim "hostile foreign forces" encourage the spread of the "three evils" there.\textsuperscript{16} These fears are not unfounded. Central Asia is spotted

\textsuperscript{8} Such abusive policies are likely to increase if China perceives the threat of instability in Xinjiang is growing. For example, Human Rights Watch writes that a draft counterterrorism law currently under consideration by China's legislature "makes clear the government's intent to establish a counterterrorism structure with enormous discretionary powers, define terrorism and terrorist activities so broadly as to easily include peaceful dissent or criticism of the government or the Communist Party's ethnic and religious policies, and set up a total digital surveillance architecture subject to no legal or legislative control." Human Rights Watch, "China: Draft Counterterrorism Law a Recipe for Abuses," January 20, 2015.

\textsuperscript{9} In the absence of reliable Chinese government statistics, a report by the Washington, DC-based Uyghur Human Rights Project estimated that 656–715 people were violently killed in Xinjiang from 2013 to 2014, with Uyghurs accounting for more than 75 percent of the deaths. Uyghur Human Rights Project, "Legitimizing Repression: China's 'War on Terror' under Xi Jinping and State Policy in Eastern Turkestan," March 3, 2015, 8.

\textsuperscript{10} For example, four bombings and a knife attack occurred in China between October 2013 and September 2014. In each incident, Uyghurs or Uyghur groups appear to have been involved. U.S.-China Economic and Security Review Commission, 2014 Annual Report to Congress, November 2014, 367.
with extremist groups and terrorist organizations that share ethnic, religious, cultural, political, and linguistic similarities with Uyghurs in Xinjiang. Members of the East Turkestan Islamic Movement, a Uyghur separatist organization labeled a terrorist group by China and the United States, reportedly have resided in or been trained by terrorist groups in Pakistan, Afghanistan, and Kyrgyzstan. In 2014, from his hideout in Pakistan, the leader of the East Turkestan Islamic Movement gave an interview to Reuters in which he said: “China is not only our enemy, but it is the enemy of all Muslims. . . . We have plans for many attacks in China.” Beijing also fears Chinese extremists will join terrorist groups and mount attacks overseas; according to Chinese officials and media reports, several Chinese citizens, including some from Xinjiang, have joined the Islamic State of Iraq and the Levant (ISIL, also known as ISIS, or IS). China’s Middle East Envoy Wu Sike acknowledged that approximately 100 Chinese citizens may be fighting or receiving training in the Middle East. One of two suspects in the August 2015 bombing of the popular Erawan Shrine in Thailand, which killed 20 people, is a Chinese Uyghur. This reality drives much of China’s engagement with Central Asia. Xinjiang shares 1,750 miles of border with Kazakhstan, Kyrgyzstan, and Tajikistan, and hundreds of thousands of Uyghurs live in Central Asia (primarily in Kazakhstan and Kyrgyzstan). According to Marlene Laruelle, professor and director of the Central Asia Program at the Elliott School of International Affairs at George Washington University, Kazakhstan at times represses its Uyghur population because “Kazakhstan understood that if it wants to have good relations with China, there is no way it can look like it is welcoming any kind of Uyghur independence or autonomous movements.” In strengthening ties with its western neighbors, China seeks to create conditions for stability and development in Xinjiang by pursuing a two-pronged, almost contradictory approach: integrating its economy with those of Central Asia while ensuring Xinjiang is insulated from the region’s pervasive problem of ethnic and religious conflict and the spread of the “three evils.” It remains to be seen whether China will be successful in its efforts to close Xinjiang’s borders to transnational threats while simultaneously opening them to regional commerce and investment.

China’s New Silk Road Policy

President Xi announced the Silk Road Economic Belt in a 2013 speech at Kazakhstan’s Nazarbayev University. According to President Xi, the initiative is aimed at enhancing regional economic and cultural integration by “building policy communication,” “having full discussions on development strategies and policy responses,” “improving road connectivity,” “promoting unimpeded trade,” and “increasing understanding” through people-to-people exchanges. China also envisions the Silk Road as a region of “more capital convergence and currency integration,” promoting the use of the renminbi (RMB) and facilitating its internationalization.

The most immediate objective of the initiative is to encourage economic development and stability in Xinjiang. According to re-
searchers who met with the Commission in Xinjiang, Urumqi is
“taking direction from President Xi” to become the “centerpiece” of
the Silk Road Economic Belt. Currently, some 78 percent of Xinjiang exports go to Central Asian states. Authorities in Beijing believe increased economic activity and trade ties with the region will benefit the Uyghur population and diminish ethnic unrest. China hopes that with construction of new roads, railways, and related infrastructure, Urumqi may be transformed into a regional and financial hub. China has already invested more than $91 billion in trade-related infrastructure in Xinjiang.

Although fostering economic development in Xinjiang is one of the stated objectives of the Silk Road Economic Belt, it remains to be seen if the initiative will bring significant economic benefits to China’s Uyghurs. Raffaello Pantucci, director of International Security Studies at the Royal United Services Institute for Defense and Security Studies in London, testified to the Commission that the vast majority of Uyghurs live in southern Xinjiang, while the majority of the new Silk Road projects and trade routes traverse the northern part of Xinjiang.

China’s Silk Road initiatives are not new; they are a culmination and a rebranding of several previous policies and projects aimed at linking China with its trading partners. The land-based Silk Road Economic Belt has a maritime counterpart, the “21st Century Maritime Silk Road,” which will run from China’s coast through Southeast Asia and the Indian Ocean to Africa and the Mediterranean Sea (see Figure 2). Together, they are commonly referred to as the “One Belt, One Road” initiative. Speaking in March 2015 at the Boao Forum held in Hainan Province—Asia’s response to the World Economic Forum held in Davos, Switzerland—President Xi said he hopes the annual volume of trade between China and countries along One Belt, One Road will be over $2.5 trillion in a decade. (For more on the 21st Century Maritime Silk Road initiative, see Chapter 3, Section 2, “China and Southeast Asia.”)

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*Although China’s engagement with Central Asia had been ongoing for some time, a Kazakhstani government researcher told the Commission that China’s Central Asia policy prior to 2013 had been “chaotic and ad hoc,” but that China’s approach has been “much more deliberate and strategic” in the years since. Kazakhstan Presidential Library, discussion with Commission, Astana, Kazakhstan, July 27, 2015.*
During the Boao Forum, China’s National Development and Reform Commission (the paramount state economic planning agency), the Ministry of Foreign Affairs, and the Ministry of Commerce released a joint action plan for the One Belt, One Road initiative. Though the plan did not detail prospective projects, it envisions a future where China and other countries coordinate their economic policies, open free trade areas, and lower nontariff barriers. The plan also calls for the expansion of bilateral currency swaps and development of a bond market in Asia.

Although the initial impact of the One Belt, One Road initiative is on China’s neighbors in Asia, the Chinese government’s official action plan calls for bringing together “China, Central Asia, Russia and Europe (the Baltic); linking China with the Persian Gulf and the Mediterranean Sea through Central Asia and West Asia; and connecting China with Southeast Asia, South Asia and the Indian Ocean.” In other words, the scope of the project is global, and will require buy-in from countries in Europe and the Middle East to be effective. In June 2015, Hungary became the first European country to sign a cooperation agreement with China on promoting the Silk Road initiatives.

To facilitate its engagement with countries that fall within One Belt, One Road, China’s State Council created the $40 billion Silk Road Fund, which went into operation in February 2015. The fund
is financed from China's foreign currency reserves (accounting for about 65 percent of the fund), with the rest coming from the government's sovereign wealth fund, China Investment Corporation (15 percent); and from two policy banks, the Export-Import Bank of China (China Exim Bank) (15 percent) and the China Development Bank (CDB) (5 percent). Unlike other recent financing vehicles spearheaded by China (the New Development Bank, also known as the BRICS* Bank, and the Asian Infrastructure Investment Bank), China is the sole founder and funding source for the Silk Road Fund. This arrangement will give absolute control over the various projects to Chinese policymakers. In addition, the National Development and Reform Commission's action plan for One Belt, One Road calls for the establishment of a financing institution administered by the Shanghai Cooperation Organization (SCO, discussed later in this section). Funding is expected to come from other sources as well, varying by project and location. For example, the CDB announced it will invest over $890 billion into more than 900 projects to bolster the One Belt, One Road initiative.

**Trade, Infrastructure, and Natural Resources in China's Central Asia Engagement**

Although the primary objective of China's economic engagement with Central Asia is to promote the security and development of Xinjiang, this policy has significant benefits for China's overall economic growth. First, China intends to diversify its energy portfolio by gaining access to Central Asian resources. Second, Beijing seeks to develop new markets for its companies through construction of roads and railways, with the ultimate goal of reaching Russia, Iran, and Europe. This has an added corollary of creating outlets for Chinese industries, such as iron, steel, and cement, which are experiencing overcapacity and slackening domestic demand due to China's economic slowdown (for more on China's economic slowdown, see Chapter 1, Section 3, "China's Economic Reforms"). Finally, China seeks to engender political goodwill and influence by fostering economically based "good neighborly relations." For landlocked Central Asia, China's economic largesse is an opportunity to upgrade its outdated infrastructure and connect to the global economy. Central Asian states also welcome China as a counterbalance to Russia, which until recently tended to dominate the former Soviet republics.

While China's economic engagement with Central Asia appears most often in imports of natural resources or investment in energy companies and energy-related infrastructure, China has also become an important source of exports of manufactured goods and loans to non-energy-related projects. The structure of the trade shows a lack of diversity, with China exporting finished goods and importing natural resources. Despite the strength of its energy exports, Central Asia as a whole tends to run trade deficits with China (see Table 1). Yet trade data do not tell the full tale. For most of these countries, China is not just an important trade partner; it is the largest by a wide margin (see Table 2).

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*BRICS is the acronym for five major emerging economies: Brazil, Russia, India, China, and South Africa.*
Table 1: China's Exports to and Imports from Central Asia

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Share of Central Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Asia Total</td>
<td>5,229.3</td>
<td>22,593.5</td>
</tr>
<tr>
<td>Exports</td>
<td>3,491.0</td>
<td>8,226.5</td>
</tr>
<tr>
<td>Imports</td>
<td>1,738.3</td>
<td>14,367.0</td>
</tr>
<tr>
<td>Balance</td>
<td>3,880.9</td>
<td>9,819.6</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2,902.3</td>
<td>7,726.2</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>761.4</td>
<td>9,092.6</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>143.9</td>
<td>1,479.7</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>129.7</td>
<td>1,459.5</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>90.4</td>
<td>803.0</td>
</tr>
<tr>
<td>Exports</td>
<td>19.0</td>
<td>28.4</td>
</tr>
<tr>
<td>Imports</td>
<td>71.5</td>
<td>774.5</td>
</tr>
<tr>
<td>Balance</td>
<td>230.2</td>
<td>1,277.4</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>451.0</td>
<td>330.4</td>
</tr>
</tbody>
</table>

Note: The table describes China's exports to, imports from, and trade balance with each country. Amounts in parentheses indicate a trade deficit.

Table 2: China's Place in Exports and Imports of Central Asian States, 2013

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Rank</td>
<td>Share Rank</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>19.5% 1</td>
<td>17% 2</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>4% 7</td>
<td>34% 1</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>11% 2</td>
<td>46% 1</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>77% 1</td>
<td>15% 3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>31% 1</td>
<td>21% 2</td>
</tr>
</tbody>
</table>


Although official statistics often understate the true magnitude of Chinese foreign direct investment (FDI) in Central Asia, they demonstrate a clear upward trend. As Figure 3 shows, the global financial crisis of 2008 was a turning point, after which Chinese investment soared, especially in Kazakhstan, where it reached $7 billion by the end of 2013.
When it comes to trade, investment, and loans, Kazakhstan, the region’s largest economy, is the dominant player. In 2014, Kazakhstan accounted for 53 percent of China’s exports to Central Asia, and 46 percent of imports (see Table 1). Kazakhstan’s importance is evident on many fronts. In September 2013, President Xi chose to inaugurate his Silk Road vision in Astana, Kazakhstan’s capital. During that visit, Kazakhstan received the lion’s share of signed agreements (up to $30 billion), compared with $8 billion in Turkmenistan, $15 billion in Uzbekistan, and $3 billion in Kyrgyzstan. Since then, Kazakhstan has continued receiving significant Chinese investment. During Chinese Premier Li Keqiang’s 2014 visit to Kazakhstan, the two countries signed $14 billion worth of economic deals, and in March 2015, Kazakhstan’s Prime Minister Karim Masimov concluded his visit to China with deals worth another $23.6 billion.

Kyrgyzstan is the second-largest destination for Chinese exports. Turkmenistan is the only country in Central Asia that has had a trade surplus with China, due to exports of natural gas. Uzbekistan, less important than Turkmenistan in terms of gas exports, is courting Chinese investment. In 2014, Uzbekistan’s President Islam Karimov and President Xi signed an agreement for cooperation in diverse sectors, including energy, high technology, and finance, with deals worth $6 billion between 2015 and 2018.

Kyrgyzstan and Tajikistan, the two smaller, energy-poor states in the region, have benefited less from China’s expansion in Central Asia than the other countries, though both are adapting in unique ways. Kyrgyzstan has exploited its central geographical position to become a regional wholesale market. Two-thirds of Kyrgyzstan’s imports come from China; Kyrgyzstan then re-exports three-quarters of these goods (primarily clothes and electrical products), mostly to Uzbekistan and Kazakhstan. So great is Kyrgyz-
stan’s dependence on China that re-exports of Chinese goods account for about 15 percent of its gross domestic product (GDP). Tajikistan, Central Asia’s poorest country, has traditionally depended on remittances from Russia for economic survival (according to World Bank estimates, remittances—90 percent of which originate from Russia—represent nearly half of the country’s GDP). However, with Russia’s economy hit by U.S. and European sanctions over annexation of Crimea, and the economy further weakened by the falling price of oil, Russian remittances to Tajikistan have been declining rapidly: in U.S. dollar value, remittances dropped 8.3 percent in 2014 year-on-year, and 40 percent the first two months of 2015 over the same period of 2014. Wedged between China, Afghanistan, and Turkmenistan, making it advantageous for transport routes, Tajikistan hopes to leverage its geographic position to attract Chinese investment. In 2014, China committed to invest at least $6 billion in Tajikistan over the next three years—a sum equivalent to two-thirds of Tajikistan’s 2013 GDP and more than 40 times its annual foreign direct investment. As of July 2014, China Exim Bank, the largest single creditor to Tajikistan, held over 40 percent of Tajikistan’s external debt, compared with the World Bank and Asian Development Bank, which held 16 percent and 14 percent, respectively.

As China’s trade with the region rises exponentially, its engagement has become more comprehensive. According to Alexander Cooley, professor of political science at Barnard College, Columbia University, China’s role in Central Asia is shifting from a mere commercial partner to a “regional provider of collective goods—including economic mediation and governance, development financing and even emergency lending.” In fact, according to Dr. Cooley, with its massive investments in Central Asia’s infrastructure, China had become the region’s “de facto development assistance provider.” The rest of this section considers this broader regional engagement.

**Strengthening Energy Security**

China has shifted from energy self-sufficiency in the 1980s to dependence on external sources of oil for about half of its consumption needs. Eighty percent of China’s energy imports arrive from the Middle East and West Africa by passing through the narrow Strait of Malacca, which China perceives is vulnerable to blockade (the so-called “Malacca dilemma”). Chinese leaders therefore look to oil- and natural-gas-rich Central Asian countries to diversify China’s energy sources and bypass critical maritime chokepoints.

Kazakhstan is the primary recipient of Chinese investment in Central Asian oil. China’s largest national oil company, China National Petroleum Corporation, is the majority owner of two of Kazakhstan’s major oil companies (it owns 85.42 percent of AktobeMunaiGas and 67 percent of PetroKazakhstan) and is involved in several oil exploration and production projects throughout the country. China’s sovereign wealth fund, China Investment Corporation, also invested almost $1 billion in Kazakh energy in 2009. Chinese companies control up to half of Kazakhstan’s oil production. During his September 2013 tour of Central Asia, President Xi reportedly signed agreements for $8 billion in loans
from the CDB and China Exim Bank to Kazakhstan—loans that will likely finance energy projects as well.

Chinese investment in Central Asian natural gas focuses on Turkmenistan, which has the sixth-largest natural gas reserves in the world. In 2012, over half of Turkmenistan’s 1.6 trillion cubic feet of natural gas exports went to China, and the two countries signed several natural gas contracts to increase exports to 2.3 trillion cubic feet by 2020. In 2014, China National Petroleum Corporation, the dominant foreign player in Turkmenistan’s hydrocarbon sector, invested around $4 billion in the industrial development of Turkmenistan’s natural-gas-rich Bagtyyarlyk field.

All of China’s Central Asian energy imports are transported via two pipeline networks: the Kazakhstan-China oil pipeline delivers Kazakh oil to Xinjiang, and the Central Asia-China natural gas pipeline delivers Turkmen (and to a lesser extent, Uzbek) natural gas to China by way of Turkmenistan, Uzbekistan, and Kazakhstan (see Figure 4). Chinese companies played a major role in funding, construction, and operation of these pipelines, with China National Petroleum Corporation occupying the lead position. Other companies, including Sinopec (another state-owned oil company) and CITIC (a state-owned conglomerate) are minor players by comparison. China also backs new oil refineries in Central Asia, or finances upgrades to old ones, since Central Asian states lack sufficient refinery capacity.

Figure 4: Oil and Natural Gas Pipelines from Central Asia to China

The Central Asia-China natural gas pipeline consists of three lines (known as Lines A, B, and C), the latest of which came online in 2014. Construction of the fourth line, Line D, is scheduled to start in December 2015. All lines originate in Turkmenistan, but where Lines A, B, and C run parallel to each other through Uzbekistan and Kazakhstan, Line D will bypass Kazakhstan, going through Kyrgyzstan and Tajikistan instead, allowing Central Asia’s poorest countries to collect transit fees. China has not provided a clear explanation for the inclusion of these energy-deficient countries in the pipeline network, though statements by China National Petroleum Corporation point to the desire to boost regional presence. The corporation said by 2020 the four lines of the Central Asia-China pipeline will carry over 2.8 trillion cubic feet of natural gas per year.

Though China’s energy needs are such that China will never overcome the “Malacca dilemma” with imports of Central Asian energy, some diversification is taking place. In 2004, China imported 26,000 barrels per day of oil from Kazakhstan; in 2014, the Kazakhstan-China oil pipeline shipped 240,000 barrels per day to China (approximately 100,000 barrels of Kazakh oil and 140,000 barrels of Russian oil), accounting for just 4 percent of China’s total crude oil imports. By comparison, for the same year Saudi Arabia supplied 20 percent of total crude imports and was China’s top oil supplier.

Turkmenistan, on the other hand, has emerged as China’s largest supplier of natural gas after the Central Asia-China pipeline went into operation in 2009. In 2014, Turkmenistan delivered 911 billion cubic feet of natural gas, accounting for 44 percent of China’s imports. Uzbekistan, a relative latecomer, started exporting natural gas to China in 2012, though there are plans for growing the relationship. For example, Uzbekneftegaz announced that gas supplies to China will be increased from 211 billion cubic feet to 353 billion cubic feet per year in 2015.

In addition to directly purchasing or investing in hydrocarbon projects, China provides energy-backed loans to Central Asian states. During the 2008 financial crisis, China provided two loans to Turkmenistan, valued at about $8 billion, in exchange for natural gas delivery commitments. China also concluded $13 billion worth of loans for energy deals with Kazakhstan, including a $3 billion loan in 2013 after China National Petroleum Corporation acquired a stake in an international oil consortium developing the offshore Kashagan oil field, the world’s largest oil field discovery in 35 years.

**Transportation Infrastructure and Other Sectors**

According to S. Frederick Starr, chairman of the Central Asia-Caucasus Institute and Silk Road Studies Program at the Johns Hopkins University School for Advanced International Studies, China “elevates transport to the level of a geopolitical project of prime importance” in Central Asia. Most countries targeted by China’s Silk Road initiatives have outdated or failing infrastructure, and lack the funds for upgrades. Seeking to fill this gap, China has invested heavily in Central Asian transportation systems. China stands to benefit from infrastructure improvement in
Central Asia in several ways: First, it facilitates trade with Europe and other regions. Second, routes heading to China’s border posts will reach isolated regions, boosting development and enhancing domestic connectivity. Third, Chinese companies, including the state-owned railway enterprises, heavy equipment manufacturers, and construction specialists, will profit from overseas infrastructure projects.

Several existing and new transportation infrastructure projects exemplify this trend:

- A $79.8 billion road project launched in 2015 in northwestern Gansu Province will add 60,000 kilometers (37,282 miles) to the existing transportation network connecting China’s westernmost provinces to North and Central Asia.

- A railway stretching 13,000 kilometers (over 8,000 miles), inaugurated in 2014, connects Yiwu, a small consumer goods hub located on China’s coast, with Madrid. This railway, the world’s longest, traverses China, Kazakhstan, Russia, Belarus, Poland, Germany, and France before reaching Spain.

Kazakhstan, which shares a border with China and Russia, thus presenting the most direct land route to Europe, had become the focus of China’s infrastructure efforts in Central Asia even before the inauguration of the Silk Road Economic Belt. China has built a series of rail links connecting Urumqi to the Chinese city of Khorgos, which borders Kazakhstan, and is an important hub along the existing Soviet-era railway networks. The first rail services along this “New Eurasian Land Bridge” began in 2012, with passage from western China to western Europe taking up to three weeks depending on destination, instead of five weeks using trucks and ships. Companies like HP, Acer, and Foxconn use the route to export computers from their manufacturing bases inland.

China also built a free trade zone in Khorgos, though it has not been well used because it is five hours away from the next nearest city, Almaty. China is working on addressing that transportation concern as well, with plans to upgrade the highway to Almaty—the last section of a transcontinental highway from China’s east coast port of Lianyungang to Russia’s St. Petersburg—to be opened by 2016. In addition, researchers at the Xinjiang Academy of Social Sciences told the Commission the central government in Beijing would like to expand high-speed rail in Xinjiang, linking the province with Central Asia (particularly from Urumqi to Kazakhstan) and with China’s eastern provinces.

In Kyrgyzstan, an $850 million allocation from the state-owned China Exim Bank is financing construction and reconstruction of major highways expected to facilitate regional trade. In Tajikistan, using a $900 million loan from China, Chinese companies built roads linking the capital, Dushanbe, with important provincial towns. In 2013, President Xi signed with Uzbekistan a contract for the construction of a $455 million railway tunnel in Uzbekistan in several ways: First, it facilitates trade with Europe and other regions. Second, routes heading to China’s border posts will reach isolated regions, boosting development and enhancing domestic connectivity. Third, Chinese companies, including the state-owned railway enterprises, heavy equipment manufacturers, and construction specialists, will profit from overseas infrastructure projects.

Several existing and new transportation infrastructure projects exemplify this trend:

- A $79.8 billion road project launched in 2015 in northwestern Gansu Province will add 60,000 kilometers (37,282 miles) to the existing transportation network connecting China’s westernmost provinces to North and Central Asia.

- A railway stretching 13,000 kilometers (over 8,000 miles), inaugurated in 2014, connects Yiwu, a small consumer goods hub located on China’s coast, with Madrid. This railway, the world’s longest, traverses China, Kazakhstan, Russia, Belarus, Poland, Germany, and France before reaching Spain.

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beksistan.88 Central Asian countries have also been purchasing locomotives and passenger carriages from Chinese suppliers.89

In his testimony before the Commission, George Washington University professor Sebastien Peyrouse documented extensive investment by Chinese companies in other sectors as well—from hydroelectricity to communications. These projects are usually financed by China Exim Bank, the CDB, or funds secured in joint venture partnerships.90 Some examples of these projects are outlined here:

- **Telecommunications:** Chinese telecommunications companies ZTE and Huawei are engaged in the development of wireless telephone networks in Kazakhstan, Tajikistan, and Turkmenistan.91

- **Hydroelectricity:** Chinese companies have entered partnerships with Central Asian states in the interest of having hydroelectricity delivered to Xinjiang or exported to countries farther south, including Afghanistan and Pakistan.92

- **Uranium:** Uranium plays an important role in China’s economic partnership with Kazakhstan. After signing several cooperation agreements and strategic partnerships between Chinese companies and Kazatomprom, the Kazakhstani national company, Kazakhstan became China’s main foreign supplier of uranium. Kazakhstan has agreed to supply a total of about 24,000 tons of uranium to China by 2020.93 China is also active in Uzbekistan: in 2009, the Guangdong Nuclear Uranium Corp. signed an agreement with the State Committee of Geology and Mineral Resources to establish a joint venture for the exploration of deposits in the Navoy region, whose uranium will be commercialized by the Chinese company.94

- **Cement:** Chinese firms are involved in the construction of many large cement factories in Tajikistan and Kyrgyzstan. Beijing has also proposed small-scale projects for the construction of mini-mills and factories for the production of bricks.95

It is worth noting that road and rail infrastructure have military applications as well.8 Many of China’s highways and rail systems have been designed to military specifications.96 China’s new highway and rail projects in Xinjiang—a large yet remote region with a smaller and more dispersed military presence relative to China’s eastern regions97—likely are being designed with these applications in mind.

China’s promise of enhanced interconnectedness and improved infrastructure leaves Central Asian states with a dilemma. Although they welcome Chinese trade and investment, many Central Asians—particularly in Kazakhstan and Kyrgyzstan, which have long borders with China—are wary of Chinese people migrating to the region. Statistics on Chinese migration patterns to Central Asia are unreliable, but Dr. Laruelle testified that “figures are mod-

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8 For example, the U.S. Strategic Highway Coordinator Network, consisting of more than 1,700 miles of corridors and interstate highways planned jointly by the U.S. Department of Defense and U.S. Department of Transportation, was designed to facilitate rapid deployment of troops and equipment for national security purposes. Rodney E. Slater, “The National Highway System: A Commitment to America’s Future,” Federal Highway Administration, 1996.
est. Nevertheless, Dr. Laruelle noted anxieties persist because the “potential for a Chinese ‘migration invasion’ into Central Asia would mean a fundamental undermining of the new states’ autonomy. Whereas the region has fewer than 60 million inhabitants, an over-populated China contains over 1.3 billion people.” As a result, most Central Asian countries have enacted strict visa restrictions for Chinese travelers. A Kazakhstani foreign policy analyst with whom the Commission met in Almaty noted that Kazakhstan has been reluctant to incentivize Chinese tourism to the country for fear that Chinese tourists would overstay their visas, causing Kazakhstan to “become too dependent on Chinese tourism for its economy and thus lose leverage to Beijing.”

China’s Security Engagement with Central Asia

As with its economic engagement, China crafts its approach to security relations with Central Asian countries with the domestic security situation in Xinjiang in mind. China-Central Asia security cooperation is designed largely to address shared concerns about terrorism and extremism. According to Zhang Xinfeng, one of China’s top officials with responsibility for Central Asia, “Terrorism attacks in Xinjiang are closely related to the activities of terrorist, separatist, and extremist forces in Central Asia, so joint anti-terrorist efforts from the [Central Asian] countries are crucial to China’s stability.” This cooperation is facilitated in part by Central Asian and Chinese governments’ shared willingness to use repression and government control—in varying degrees—to defend sovereignty and maintain stability.

The Shanghai Cooperation Organization

The SCO, established in 2001 by China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan (and which agreed to admit India and Pakistan as new members in June 2015), is the primary vehicle for China’s security engagement with Central Asia. Although the SCO ostensibly concerns itself with a wide range of issues, including economic cooperation, energy ties, counternarcotics, tourism, cultural exchanges, and international affairs, counterterrorism is the stated primary focus of the organization. One of the SCO’s foundational documents, the 2005 Concept of Cooperation, states SCO cooperation on counterterrorism focuses on developing unified political, legal, and law enforcement approaches to counterterrorism; conducting joint counterterrorism exercises and developing counterterrorism personnel; sharing information about terrorists and suspected terrorists and developing shared capacity for counterterrorism research and analysis; and collaborating with civil society and mass media to combat terrorism, among other activities. In some respects, this list of objectives remains aspirational, as illustrated below.

*Turkmenistan, in keeping with its isolationist foreign policy, is the only Central Asian country that is not a member of the SCO. There currently are four SCO observers (Afghanistan, Belarus, Iran, and Mongolia), six dialogue partners (Armenia, Azerbaijan, Cambodia, Nepal, Sri Lanka, and Turkey), and three guests (the Association of Southeast Asian Nations, Turkmenistan, and the Commonwealth of Independent States). The SCO’s predecessor, the Shanghai Five (China, Russia, Kazakhstan, Kyrgyzstan, and Tajikistan), was established in 1996.
Aside from frequent joint statements and regular high-level meetings, military exercises are the most visible manifestation of the SCO's activities. China has participated in 15 military drills or exercises under the auspices of the SCO since 2002, when China conducted its first-ever military exercise with another country, Kyrgyzstan.106 These exercises always include China and at least one other SCO country, and have included anywhere from a few hundred to 10,000 personnel.107 All but one of these exercises have focused explicitly on counterterrorism; various activities have included apprehending illegal border crossers, rescuing hostages, recovering a hijacked airplane, subduing ethnic conflict, engaging in close combat, and conducting reconnaissance, electronic warfare, and psychological warfare.108

On the whole, these exercises are not particularly sophisticated, and observers point out that they are largely scripted events with minimal interoperability demonstrated by troops from the participating countries. Interoperability is hindered in part by language barriers: Russian is the common operating language used in the exercises, requiring the Chinese participants to rely heavily on translators, which can be time consuming and cumbersome.109 Nevertheless, the SCO has been a valuable vehicle for the People's Liberation Army (PLA) to gain much-needed experience.8 Close to half of China's military exercises with other countries have been held under SCO auspices, enabling the PLA to interact with political and military leadership of other countries; operate in unfamiliar environments outside China; address linguistic, cultural, and other logistical barriers to effective communication with foreign troops; and practice battlefield tactics and combat methods.110 The PLA has also achieved a number of firsts in its SCO exercises: in its Coordination-2006 exercise with Tajikistan, the PLA Air Force for the first time transported troops across the Chinese border; and in the Peace Mission-2007 exercise, the PLA conducted its first joint land-air exercise outside Chinese territory.111

The SCO's Regional Anti-Terrorism Structure

The SCO's only permanent operational entity, the Regional Anti-Terrorist Structure (RATS) headquartered in Tashkent, Uzbekistan, is the organization's clearinghouse for exchanging information on suspected terrorists and promoting common counterterrorism practices. RATS is notoriously opaque, but is known for its role in the extradition of suspected terrorists to and from member countries, and for its secret “black list” of approximately 1,000 individuals and 40 organizations.112 In their 2012 book, The Chinese Question in Central Asia: Domestic Order, Social Change, and the Chinese Factor, Drs. Laruelle and Peyrouse write:

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8The PLA was joined in several of these exercises by People's Armed Police border troops, anti-terror reconnaissance units, and militia personnel. Dennis J. Blasko, “People's Liberation Army and People's Armed Police Ground Exercises with Foreign Forces, 2002–2009,” in Roy Kamphausen et al., The PLA at Home and Abroad: Assessing the Operational Capabilities of China's Military, Strategic Studies Institute, 2010, 384–387.
The SCO’s Regional Anti-Terrorism Structure—Continued

It seems that on several occasions the Chinese authorities have requested their Central Asian partners to arrest and deport some Uyghur opponents, and when alleged Islamists cross the border, they are followed by the RATS joint procedures set up to monitor them. However, it is difficult to say whether this type of information exchange has been made possible thanks to RATS, or rather whether it took place in a bilateral framework. Truly sensitive matters, such as the expulsion of Uyghur opponents to China, are generally managed at the highest levels of bilateral relations.113

Testifying in 2011 to the Tom Lantos Human Rights Commission of the U.S. House of Representatives, Martin Scheinin, then UN special rapporteur on human rights and counterterrorism, asserted RATS’ activities (and those of the SCO in general) pose serious human rights concerns.114 For example, the SCO charter conflates acts of extremism, separatism, or terrorism, and considers all three to be extraditable offenses, whereas international law follows the principle that only acts of terrorism—not to include crimes related to extremism or separatism, no matter how serious—may be targeted by counterterror legislation.115 China regularly pressures neighboring countries to detain and deport Chinese Uyghurs (many of whom are refugees) back to China. China often refers to these individuals as criminals or terrorists, but in many cases they appear to be ordinary citizens seeking economic opportunity or fleeing religious and cultural repression in China. Once back in the country, these forcibly returned individuals often “disappear” into China’s secretive security apparatus.116

China is by far the dominant actor in the SCO, and its priorities drive the organization’s agenda.117 The SCO serves three main purposes for China: First, in adopting China’s “three evils” construct and sharing its heavy-handed approach to ethnic unrest, the SCO lends a veneer of international legitimacy to China’s brand of stability maintenance.119 Second, it provides China the opportunity to use intelligence and resources from neighboring countries to inform and augment its domestic security activities in Xinjiang. Third, as the first intergovernmental organization with Chinese leadership, the SCO provides Beijing an avenue to demonstrate regional leadership and goodwill. In particular, it provides an opportunity for China to seek a larger security role in what has long been Russia’s sphere of influence.

For all its utility to China, the SCO has avoided taking on some of the region’s most pressing challenges, like cross-border water conflicts, civil unrest, and participating in postwar Afghanistan reconstruction efforts.120 The reluctance of SCO countries to be perceived as interfering in the internal affairs of other countries also contributes to its ineffectiveness. According to Drs. Laruelle and Peyrouse, even RATS, arguably the most tangible manifestation of
SCO action, is apparently viewed by China as “an empty shell with virtually no efficacy.” As SCO membership is set to expand with the inclusion of regional rivals India and Pakistan, achieving consensus on sensitive issues may be even more difficult. Moreover, Russia actively seeks to undermine the efficacy of the SCO (see “China in Russia’s Backyard?” later in this section).

China’s Bilateral Security Cooperation with Central Asian Countries

China’s security engagement with Central Asian countries is limited outside the umbrella of the SCO. This is due in large part to China’s preference to conduct even its bilateral security engagements with these countries through the SCO, presumably to lend substance to the organization and avoid creating the impression that China is unilaterally pursuing self-interested objectives in the region. When bilateral engagement does occur, it is usually in the form of border security cooperation, arms sales, and military education and training.

China and Central Asian countries sometimes cooperate on non-traditional security issues like drug trafficking and organized crime. For example, Chinese and Kazakhstani border security forces have conducted drug-seizing operations along their shared border since 2008 (in 2012, 70 percent of drugs in Urumqi were from South and Central Asia). Efforts in this area remain minimal, however, despite hopeful pronouncements during bilateral meetings that the two sides will enhance cooperation on drug trafficking. China also cooperates with Tajikistan on counter-narcotics (Tajikistan is a major conduit for opium trafficked from Central and South Asia to China). In 2014, a joint force of more than 5,000 Tajikistani and Chinese police seized 181 kilograms of heroin and other illegal drugs and arrested 38 suspected drug manufacturers and dealers.

Reports indicate China allocated approximately $40 million worth of military aid (including equipment sales, construction of military facilities, loans for purchases of military equipment, and other forms of military assistance) to Central Asia from the 1990s to 2014. Equipment transfers have mostly included small arms (such as sniper rifles), communications equipment, vehicles, mobile scanning equipment to monitor border crossings, and other unspecified military hardware. According to U.S. diplomats who met with the Commission in Uzbekistan, China is among Uzbekistan’s biggest suppliers of security-related products, which since 2013 have included surface-to-air missiles and at least one unmanned aerial vehicle (the cost of which is not included in the aforementioned $40 million figure). China’s arms sales to Central Asia represent a small share of China’s global arms sales, and pale in comparison to Russian arms sales to the region. China also provides military education and training to Central Asian troops, although language barriers limit the efficacy of such interactions.

China’s ability to expand its security presence in Central Asia may grow over time, particularly if a new draft counterterrorism law under consideration by China’s National People’s Congress passes. The draft law stipulates that the PLA or China’s police force could send troops outside the country to perform counter-
terror missions with a host country’s approval. If passed, this law could have broad applicability in Central Asia given China’s terrorism concerns there and existing structures for collaboration and information sharing between Beijing and Central Asian capitals.

**The Question of Afghanistan**

Since 2012, China has pursued an increasingly proactive policy toward Afghanistan. This marks a decisive shift from previous years, during which China largely avoided engagement with Afghanistan. China for several decades perceived Afghanistan through the lens of ongoing competition with Russia and the United States for influence in Central Asia, though China’s engagement in the country was minimal. After September 11, 2001, the threat of terrorism emanating from Afghanistan and the consequent U.S. military presence in the region caused Afghanistan’s strategic importance to China to grow; but even then, bilateral engagement remained limited. Since 2012, however, China appears to have come to terms with the fact that creating conditions for stability in Xinjiang requires it to take greater responsibility for the security and stability of Afghanistan as the United States and International Security Assistance Force withdraw from the country and the region. Still, China’s security engagement with Afghanistan is in a nascent stage.

**Drivers of China’s Shifting Approach to Afghanistan**

As with its Central Asian neighbors, China seeks to ensure terrorist or other groups in Afghanistan do not contribute to instability in Xinjiang or provide a safe haven for militant Uyghurs. Estimates of militant Uyghurs operating from Afghanistan range from the tens to the low hundreds. They affiliate largely with the Islamic Movement of Uzbekistan, a terrorist organization that operates primarily from Afghanistan. One senior Afghan Taliban commander told Reuters in 2014 that “[Chinese Uyghurs] live here with us but are always concerned about their people and mission in China. They are nice people, good Muslims and the best fighters.” It is unclear, though, whether Taliban-affiliated Uyghurs have participated in any terrorist activity in China.

Beyond the immediate concern related to China’s Uyghurs, Beijing is increasingly worried the International Security Assistance Force’s departure from Afghanistan will leave the country in chaos, and fears the potential implications for stability in Afghanistan, South and Central Asia, and—ultimately—China. As noted above, however, China had been reluctant to play any role in Afghanistan, largely rebuffing requests by the international community to contribute to security activities in the country. This was...
in large part due to deep skepticism and fears of encirclement as the U.S. military quickly established a robust presence in Afghanistan and Central Asia in the early 2000s. After the Obama Administration announced its plan to gradually withdraw forces from the region in 2011, China’s concerns shifted from the U.S. presence to the uncertain future of a post-occupation Afghanistan. Starting in 2012, China began to signal greater willingness to contribute to Afghanistan’s security. Recent engagement in the region includes:

- In September 2012, then Chinese Minister of Public Security and Politburo Standing Committee member Zhou Yongkang traveled to Afghanistan—the highest-level visit by a Chinese official since 1966—and pledged China would train about 300 Afghan police officers over the next four years.

- Also in 2012, China and the United States began an annual collaborative program to train Afghan diplomats in either Beijing or Washington, DC. In 2013, bilateral cooperation became more institutionalized, with the two sides establishing regular meetings on Afghanistan through the biannual Strategic & Economic Dialogue.

- During Afghan President Ashraf Ghani’s 2014 state visit to Beijing (his first foreign trip after becoming president), Chinese Foreign Minister Wang Yi pledged, “We will help Afghanistan to enhance its counterterrorism capabilities.” It is unclear, however, what form this assistance will take. That same year, Beijing appointed a special envoy for Afghanistan under the Ministry of Foreign Affairs.

- In November 2014, China sent a military equipment package worth $1 million to the Afghan Ministry of Interior Affairs. The equipment package included 17 types of military equipment to increase Afghan police force capabilities and assist them in seizing narcotics and drugs.

- In addition to strengthening bilateral diplomatic relations, China increasingly seeks to engage Afghanistan in multilateral contexts, primarily via the SCO-Afghanistan Contact Group (established in November 2005). Afghanistan became an observer to the SCO in 2012.

- Chinese Ambassador to Afghanistan Deng Xijun remarked in November 2014 that China supports “the ‘Afghan-led and Afghan-owned’ peace and reconciliation process,” referring to Afghanistan’s internal peace process between the government and opposition groups, including the Taliban, with which Beijing is increasingly engaging. China in the past year has publicly indicated its interest in hosting or mediating political talks between the Afghan civilian government and the Taliban, and in July 2015 participated (along with the United States and Pakistan) in the first of a series of planned talks between the two sides. It is unclear, however, whether China can

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provide the diplomatic prowess and leadership required to make meaningful progress toward reconciliation, especially given the death—reported in late July 2015—of longtime Taliban leader Mullah Omar, who had been Beijing’s most important contact with the group.

China’s relationship with the Taliban is complicated. 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 emerges as a major political player in Afghanistan.

China also has economic interests in Afghanistan, but instability and violence have limited investment so far. China’s two major projects in the country—the Aynak copper mine and the Amu Darya oil field—have significant economic potential but have suffered major delays in the past several years due to instability and terror threats. Chinese investment in the Aynak copper mine, for instance, has stalled due to an uptick in violence—including rocket attacks and improvised explosive devices—in nearby areas in 2014. China’s economic interests in Afghanistan are likely to remain aspirational until the security environment improves considerably.

China in Russia’s Backyard?

One of the consequences of China’s growing influence in Central Asia has been the relative weakening of Russia’s preeminence in the region. This has particularly been the case in the economic realm, where China is establishing itself as a provider of development assistance and a reliable consumer of Central Asian resources as Russia’s relative economic power declines. China’s security presence is growing as well, though Russia remains the region’s dominant security actor and cultural influence.

Russia has been reluctant to embrace China’s economic plans for the region, seeing in them the diminution of its own influence over its former republics in Central Asia. During the 2008 financial crisis, China surpassed Russia as the region’s leading trading partner, and Russia’s recent economic troubles have contributed to the perception that China, not Russia, is the “regional economic stabilizer.” Russia has other reasons to dislike China’s growing economic presence. According to Erica Downs, senior analyst at Eurasia Group, China’s investment in Central Asia’s energy sector has contributed to the “erosion of Russian influence over Central Asian states by providing them with non-Russian export routes and sources of financing.”

Russia has been actively promoting its own regional economic integration effort, the Eurasian Economic Union, which comprises Russia, Belarus, Kazakhstan, Armenia, and—as of May 2015—Kyr-
For example, the Baikonur Cosmodrome—the launching site of Sputnik and the world’s first and largest space launch facility—was established in 1955 in what is now Kazakhstan. Russia, which now leases Baikonur from Kazakhstan, continues to operate it.

† Established in 1992, the Collective Security Treaty Organization is a Russia-led intergovernmental military alliance among Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan.

Still, Moscow has found it prudent to link this effort with China’s economic plans for the region. In May 2015 during a summit in Moscow, Russian President Vladimir Putin and President Xi signed a declaration on cooperation between the Eurasian Economic Union and China’s Silk Road initiative. As part of this cooperation, China agreed to invest $5.8 billion in a $21.4 billion project to extend the Moscow-Kazan high-speed railway through Kazakhstan to China.

The Eurasian Economic Union had an unexpected benefit for China: because it created a customs union among its members that took effect in January 2012, the Eurasian Economic Union eliminated lengthy inspections at each border; cargo traveling from China needs to be inspected only once upon entering the customs union—through Russia or Kazakhstan—and can proceed to Europe unimpeded.

The SCO is perhaps the most compelling illustration of emerging Sino-Russian competition in Central Asia. Dr. Cooley testified to the Commission that “Russia has at every point dragged its feet [in] signing off on major Chinese economic initiatives, especially through the SCO.” For example, Russia prevented China from creating an SCO emergency crisis fund in the wake of the global financial crisis (though China went on to provide unilateral assistance to several Central Asian countries, as noted earlier) and blocked China from establishing an SCO development bank.

Similarly, Russia has sought to downplay the SCO’s role in the Central Asian security realm to maintain its place as the region’s top security provider. Niklas Swanström, director of the Institute for Security and Development Policy in Stockholm, Sweden, told the Commission that China’s SCO leadership “has arguably only been accepted by Russia for the purpose of monitoring the Chinese expansion into the region.” By virtue of its legacy of military influence during the Soviet era, Russia’s security ties with Central Asia remain robust (Russia has military bases in Kazakhstan, Kyrgyzstan, and Tajikistan and is the primary source of military equipment and training for Central Asian countries). Further, the Russia-led Collective Security Treaty Organization has been the dominant security organization in the region, a position Moscow does not wish to cede to a China-led organization. Yet China and Russia both seek to downplay this growing rivalry. China in particular is careful not to create the impression that it has military ambitions in Central Asia, and recognizes that attracting suspicion from the Central Asian countries and Russia would tarnish its reputation. According to Mr. Pantucci, “Whenever Chinese officials and experts talk of Russia in a Central Asian context, they go to great lengths to highlight the fact that they would do nothing that would contradict their Russian counterparts’ inter-
For example, Xinjiang public security officials stressed to the Commission that China’s Silk Road Economic Belt did not affect China-Russia relations or Russian economic interests in the region. Border Department, Xinjiang Foreign/Public Affairs Office, Xinjiang Provincial Government, discussion with Commission, Ürümqi, China, July 24, 2015.

† In parts of Kazakhstan, for example, ethnic Russians constitute as much as half of the population. Robert Coalson, “Putin Pledges to Protect All Ethnic Russians Everywhere. So Where Are They?” Radio Free Europe, September 20, 2015.

Enhanced Sino-Russian competition in Central Asia occurs in the context of a growing disparity of power between the two countries more generally, and the emergence of a relationship in which Russia is highly dependent on China, a reality of which Moscow is painfully aware. According to the RAND Corporation, “Many Chinese analysts view Russia as a weak great power that is likely to weaken even further in the future.” In the economic realm, Russia relies heavily on China as a market for its oil and natural gas exports. Particularly after its intervention in Ukraine, Russia has been economically and politically isolated and forced to depend on China to withstand economic sanctions and alienation by the international community. Still, ethnic Russians are a prominent group in populations across Central Asia,† and Russia’s deeply rooted cultural influence in the region—through language, media, and shared history—cannot be underestimated. For example, as Commissioners heard during their 2015 trip to Kazakhstan, most Kazakhstanis obtain their news from Russian television and newspapers.

Implications for the United States

The United States has identified “four critical areas of cooperation and concentration in Central Asia—security cooperation, economic ties, promotion of human rights and good governance, and efforts to bolster each country’s sovereignty and independence.” From an economic perspective, China’s efforts to promote development and connectivity in Central Asia may offer opportunities for U.S.-China cooperation.

To its Central Asian neighbors, China emphasizes the “win-win” aspect of its economic engagement with the region. To be sure, creation of new infrastructure in landlocked Central Asia has broad benefits, such as improved transportation and communication, which could ultimately lead to greater integration of the region into the global economy. But the focus on infrastructure aids China’s own economic interests first: the new trade routes will serve pri...
The Corruption Perceptions Index ranks countries and territories based on how corrupt their public sector is perceived to be. Ranked from 1 (very clean) to 175 (highly corrupt), Central Asian states fall at the corrupt end of the spectrum: Kazakhstan (126), Kyrgyzstan (136), Tajikistan (152), Uzbekistan (166), and Turkmenistan (169). Transparency International, “Corruption Perceptions Index 2014: Results.”

By building roads and railways, purchasing the region’s natural resources, and promoting the use of the RMB, China is ultimately tying its Central Asian neighbors’ prosperity to their relationship with China, potentially creating an unhealthy dependency. Indeed, there have been instances of public backlash in some countries, driven by lack of opportunities and fear of being overwhelmed by the Chinese presence. For example, as Commissioners heard during their fact-finding trip to Kazakhstan, China often uses its own workers for projects, which increases resentment of China and, on occasion, has led to minor clashes between locals and the Chinese workers. Environmental concerns also inform these fears, as in the case of Kyrgyzstan, which temporarily suspended operations at a Chinese-built oil refinery in 2014, after public protests over pollution. Xinjiang-based researchers told the Commission that Beijing is becoming more sensitive to these concerns, however, and is trying to address them by hiring more local workers at Chinese embassies in the region; establishing more cultural exchanges, including opening Confucius Institutes and “building bridges” between Uyghurs in Xinjiang and their counterparts in Central Asia; and highlighting Chinese investments that bring economic benefits to the region.

It is not clear if the economic benefits from Chinese engagement extend beyond Chinese companies getting valuable tenders and rent-seeking by local elites. Central Asian countries have severe corruption problems. According to Transparency International’s 2014 Corruption Perceptions Index, of 175 countries and territories surveyed, Central Asian states were some of the most corrupt. Growing economic linkages with China may exacerbate the situation, since Chinese enterprises are perceived to be very corrupt. According to Transparency International’s 2011 Bribe Payers Index, of 28 countries surveyed, China was the second most likely country (after Russia) to have firms that pay bribes while operating abroad. In his book on Central Asia, Dr. Cooley documented multiple instances of corrupt dealings by Chinese companies in Central Asia, centered primarily on getting access to natural resources. The Commission was told during its trip to Kazakhstan that Chinese companies are “more than willing to pay bribes” to close business deals in Kazakhstan.

When it comes to U.S. goals of advancing human rights and good governance in Central Asia, China’s presence poses several challenges. China, with its poor record on human rights, transparency, and corruption, is unlikely to be a force for good governance in Central Asian countries, which already have similarly poor records.
in these areas. As Dr. Cooley pointed out in his testimony to the Commission, Chinese investment tends to focus on “hardware” rather than “software”:

The current assumption of Chinese leaders is that better “hardware,” in the form of modern infrastructure, will spur economic development and improve market-oriented practices. But the region is challenged as much by its poor “software”—particularly corruption and rent-seeking—at all levels of government. We should not underestimate the extent of these governance challenges, for Central Asia today remains one of the [most] trade-unfriendly regions in the world.191

This poses a direct challenge to U.S. and Western efforts to encourage the adoption of transparent and democratic processes in Central Asia. According to Dr. Cooley, for governments in the region—all of which exhibit varying degrees of authoritarianism—the presence of Chinese patronage creates an opportunity “to push back and bargain against the conditions and terms demanded of them by more traditional Western lenders.”192 One consequence of this is that U.S. companies are disincentivized from trading with and investing in this risky environment, which in turn weakens overall U.S. influence in the region and reinforces Central Asian countries' preferences for working with Chinese companies.193

In the security realm as well, China's lack of transparency, heavy-handed approach to securing its western frontier, and preference for security and stability over fundamental human rights and religious freedom could have lasting impacts on the direction of Central Asia's development.

It remains to be seen how China's Silk Road initiatives will impact U.S. objectives in the region, and whether China's Silk Road Economic Belt and the United States' “New Silk Road” initiative will complement or compete with each other. Currently, China's well-funded projects appear to be outshining the United States' initiative. The U.S. program, announced by the Obama Administration in 2011, aims to foster communication and economic growth between Central Asia and Afghanistan, but it receives little attention and limited resources.194 For example, the U.S. New Silk Road initiative’s cornerstone project, the Turkmenistan-Afghanistan-Pakistan-India natural gas pipeline, has yet to attract any energy companies. Notably, the U.S. New Silk Road's central goal is to integrate Afghanistan with the rest of the region, whereas China has made no effort to incorporate Afghanistan into its many regional integration efforts. Part of the challenge the United States faces in realizing this goal is Central Asian countries' desire to distance themselves from Afghanistan, which they perceive to be a highly unstable neighbor.195

U.S. State Department officials told the Commission that the United States and China have held “remarkably candid and friendly consultations” on potential areas of cooperation in Central Asia,196 and China's ambassador to Kazakhstan told the Commission that Beijing “is ready to foster close cooperation with the United States in Central Asia.”197 In an influential 2012 article urging China to “march westwards” and engage more with Central
Asia, Wang Jisi, dean of the School for International Studies at Beijing’s Peking University, pointed out that “if China ‘marches westwards,’ the potential for U.S.-China cooperation in the fields of investment, energy, terrorism, non-proliferation, and the maintenance of regional stability will increase.” Indeed, China and the United States appear to have converging interests in the region: enhancing stability, promoting economic growth, and discouraging patterns of extremism, militancy, and terrorism. Nevertheless, the two countries’ preferred means to reach these similar ends vary greatly. On the whole, Washington’s policies in Central Asia seek to encourage the development of good governance and discourage authoritarianism and corruption. China’s preferred approach appears more appealing to Central Asian leaders, many of whom share China’s views on counterterrorism and understand China will support their efforts to remain in power and ignore corruption and human rights violations. This divergence in principles both undermines U.S. policy in Central Asia and will make it difficult for China and the United States to cooperate, particularly on counterterrorism, where Chinese practices may not be morally or legally compatible with U.S. practices and international standards.

Conclusions

• Although engagement with Central Asia has been a longstanding endeavor for the Chinese government, Chinese President Xi Jinping has recently elevated the region in China’s foreign policy in the form of the Silk Road Economic Belt initiative, which envisions a massive network of trade and infrastructure connecting China with Europe by way of Central Asia.

• China’s overarching objective for engagement with Central Asia is to encourage economic development and stability in its westernmost province, Xinjiang, which shares an extensive border with Kazakhstan, Kyrgyzstan, and Tajikistan. Chinese leaders perceive ethnic tensions, separatist movements, and related violent activity in Xinjiang to be among the greatest security threats facing China today, and fear patterns of religious extremism and terrorism in Central Asia enable this unstable environment. Therefore, Beijing uses its relations with Central Asian governments to seek to neutralize and eradicate these perceived threats.

• China’s security cooperation with Central Asia is designed to augment domestic security policies in Xinjiang, and therefore focuses on counterterrorism and information sharing about extremist and terrorist groups and individuals. China’s security engagement with the region occurs primarily via the Shanghai Cooperation Organization, which China uses as a tool to influence and demonstrate leadership in the region, but which has yet to play a significant security-providing role.

• Although the primary objective of China’s economic engagement with Central Asia is to promote the security and development of Xinjiang, this domestic-oriented policy also promotes China’s overall economic growth by (1) allowing China to diversify its
energy portfolio by gaining access to Central Asian resources, (2) developing new markets for its companies in industries experiencing overcapacity at home, and (3) engendering goodwill toward its policies in the region.

- China’s trade with the region is growing rapidly, but it is very unbalanced, with China exporting finished goods and importing natural resources. Despite the strength of its energy exports, Central Asia as a whole tends to run trade deficits with China. For most countries in the region, China is the biggest trade partner. Kazakhstan, the region’s largest economy, is the biggest recipient of Chinese trade, investment, and loans. Through its massive investments in Central Asia’s infrastructure—including roads, railways, hydroelectricity, and telecommunications—China has also become a de facto provider of development assistance.

- Chinese leaders look to oil- and natural gas-rich Central Asian countries to diversify China’s energy sources, though the volumes involved will not be sufficient to overcome China’s dependence on traditional sources of hydrocarbon imports, particularly Middle Eastern oil. One notable exception is Turkmenistan, which in recent years has emerged as China’s largest supplier of natural gas, accounting for 44 percent of China’s imports in 2014.

- As China’s influence in Central Asia grows, it increasingly is competing with Russia, which has long dominated the region in the economic, security, and cultural realms. China now dominates in the economic realm, though Russia is still the primary military and cultural power in the region. Beijing, which seeks stable ties with Moscow, avoids creating the perception of overt competition between the two countries.

- After several years of relative disinterest, China has been increasing engagement with Afghanistan since 2012. As with Central Asia, China fears extremist and terrorist elements in Afghanistan contribute to instability in Xinjiang. Anticipating the U.S. withdrawal from Afghanistan, China is starting to realize it will have to involve itself in the country’s reconstruction and stabilization to preserve stability and security in Xinjiang.

- China and the United States appear to share similar priorities in Central Asia, such as promoting economic growth and connectivity and preventing the spread of extremism and terrorism. Yet Beijing and Washington pursue these goals in very different ways, which could make meaningful cooperation in the region challenging. In particular, while the United States seeks to encourage democratization and discourage corruption in government and business, China supports the region’s authoritarian governments and is more tolerant of the region’s widespread corruption.
ENDNOTES FOR SECTION 1


25. Xinjiang Academy of Social Sciences’ Institute of Central Asia, discussion with Commission, Urumqi, China, July 24, 2015.
42. Shannon Tiezzi, “China’s Silk Road in the Spotlight as Xi Heads to Kazakhstan,” Diplomat (Tokyo), May 8, 2015.


85. Xinjiang Academy of Social Sciences’ Institute of Central Asia, discussion with Commission, Urumqi, China, July 25, 2015.


135. Andrew Small (Transatlantic Fellow, German Marshall Fund of the United States), interview with Commission staff, August 19, 2015; Saud Mehsud and Maria Golovnina, “From His Pakistan Hideout, Uighur Leader Vows Revenge on China,” *Reuters*, March 14, 2014.


161. RT (Russia), “Russia, China Agree to Integrate Eurasian Union, Silk Road, Sign Deals,” May 8, 2015.

162. RT (Russia), “Russia, China Agree to Integrate Eurasian Union, Silk Road, Sign Deals,” May 8, 2015.


186. Xinjiang Academy of Social Sciences’ Institute of Central Asia, discussion with Commission, Urumqi, China, July 25, 2015.


SECTION 2: CHINA AND SOUTHEAST ASIA

Introduction

China’s relations with Southeast Asia are complex and dynamic. Some of China’s strongest and weakest bilateral relationships are with Southeast Asian countries, and Southeast Asia is a useful prism through which to observe how Beijing perceives its place in the Asia Pacific and in the world. Currently, China-Southeast Asia relations are characterized by seemingly contradictory trends: China is aggressively advancing its territorial claims in the South China Sea at the expense of its Southeast Asian neighbors while simultaneously seeking to strengthen relations with the region, often through economic diplomacy.1

Since December 2013, China has expanded seven land features it controls in the Spratly Islands, which the Philippines and Vietnam also claim, by more than 2,900 acres—the equivalent size of more than 2,000 football fields.2 The scale and speed of these activities have far outpaced the activities of other claimants on the land features they control, and China intends to use its enhanced land features for military and other purposes. At the same time, however, China has sought to improve relations with Southeast Asian countries, primarily through economic initiatives and engagement with the Association of Southeast Asian Nations (ASEAN). China established the Asian Infrastructure Investment Bank (AIIB), which all the countries in ASEAN joined, and the “21st Century Maritime Silk Road,” a massive (and thus far largely conceptual) initiative that aims to enhance regional connectivity through infrastructure and other projects, traversing all of Southeast Asia and beyond once it is established.3 China appears to view economic cooperation through such initiatives as a way to ease tensions arising from China’s actions in the South China Sea.4 Moreover, China uses its engagement with ASEAN as a means of improving its relations with Southeast Asian countries and trying to reassure them that it seeks to be a peaceful and cooperative partner, while also promoting its own economic development.5 Among other ASEAN and ASEAN-related fora, China participates annually in the ASEAN-China Summit, the ASEAN Plus Three Summit, the ASEAN Regional Forum, and the East Asia Summit.† At the

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1ASEAN is comprised of Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

†In these fora, representatives of the member countries discuss regional and international issues and promote economic, political, and security cooperation and people-to-people and cultural exchange, among other things. The ASEAN-China Summit is attended by the heads of state of ASEAN member countries and China’s premier. The ASEAN Plus Three Summit consists of ASEAN member countries and China, Japan, and South Korea. The ASEAN Regional Forum is comprised of the ASEAN Plus Three member countries as well as Australia, Bangladesh, Canada, the EU, India, Mongolia, New Zealand, North Korea, Pakistan, Papua New Guinea, Russia, Sri Lanka, Timor-Leste, and the United States. The East Asia Summit consists of the ASEAN Plus Three member countries as well as Australia, India, New Zealand, Russia,
China-ASEAN Summit in November 2014, Chinese Premier Li Keqiang announced that China would provide loans and development aid to Southeast Asia and take further steps to develop the China-ASEAN Investment Cooperation Fund, which is focused on investment in natural resources, energy, and infrastructure in ASEAN countries.\(^6\) He also promoted the idea of a “China-ASEAN Treaty on Good Neighborliness, Friendship and Cooperation,” which he said would “provide an institutional framework and legal guarantee for the peaceful coexistence of both sides from generation to generation.”\(^7\)

This section explores this dynamic of competition and cooperation, discussing the South China Sea disputes, China-Southeast Asia economic relations, and China’s security cooperation with Southeast Asia. The findings in this section are based on a May 2015 Commission hearing on the security, diplomatic, and economic elements of China’s relations with Southeast Asia; the Commission’s July 2015 fact-finding trip to China and Vietnam; and open source research and analysis.

The South China Sea Disputes: New Developments and China’s Relations with the Southeast Asian Claimants

Among security and geopolitical challenges in Southeast Asia, the South China Sea disputes are the most contentious.\(^8\) In the past six years, China has taken a more assertive approach to its territorial claims in the South China Sea.\(^9\) China has largely employed a gradual, “salami-slicing” approach to consolidating its claims, which Bonnie Glaser, a senior adviser for Asia at the Center for Strategic and International Studies, describes as “using small, incremental actions, none of which by itself is a casus belli.”\(^8\) Starting in late 2013, however, Beijing’s efforts took on increased urgency as it began to use land reclamation and construction on the land features it controls to vastly expand its civilian and military presence in contested waters (see Figure 1).

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\(^6\) Six countries have overlapping claims to territory in the South China Sea: Brunei, China, Malaysia, the Philippines, Taiwan, and Vietnam. China delineates its claims on its South China Sea maps using a nine-dash line, which encompasses almost all of the South China Sea (see Figure 1). China occupies the Paracel Islands, though Taiwan and Vietnam also claim them. All the claimants, except Brunei, have military outposts in the Spratly Islands. (See Chapter 3, Section 3, “Taiwan,” for further discussion of Taiwan’s role in the South China Sea disputes.)

The United Nations Convention on the Law of the Sea

The United Nations Convention on the Law of the Sea (UNCLOS) specifies up to four main sovereign territorial or jurisdictional zones to which coastal states are entitled. A coastal state is entitled to a “territorial sea” of no more than 12 nautical miles (nm) extending out from its coast, over which the state has full sovereignty, subject to the right of innocent passage. Extending out an additional 12 nm is a “contiguous zone,” in which a coastal state can prescribe and enforce customs-related laws. A coastal state is also entitled to an “exclusive economic zone” (EEZ), a 200-nautical-mile zone extending from its coastline within which that state can exercise exclusive sovereign rights and jurisdiction over living and nonliving resources, but not full sovereignty. In addition, if a state’s continental shelf extends beyond its EEZ, it can submit a claim for an outer limit to its continental shelf to an UNCLOS governing body, which will provide recommendations on its delimitation. According to UNCLOS, “The continental shelf of a coastal State comprises the seabed and subsoil of the submarine areas that extend beyond its territorial sea throughout the natural prolongation of its land territory to the outer edge of the continental margin. . . .”

UNCLOS stipulates that only a country’s coastline and islands may generate an EEZ and a continental shelf. Islands, as defined by UNCLOS, must be above water at high tide and be capable of sustaining human habitation or economic activity of their own. Rocks, which are defined as being above water at high tide but unable to sustain human habitation or economic activity, only generate a 12-nm territorial sea. “Low-tide elevations,” which are submerged at high tide, do not generate a territorial sea (unless they are located within the territorial sea of an island or mainland coastline). Artificial islands, with the exception of those that are built on rocks, do not generate a territorial sea.

Under UNCLOS, foreign civilian and military ships may transit through a country’s territorial sea according to the principle of “innocent passage.” Passage is innocent so long as it does not involve activities that are “prejudicial to the peace, good order or security of the coastal State,” such as military exercises or intelligence gathering. Foreign aircraft do not have the right of innocent passage above a country’s territorial sea. China asserts that it has the right to require foreign ships to obtain permission or provide notification before conducting innocent passage, though UNCLOS does not include such a provision.

UNCLOS also entitles both foreign military ships and aircraft to conduct freedom of navigation and overflight and “other internationally lawful uses of the sea” such as conducting military exercises and collecting intelligence in the EEZ. In contrast, China and a minority of other states assert a right to restrict military activity in their EEZs. Although China does not object to foreign military vessels or aircraft merely transiting through

or flying over its EEZ, China rejects their right to conduct military activities, including intelligence gathering, while in the EEZ.24

U.S. law and practice is generally compatible with UNCLOS, but the United States has not ratified the treaty due to concerns in Congress. Proponents of ratifying the treaty argue that doing so would be economically beneficial and, by giving the United States a “seat at the table,” would enable the United States to have greater influence over international discussions and negotiations related to the treaty.25 Opponents of ratification argue that the treaty would impinge on U.S. sovereignty, and that signing it would be detrimental to U.S. economic interests.26

Figure 1: South China Sea Map


China’s Land Reclamation and Construction Activities in the Spratly Islands

China’s recent land reclamation activities in the Spratly Islands began in late 2013.27 Since then, China has conducted land reclamation activities on Johnson South, Cuarteron, Gaven, Subi, Mis-

Table 1: China’s Recent Land Reclamation and Construction Activities in the Spratly Islands

<table>
<thead>
<tr>
<th>Land Feature</th>
<th>Approximate Date Reclamation Began</th>
<th>Change in Size</th>
<th>Preexisting Infrastructure (Selected)</th>
<th>New Infrastructure (Selected)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mischief Reef</td>
<td>Early 2015</td>
<td>5,580,000 square meters</td>
<td>Two military facilities and a shelter for fishermen.</td>
<td>Reinforced seawalls, and airstrip (potential).</td>
</tr>
<tr>
<td>Subi Reef</td>
<td>July 2014</td>
<td>3,950,000 square meters</td>
<td>Helipad, military facility, and probable radar facility.</td>
<td>Reinforced seawalls and airstrip (potential).</td>
</tr>
<tr>
<td>Fiery Cross Reef</td>
<td>August 2014</td>
<td>2,740,000 square meters</td>
<td>Oceanic observation station, communications equipment, helipad, pier, air-defense guns, and garrison for approximately 200 soldiers.</td>
<td>Airstrip, administrative facility and support building, harbor, port, a second helipad, radar tower (potential), and circular antenna array.</td>
</tr>
<tr>
<td>Cuarteron Reef</td>
<td>Summer 2014</td>
<td>231,100 square meters</td>
<td>Military facility and satellite communication antenna.</td>
<td>Helipad, sensor array, and support buildings.</td>
</tr>
<tr>
<td>Gaven Reef</td>
<td>Spring 2014</td>
<td>136,000 square meters</td>
<td>Military facility.</td>
<td>A second military facility, port, and helipad.</td>
</tr>
</tbody>
</table>

Although China correctly points out that other countries in the region have also engaged in land reclamation and construction on land features in the South China Sea, China’s activities differ from those of the other claimants in the pace at which they have occurred and the amount by which they have enlarged the features. For example, in contrast to the more than 2,900 acres China has reclaimed since 2013, Vietnam’s reclamation activities in the South China Sea since 2009 have yielded around 60 acres of land. Although the Philippines military developed a plan to upgrade facilities on the eight Philippines-controlled islands and reefs in the Spratly Islands, it apparently did not carry out these plans.

The number of land features in the Spratly Islands that are occupied by each of the claimants is as follows: China, 8; Malaysia, 5; the Philippines, 8; and Taiwan, 1. Reports vary as to the number of features occupied by Vietnam, with the number ranging between 22 and 27. Available information indicates that at least Fiery Cross Reef (China), Gaven Reef (China), Mischief Reef (China), Johnson South Reef (China), Subi Reef (China), Swallow Reef (Malaysia), Thitu Island (Philippines), Itu Aba Island (Taiwan), Spratly Island (Vietnam), and Sand Cay (Vietnam) are inhabited by military or coast guard personnel. Civilians not affiliated with government agencies also live on several of these islands. Reporting on the human population of the Spratly Islands is limited; a comprehensive listing of the number of people living on each land feature is unavailable. Among the facilities the other claimants have built or are building on the land features they administer in the Spratly Islands are airstrips, port facilities, lighthouses, a surveillance facility, radar and communications equipment, hangers, helipads, gun emplacements, schools, and medical clinics.

<table>
<thead>
<tr>
<th>Land Feature</th>
<th>Approximate Date Reclamation Began</th>
<th>Change in Size</th>
<th>Preexisting Infrastructure (Selected)</th>
<th>New Infrastructure (Selected)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Johnson South Reef</td>
<td>January 2014</td>
<td>109,000 square meters</td>
<td>Military facility, pier, helipad, communications facility, and garrison building.</td>
<td>A second military facility, harbor, port, fuel dump, desalination pumps, radar tower, and defensive towers.</td>
</tr>
<tr>
<td>Hughes Reef</td>
<td>Summer 2014</td>
<td>76,000 square meters</td>
<td>Lighthouse and helipad.</td>
<td>Harbor, port, military facility, and defensive towers.</td>
</tr>
</tbody>
</table>

The Contentious China-Philippines Dispute and the Philippines' South China Sea Arbitration Case

The China-Philippines dispute is among the most volatile of the South China Sea disputes. In recent years, China has taken advantage of its superior maritime presence and greater economic, political, and military footprint in the region to gain the upper hand in the competition for territory. China-Philippine relations came under stress in 2011 with a tense encounter between Chinese maritime law enforcement ships and a French ship conducting seismic testing in oil and gas fields for the Philippines government. In 2012, after a standoff between Philippine and Chinese ships, China effectively secured control of Scarborough Reef, a contested fishing ground approximately 500 nm from Hainan Island, China's southernmost province, and 124 nm from the Philippines' province of Zambales. Although accounts of how the standoff ended differ widely, U.S. officials assert that in a meeting with Chinese counterparts in June 2012 they reached an understanding for both sides' ships to simultaneously withdraw from the reef. According to China's Vice Foreign Minister Fu Ying, who participated in the meeting in June 2012, there was no such understanding. U.S. officials told the Financial Times "there was a clear understanding at the 2012 meeting that the Chinese would take the idea of a mutual withdrawal from Scarborough [Reef] back to senior leaders in Beijing. They say it is unclear whether Ms. Fu really tried to sell the agreement in Beijing or whether the foreign ministry was overruled by more hawkish elements in the Chinese system, including the military." The Philippines later accused China of reneging on this "agreement." According to one report, the Chinese ships initially left Scarborough Reef, but they returned shortly thereafter. In 2014, China Coast Guard (CCG) ships attempted to block the Philippines from resupplying its South China Sea outpost aboard the Sierra Madre, a navy ship the Philippines intentionally grounded in 1999 to mark its claim to

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The Contentious China-Philippines Dispute and the Philippines’ South China Sea Arbitration Case—Continued

Second Thomas Shoal. Since then, CCG ships have continued to patrol in that area, and the Philippine Navy has air-dropped supplies by parachute or delivered supplies by small boat.44

Economically, diplomatically, and militarily outmatched by China, the Philippines turned to legal arbitration. In 2013, the Philippines, among other requests, asked an arbitral tribunal at the Permanent Court of Arbitration in The Hague to: (1) declare whether China’s claims based on the nine-dash line* are invalid under UNCLOS; (2) declare whether certain land features in the South China Sea are rocks rather than islands and whether certain features are low-tide elevations; and (3) declare whether China has interfered with the Philippines’ right to exploit resources within the Philippines’ EEZ and continental shelf.45 Before the tribunal can rule on the Philippines’ case, it must first decide whether it has jurisdiction over such a case.† In July 2015, the tribunal convened and the Philippines’ delegation presented its arguments in support of the tribunal’s jurisdiction.46 The Philippines’ legal consul estimated the tribunal would issue a ruling on the question of jurisdiction by October 2015.47 At the time of the writing of this Report a ruling had not been issued. Should the tribunal decide it has jurisdiction over the Philippines’ case, it is expected to rule on the case by June 2016.48

China’s land reclamation may complicate the ability of the tribunal to rule on the status of the land features. Mira Rapp Hopper, then director of the Asia Maritime Transparency Initiative at the Center for Strategic and International Studies, told the Commission that “while China will surely not convince the [arbitral tribunal of the Permanent Court of Arbitration in The Hague] that these artificial features deserve to be treated as full-fledged islands under UNCLOS, its rapid-fire building may make it more difficult for the tribunal to rule on their previous status.”49

Beijing has rejected the arbitration process as “manifestly unfounded” under UNCLOS and declined to participate, rejecting the involvement of third parties.50 China’s leaders likely fear the tribunal will rule, at least partially, in the Philippines’ favor, and seek to avoid tacitly affirming the arbitration’s legitimacy by participating in the case.

China’s rapid land reclamation and construction activities appear to be driven by several factors: China’s desire to unilaterally im-

*Although China’s claim in the South China Sea is often depicted by a nine-dash line, Beijing in recent years has issued new maps with ten dashes. Ishaan Tharoor, “Could This Map of China Start a War?” Washington Post, June 27, 2014; Euan Graham, “China’s New Map: Just another Dash?” Australian Strategic Policy Institute (The Strategist blog), September 17, 2013.
†If the tribunal decides the Philippines is seeking a ruling on territorial sovereignty, a question over which the tribunal does not have jurisdiction, it will refuse to allow the case to proceed. Center for Strategic and International Studies, Asia Maritime Transparency Initiative, “Arbitration on the South China Sea: Rulings from The Hague.”
pose its claims and avoid arbitration or negotiation with other parties over the disputes; China's ambition to enhance its ability to project power into the South China Sea; and, potentially, China's intention to establish an air defense identification zone (ADIZ) over part of the South China Sea.⁸†

China's land reclamation and construction projects present the other claimants with a fait accompli.⁵¹ Regardless of the protestations of other countries, once the work is completed China will have significantly enhanced its control over these features and its presence in the South China Sea.

China will be able to use these land features to bolster its ability to sustain its military and maritime law enforcement presence in the South China Sea. Currently, the ability of the People’s Liberation Army (PLA) Air and Naval Aviation forces to conduct combat air patrols near the Spratly Islands is limited not only by the long distance from China’s airbases, but also by the PLA’s nascent aircraft carrier aviation capability and its limited capacity for aerial refueling.⁵² The recently completed airstrip on Fiery Cross Reef is 10,250 feet (3,125 meters) in length, which should allow it to accommodate most PLA combat and support aircraft.‡⁵³ There are indications that China also may be preparing to build airstrips on Subi Reef and Mischief Reef.⁵⁴ In addition, China appears to be building a seaport at Fiery Cross Reef, with a harbor that could be large enough to allow large Chinese naval and maritime law enforcement ships to dock to replenish supplies.⁵⁵ The newly upgraded islands also enable the PLA Navy and maritime law enforcement entities to enhance maritime domain awareness and improve intelligence, surveillance, and reconnaissance capabilities farther from China’s coast.⁵⁶ At a November 2014 international defense forum in China, a senior PLA officer said, “There is a need for a base [in the Spratly Islands] to support our radar system and intelligence-gathering activities.”⁵⁷ China appears to already have or to be building radar facilities on Fiery Cross, Johnson South, and Subi reefs, and Fiery Cross Reef will be able to accommodate surveillance aircraft once the airstrip is completed.⁵⁸

China also may use the facilities it is building on these land features in the Spratly Islands to establish an ADIZ over part of the South China Sea.⁵⁹ In December 2013, after China declared an ADIZ over the Senkaku Islands in the East China Sea, China’s then ambassador to the Philippines responded to questions about whether China might declare an ADIZ in the South China Sea, saying China was entitled to decide “where and when to set up the new air identification zone.”⁶⁰ During the International Institute

⁴For more information on the drivers of China’s approach to the maritime disputes in the South China Sea, including nationalism and natural resources, see U.S.-China Economic and Security Review Commission, 2013 Annual Report to Congress, November 2013, 270–272.

†An ADIZ is a publicly declared area established in international airspace adjacent to a state’s national airspace, in which civil aircraft must be prepared to submit to local air traffic control and provide aircraft identifiers and location. Its purpose is to allow a state the time and space to identify the nature of approaching aircraft prior to entering national airspace in order to prepare defensive measures if necessary. For an in-depth examination of China’s East China Sea ADIZ, see 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.

‡China has one other airstrip in the South China Sea on Woody Island in the Paracel Islands.
for Strategic Studies’ May 2015 Shangri-La Dialogue, Chinese Admiral Sun Jianguo, the head of China’s delegation to the dialogue and deputy director of the PLA’s General Staff Department, said China would only establish an ADIZ in the South China Sea if faced with security threats. This remark followed a similar statement by Ouyang Yujing, the director general of the Department of Boundary and Ocean Affairs of China’s Ministry of Foreign Affairs. He said, “Whether China will set up an ADIZ in the South China Sea depends on whether and to what extent the security of airspace is threatened as well as other factors. Currently, the situation in the South China Sea is stable on the whole.” These statements indicate China is positioning itself to justify the establishment of an ADIZ as a defensive response to the actions of other countries.

Figure 2: Comparison of Airstrips by Claimant in the South China Sea’s Spratly Islands

China has stated its land reclamation and construction activities are primarily for civilian purposes, such as providing services to Chinese and foreign ships transiting the South China Sea; facilitating oceanic research and meteorological observation; and providing fisheries services. The Chinese government acknowledged in April 2015 that the islands have military purposes as well, when a Ministry of Foreign Affairs spokesperson stated that the islands are intended to satisfy China’s “military defense needs” and to “better safeguard territorial sovereignty and maritime rights and interests.”

The Shangri-La Dialogue is a high-profile meeting of regional defense leaders held annually in Singapore.
China has consistently argued that it has the right to conduct these activities. Beijing frequently asserts that it has “indisputable sovereignty over the Nansha Islands [China’s name for the Spratly Islands] and their adjacent waters” and that “the relevant construction, which is reasonable, justified and lawful, is well within China’s sovereignty. It does not impact or target any country, and is thus beyond reproach.” In written responses to questions submitted by the Wall Street Journal before his state visit to the United States in September 2015, Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping reiterated China’s stance that “the [Spratly Islands] have been China’s territory since ancient times. This is fully backed by historical and legal evidence.” In fact, China argues that the United States, not China, is increasing tensions in the region through its surveillance flights and criticism of China. In addition, China regularly asserts that the United States is not acting like a neutral party in the South China Sea disputes.

Perhaps recognizing the alarm the land reclamation and construction has caused in the region, China also has begun to stress how the islands help it meet its international obligations in areas such as maritime search and rescue. China’s Ministry of Transportation noted that its construction of lighthouses on both Cuarteron and Johnson South reefs will “immensely improve the navigation safety” in the South China Sea. Ms. Glaser explained that “the Chinese are now attempting to assuage concerns about their artificial island building by claiming that these activities are aimed at providing public goods.”

China also appears to be seeking to legitimize some of the civilian facilities it is building in the Spratly Islands by suggesting they are endorsed by international organizations. For example, during the 2015 Shangri-La Dialogue, Admiral Sun remarked that “China has built an oceanic survey station for the United Nations on the Yongshu Jiao [the Chinese name for Fiery Cross Reef].” Admiral Sun was referring to China’s construction of an observation station that began in 1988 in response to a directive by the UN Educational, Scientific, and Cultural Organization for its members to build monitoring stations for a study of oceans around the world.

Ecological Impacts of China’s Land Reclamation

Despite China’s claims about the benefits of its land reclamation and construction activities in the Spratly Islands, the damage to the coral reefs caused by China’s land reclamation may have a major impact on the South China Sea’s ecosystem, particularly its fish, which are a critical protein source for the populations of Southeast Asia.* Since China’s enhanced land features are intended in part to support Chinese fishermen,† they will lead to in-

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*For example, more than a quarter of the Philippines’ fishing grounds are located in the South China Sea, where around 12,200 Filipino fishermen pursue their livelihoods. Pia Ranada, “China Reclamation Poses P4.8-B Economic Loss for PH,” Rappler (Philippines), April 23, 2015.
†A spokesperson for China’s Ministry of Foreign Affairs said these land features will support “fishery production and service,” and China’s National Development and Reform Commission announced it will provide fishing boats with shelter during storms and repair and replenishment services. China’s National Development and Reform Commission, National Development and Reform Commission Draws up a Plan for the Construction of Civilian Infrastructure on the Islands and Reefs in the Spratly Islands, June 17, 2015. Staff translation; Open Source Center, “Tran-
creased Chinese fishing in the South China Sea and greater depletion of local fisheries. Given the massive size of China's fishing fleet and its record of overfishing along China's coast, greater capacity for Chinese fishermen to fish in the South China Sea bodes ill for the fish stocks there.  

According to the Philippines Bureau of Fisheries and Aquatic Resources, China's land reclamation activities on five land features have buried 768 acres of coral reef. Since the coral reefs contribute to food production as well as to "raw materials, waste treatment, erosion prevention, and tourism," Edgardo Gomez, professor emeritus at the University of the Philippines' Marine Science Institute, estimates that China's destruction of the reefs through reclamation will result in about $110 million in economic losses annually. In addition, land reclamation may result in ecological damage that extends beyond the South China Sea. For example, some marine species spawn in the coral reefs of the South China Sea and the young fish then swim to adjacent seas and the coastal areas of Southeast Asia. Moreover, the reefs in the South China Sea are home to significant biodiversity and China's activities could lead to the extinction of some marine species.

China's land reclamation activities also may have violated its obligation as a signatory to UNCLOS to "protect and preserve the marine environment." China dismisses concerns about the environmental impact of its land reclamation activities.

Different Claimants, Different Approach

China tailors its approach to its maritime and territorial disputes depending on the claimant. As discussed previously, China's approach to the Philippines involves bullying and intimidation. China's approach to Vietnam, as discussed later, is also hardline. On the other hand, China handles its disputes with Malaysia and Brunei more quietly, and has avoided publicly clashing with these claimants. China's approach to Taiwan's claims is altogether different given the unique cross-Strait relationship (see Chapter 3, Section 3, "Taiwan," for more information regarding the South China Sea disputes in cross-Strait relations.)

China's "Soft Approach" to Malaysia

China takes a "soft approach" to Malaysia, according to Pek Koon Heng, assistant professor and director of the ASEAN Studies Initiative at American University's School of International Service. In its relations with Malaysia, Beijing has not confronted Kuala Lumpur in public over Malaysia's oil and gas exploration in the South China Sea, and Kuala Lumpur has adopted a similarly low-profile approach to China. The two sides appear to have reached a consensus to not air their grievances through the media. After a meeting with President Xi Jinping

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* However, recent events suggest Malaysia may be departing from this approach. (See "A Change in Southeast Asia's Strategy?" later in this section.)
In 2002, ASEAN and China signed a nonbinding “Declaration on the Conduct of Parties in the South China Sea,” and the parties intend to elevate this declaration to a binding Code of Conduct. This document, known as the Declaration of Conduct, expresses ten principles aimed to build trust and avoid escalation in disputed areas. ASEAN still seeks to sign a Code of Conduct on the South China Sea with China, but China is unlikely to agree to such a code at present. U.S.-China Economic and Security Review Commission, Hearing on China’s Relations with Southeast Asia, written testimony of Bonnie Glaser, May 13, 2015.
threatened by China’s actions. At the 2012 ASEAN foreign ministers summit, disagreement over whether to include a reference to the standoff at Scarborough Reef led to a failure of ASEAN to issue its usual joint communiqué. Cambodia, which held the chair of ASEAN that year, reportedly prevented consensus in response to overtures from China not to include a statement on the South China Sea in the communiqué. In what appears to have been an effort to cement Cambodia’s support for China’s stance on ASEAN’s involvement in the South China Sea disputes, days before the ASEAN summit, then Chinese President Hu Jintao visited Cambodia and announced that China’s trade with Cambodia would increase by $5 billion by 2017 and promised additional aid to Cambodia.

Like Cambodia, Laos appears to be subject to Chinese influence. In her oral remarks to the Commission, Dr. Heng said, “We don’t know what Laos is going to do as ASEAN chair [in 2016]. That is a concern. For Malaysia [the 2015 ASEAN chair], we know that there will be a consensus and Malaysia will uphold the consensus, and will articulate or communicate Vietnam’s and the Philippines’ concerns [related to the South China Sea disputes], but Laos is a different story. And that’s where we’re going to see problems in ASEAN.”

China does not have the same level of influence over most members of ASEAN. In written testimony to the Commission, Priscilla Clapp, senior advisor to the U.S. Institute of Peace and the Asia Society and former U.S. charge d’affaires in Burma (Myanmar), said even Burma, which once was widely believed to be beholden to China, “can be expected to remain a loyal, if not particularly dynamic, member of ASEAN.” She elaborated on this point in her oral remarks to the Commission, saying Burma “would stand by ASEAN over China on some of these issues, because ASEAN is [its] protection against China.” Accordingly, during the 2014 oil rig crisis between China and Vietnam, ASEAN countries—with Burma as the chair—reached a consensus on the South China Sea, issuing a statement that “expressed their serious concerns over the ongoing developments in the South China Sea, which have increased tensions in the area.” (For more information on the oil rig crisis, see “China-Vietnam Relations: A Case Study,” later in this section.) In 2015, Malaysia presided over the strongest ASEAN statements about the South China Sea yet, despite Kuala Lumpur’s preference for dealing with disputes with Beijing in private. The chairman’s statement issued at the end of the April 2015 summit of ASEAN heads of state declared that China’s land reclamation activities “eroded trust and confidence and may undermine peace, security and stability in the South China Sea.” Several months later, the joint communiqué issued at the conclusion of the August 2015 ASEAN foreign ministers meeting included the same language, with the addition of the sentiment that these activities have “increased tensions” in the South China Sea.
### Chinese Cyber Intrusions Targeting Southeast Asian Countries

In 2015, reports by companies that conduct cyber intelligence research revealed that China-based cyber actors have carried out intrusions into the computer networks of a wide range of targets across Southeast Asia, including ASEAN. ThreatConnect Inc. and Defense Group Inc. published a report in September that associated the activities of an advanced persistent threat (APT) group commonly referred to as “Naikon” with PLA Unit 78020, the Second Technical Reconnaissance Bureau under the Chengdu Military Region. According to the report, “Unit 78020 conducts cyber espionage against Southeast Asian military, diplomatic, and economic targets. The targets include government entities in Cambodia, Indonesia, Laos, Malaysia, Myanmar, Nepal, the Philippines, Singapore, Thailand, and Vietnam as well as international bodies such as United Nations Development Program (UNDP) and [ASEAN].” Prior to the release of this report, in April, FireEye detailed the activities of another China-based APT group focused on Southeast Asia which it calls APT 30. Although FireEye could not conclusively link APT 30 to the Chinese government, it states that the group’s activities are likely sponsored by the Chinese government.

### Southeast Asia’s Response to China’s Activities in the South China Sea

While each Southeast Asian claimant’s approach to maritime and territorial disputes with China varies, Southeast Asian countries have reacted with increasing alarm to China’s activities in the South China Sea. In response to China’s assertiveness in the South China Sea and its massive military modernization program, Southeast Asian countries are enhancing their military and civilian maritime patrol capabilities and strengthening security cooperation with the United States and other countries in the Asia Pacific. Of all the Southeast Asian countries, Vietnam has taken the boldest measures to enhance its deterrent capability against China’s military. Hanoi has already received 4 of 6 KILO-class submarines, and 28 of 50 submarine-launched antiship and land-attack missiles, purchased from Russia. Vietnam’s acquisition of land-attack missiles—which have a range of 300 kilometers (186 miles)—enhances its ability not only to hold PLA Navy ships at risk, but also to threaten PLA airfields and ports. Carlyle A. Thayer, professor emeritus at the University of New South Wales in Canberra, Australia, said by acquiring land-attack missiles the Vietnamese have “given themselves a much more powerful deterrent that complicates China’s strategic calculations.” Vietnam is the first Southeast Asian country to acquire submarines with a land-attack capability.

Among the most recent developments, in what appears to be driven in part by China’s assertive actions in the South China Sea, Indonesia’s Defense Minister announced in September 2015 that the country would proceed with plans to enhance military infra-
structure and capabilities on Natuna Island, the surrounding waters of which are partially within China’s nine-dash line. The Defense Minister said that Indonesia would build a port, lengthen its existing military runway, and station more fighter aircraft on Natuna Island. Although these measures may be driven by concerns about various threats, tensions in the South China Sea appear to be one factor that is prompting this action. “We are not in a war situation, but the South China Sea is very close to us. We have to be prepared,” the Defense Minister explained.

Japan—which is currently embroiled in a dispute with China in the East China Sea—is emerging as a key source of support to Southeast Asian countries on maritime security. In 2015, the Philippines reached an agreement to purchase ten patrol vessels for the Philippine Coast Guard from a Japanese shipbuilding company, and the Japanese government agreed to give the Philippines a $150 million low-interest loan to facilitate the transaction. These ships likely will patrol Philippines-claimed waters disputed by Beijing. In 2014, Japan also pledged to give Vietnam six used patrol vessels valued at a total of $5 million, a transfer that will be completed in 2015, according to the Japanese embassy in Vietnam. As of August 2015, Japan had delivered one vessel to the Fisheries Resources Surveillance Department under Vietnam’s Ministry of Agriculture and Rural Development, and another vessel to the Vietnam Marine Police.

Southeast Asian countries and Japan are also expanding opportunities for joint exercises, information sharing, and cooperation on defense technology. The Philippines and Japan conducted the first-ever exercise between their navies in June 2015. The exercise focused on search and rescue operations and included a flight over the South China Sea by a Japanese P-3C Orion surveillance aircraft with three Philippine Navy personnel aboard. Before the exercise, a Philippine Navy spokesperson explained that the two sides also planned to conduct “staff-to-staff talks” to “strengthen and institutionalize information-sharing between the [Philippine Navy] and [Japan Maritime Self Defense Force] to step-up maritime situational awareness.” Moreover, during his visit to Japan in June 2015, Philippines President Benigno Aquino said that he and Japanese Prime Minister Shinzo Abe agreed to begin talks on a potential Philippines-Japan visiting forces agreement. These steps build upon a defense cooperation agreement signed by the two countries’ defense ministers in January 2015. Malaysia and the Philippines respectively reached agreements with Japan to initiate negotiations regarding cooperation on defense equipment and technology transfer in May and June 2015.

Southeast Asian claimants are also enhancing their security relations with one another. The most notable example is the strengthened relationship between the Philippines and Vietnam, the two...
A Change in Southeast Asia’s Strategy?

Rising concern in Southeast Asian countries about China’s land reclamation and construction activities and intentions in the South China Sea raises questions about whether the trajectory of these countries’ relations with China and the United States and their approach to the Southeast Asia-China-U.S. triangular relationship is changing. Analysts have widely noted that Southeast Asian countries pursue an “engage-and-hedge” strategy toward China and do not want to choose sides between the United States and China. However, in response to China’s recent activities, some Southeast Asian countries are becoming more vocal regarding their concerns about China and are enhancing their relations with the United States and with other countries in the region.

Interlocutors at many governmental and nongovernmental organizations with which the Commission met during its July 2015 trip to Vietnam expressed concern about China, and several interlocutors during the trip argued that the trust that had previously existed between the two countries had been broken in recent years. Many interlocutors emphasized the need for the United States to provide assistance to Vietnam and other Southeast Asian countries in light of China’s assertiveness in the South China Sea. (See “China-Vietnam Relations: A Case Study” later in this section for more detail.)

In June 2015, Malaysia responded to the presence of a CCG ship near Luconia Shoal, which is located within Malaysia’s EEZ, with rare public displeasure. Shahidan Kassim, the official in the prime minister’s office who oversees the Malaysian National Security Council and Malaysian Maritime Enforcement Agency, posted photos of the ship on his personal Facebook page and declared that Malaysia was taking “diplomatic action,” including that Prime Minister Najib would broach Malaysia’s concern with President Xi. The CCG began patrolling near Luconia Shoal in August 2013 and, according to China’s State Oceanic Administration, was “on guard” there in 2014. In August 2015, Minister Shahidan told reporters that Malaysia has been submitting protests to the Chinese government once a week. He said, “They have to get out of our national waters. . . . No parties should try to trespass [sic] the territorial right of this country.”

Singapore, which like Malaysia maintains positive relations with both China and the United States, has also expressed concerns about China’s activities. At the 2015 Shangri-La Dialogue, Singapore’s Prime Minister Lee Hsien Loong acknowledged that
A Change in Southeast Asia’s Strategy?—Continued

China’s behavior was alienating and alarming other countries, including the United States. He said, “Each country feels compelled to react to what others have done in order to protect its own interests.”

Nevertheless, despite growing worry among Southeast Asian countries about China’s intentions and increased willingness to express these concerns, they still seek to preserve positive relations with China and do not appear to have chosen to align exclusively with the United States. In fact, they may seek to avoid becoming too close to the United States. In his written testimony to the Commission, Patrick M. Cronin, senior advisor and senior director of the Asia-Pacific Security Program at the Center for a New American Security, asserted:

Attempts by the United States to provide military reassurance and presence, or to offer assurances to particular members [of ASEAN] such as the Philippines, incur a predictable backlash out of fear that America’s stabilization efforts may also roil the region. That is why it is incumbent on U.S. officials to calibrate efforts to strengthen our access and security cooperation in Southeast Asia with a sharp understanding of how far the region will go based on the balance of political forces.

Other Developments in China’s South China Sea Efforts

Aside from land reclamation, China continues to use other methods to promote its interests in the South China Sea.

China Coast Guard Patrols

Beijing enforces its territorial claims through an approach in which civilian maritime law enforcement ships are at the forefront with support from naval ships.* According to the U.S. Office of Naval Intelligence’s 2015 report The PLA Navy: New Capabilities and Missions for the 21st Century:

When deployed, the CCG sometimes coordinates with the [PLA Navy], which, when necessary, will deploy destroyers and frigates several dozen miles from the incident to provide a nearby, but indirect presence. . . . In recent years the [PLA Navy] has reduced its overt participation in coastal patrols, law enforcement, EEZ enforcement, and territorial claim issues as the CCG assumed these operations. China prefers using its Coast Guard as the primary enforcer of its maritime claims. This approach limits the potential for confrontational incidents to escalate since most CCG ships are unarmed, and those that are have relatively light weapons. This approach also helps Beijing manage the public optic of any enforcement actions.

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China’s commitment to this strategy is reflected in its enhancement of the size and capabilities of its maritime law enforcement forces. China has acquired around 100 new ships—including patrol combatants, large patrol ships, and support ships—over the past ten years and is expected to supplement these ships with more than 20 patrol combatants and more than 30 large patrol ships by 2015.136 In November 2014, Chinese military websites featured images of a CCG ship based on the hull of the PLA Navy’s JIANGDAO-class corvette.137 The adaptation of the JIANGDAO hull for coast guard use suggests China seeks to increase systems compatibility between the CCG and the PLA Navy, likely to cut costs and increase interoperability. Furthermore, media reports from October 2014 showed images of two coast guard ships under construction, with displacements over 10,000 tons.138 The CCG’s acquisition of these larger, more capable ships will increase the range, seaworthiness, and firepower of its fleet. Furthermore, according to an article on the website of People’s Daily, a Chinese state-run publication, China’s new-generation 12,000-ton coast guard ship “has the power to smash into a vessel weighing more than 20,000 tons and will not cause any damage to itself when confronting a vessel weighing under 9,000 tons. It can also destroy a 5,000 ton ship and sink it to the sea floor.”139 Most of the Philippines’ and Vietnam’s maritime law enforcement ships are between 500 and 1,000 tons.140

Filipino and Vietnamese fishermen complain they have been harassed by Chinese ships, threatening not only the fishermen’s livelihood but also their personal safety. For example, Filipino fishermen say they are no longer able to fish at Scarborough Reef because Chinese ships block their access or harass them, ramming their fishing boats or spraying them with water cannons.8 141 In June 2015, Vietnamese fishermen said Chinese ships used water cannons to spray Vietnamese fishing boats near the Paracel Islands (which China administers but Vietnam claims), breaking the leg of one of the fishermen.142 Vietnamese fishermen also allege that a few days later, Chinese vessels confronted them and the individuals on board took away their communications devices and other equipment, as well as their fish.143 Such instances of harassment, if true, may increase as China’s maritime law enforcement forces’ ability to operate in the Spratly Islands grows due to the land reclamation and construction activities.144

The Role of Fishermen

Chinese fishermen also play an increasingly important role in the South China Sea disputes. Fishermen on Hainan Island have been encouraged by the Hainan provincial government to fish in disputed waters.145 Fishing boat captains also receive government subsidies for fuel and at reduced price can purchase satellite navigation systems that connect to Chinese authorities with the push of a button.146

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8 In September 2015, 16 Filipino fishermen submitted a petition to the United Nations requesting the organization ask China to allow them to fish in Scarborough Reef. Gabriel Cardinoza, “16 PHI Fishermen Sue China at UN over Sea Dispute,” Inquirer (Philippines), September 23, 2015.
Furthermore, according to U.S. Naval War College associate professor Andrew Erickson and research fellow Conor Kennedy, China under President Xi is “strengthening its maritime militia, a dual-hatted force of specially registered fishing vessels with fisherman-soldier crews. Portions of these coastal militias are organized by local military and government officials along the nation’s many ports, providing China with small tactical units designed to execute specific missions in support of the country’s more professional military and maritime interests.”147 China’s maritime militias receive military training, including in the use of light weapons.148 China is training these maritime militias to support the activities of the PLA Navy and China’s maritime law enforcement forces in the South China Sea.149 Among its duties, the Tanmen Village Maritime Militia Company on Hainan Island encourages fishermen to upgrade their fishing boats, activities that Dr. Erickson and Mr. Kennedy assert “have expanded Chinese patriot fishermen fleets multifold in recent years.”150 The company also transports building materials, water, and food to Chinese outposts in the Spratly Islands, and conducts maritime search and rescue and reconnaissance, gathering information for the PLA.151 These militias are well-resourced, with subsidies provided by the central and local governments to build new fishing boats; 29 new boats were ordered for the Tanmen Maritime Militia, and 17 of these boats have been delivered.152

Large-Scale PLA Navy Exercise in the South China Sea

The PLA Navy in July 2015 conducted a live-fire exercise in the South China Sea involving more than 100 ships, dozens of aircraft, and several Second Artillery Corps battalions.153 The Vietnamese government protested the exercise, which took place near Hainan Island and the disputed Paracel Islands, asserting that it violated Vietnam’s sovereignty.154 A PLA Navy spokesperson described the exercise as a “regular, annual drill” and called for observers to refrain from “excessive interpretations.”155 Xu Liping, a researcher at the Chinese Academy of Social Sciences, said the drill is “a normal exercise of sovereignty. China wants to modernize its navy to make sure it has the capability to protect its islands and waterway.”156 However, Rory Medcalf, the head of the Australian National University’s National Security College, said “an exercise on this scale in the South China Sea seems a needlessly excessive show of force,” and that the drill “reinforces the view that China’s wish to control the South China Sea is in large measure about seeking strategic advantage.”157

China’s Economic Engagement with Southeast Asia

China’s Economic Assistance to Southeast Asia

China’s economic assistance to Southeast Asia is an increasingly important component of its engagement strategy with the region. With the announcement by President Xi and Premier Li that China will construct a 21st Century Maritime Silk Road, China has accelerated its economic engagement with Southeast Asia in what many have called a “charm offensive” focused on development assistance.158 At the 2014 East Asia Summit, Premier Li said China would be extending more loans and investments to ASEAN mem-
bers, with assistance targeting infrastructure development and poverty alleviation. China hopes its enhanced economic aid and investment will not only garner goodwill among its Southeast Asian neighbors, but also achieve “favorable outcomes” on politically contentious issues such as the South China Sea disputes.

Although some Southeast Asian countries are reportedly welcoming greater aid from China, many are concerned about the political and security implications of accepting China’s money. According to a report from the Center for a New American Security, Chinese foreign assistance in Southeast Asia “diverge[s] from internationally accepted norms emphasizing good governance, transparency, and conditionality.” Although China purports its foreign aid adheres to a policy of nonintervention toward recipient countries, the Center for a New American Security reported that in practice, “China often uses its development and investment policies to gain access to resources or achieve favorable diplomatic outcomes.” China is putting stock in the potential for economic aid to gain diplomatic sway in Southeast Asia, and is doing so through bilateral infrastructure investment, including via broad policy initiatives like the 21st Century Maritime Silk Road and the establishment of China-led development banks such as the Asian Infrastructure Investment Bank (AIIB).

**China’s 21st Century Maritime Silk Road Initiative**

Frequently described as a counterbalance to the Obama Administration’s “rebalancing” policy in the Asia Pacific, China’s 21st Century Maritime Silk Road initiative touts a vision of constructing an economic corridor stretching from its eastern seaboard through the Taiwan Strait, South China Sea, Strait of Malacca, Indian Ocean, Suez Canal, and Mediterranean Sea to southern Europe. Although many of the details of the Maritime Silk Road remain undefined, the initiative intends to develop a network of port and coastal infrastructure projects that are expected to link directly with goals set out in China’s 13th Five-Year Plan, and will predominantly target Southeast Asia.

At present, the Maritime Silk Road remains largely a symbolic vision linked to preexisting or tangentially related economic programs. For example, during an ASEAN Regional Forum meeting in March 2014, a representative of China’s Ministry of Foreign Affairs linked the Maritime Silk Road to the $500 million China-ASEAN Maritime Cooperation Fund, established two years before the announcement of the Maritime Silk Road. In addition, in a December 2014 *People’s Daily* article, the author describes the Greater Mekong Subregion—a cooperative initiative established under the Asian Development Bank in 1992—as a component of the Maritime Silk Road that exemplifies concepts of a “new Asian security” and “peripheral diplomacy” advocated by China. In May 2015, China’s Consul General in Mandalay, Burma, said that all development projects between China and Burma could be classified as part of the “One Belt, One Road” initiatives, which encompass the Maritime Silk Road as well as the Silk Road Economic Belt that connects China to South and Central Asia (see Figure 3). (For more analysis of the One Belt, One Road initiatives and the Silk Road Economic Belt, see Chapter 3, Section 1, “China and Central Asia.”)
Although these statements imply some arbitrariness as to what constitutes a Maritime Silk Road project, China has taken a few concrete steps to realize its vision, primarily by pledging infrastructure investment funding for projects in Southeast Asia. For example, after declaring 2015 “the ASEAN-China Year of Maritime Cooperation,” China pledged $20 billion in loans at the 2014 ASEAN-China Summit for infrastructure projects in Southeast Asia. Similarly, China announced the $40 billion China Silk Road Fund in November 2014, which will fund infrastructure projects along the Silk Road Economic Belt and the Maritime Silk Road. The fund’s first project, the construction of a $1.65 billion hydropower station in Pakistan, is expected to be “emblematic of the kinds of medium to long-term projects that will be supported by the Fund in Southeast Asia.” In addition, Chinese state-owned banks are already involved in realizing the Maritime Silk Road: The state-owned Industrial and Commercial Bank of China announced it is currently funding more than 130 projects with an estimated value of $158.8 billion under the banner of the One Belt, One Road initiatives. Moreover, Chinese-funded port projects in Burma and Malaysia are underway and predicted to be models for more port development elsewhere in Southeast Asia and along the entire Maritime Silk Road. In addition, China and Thailand agreed in May 2015 to construct a canal through the Kra Isthmus, the narrowest part of the Malay Peninsula in southern Thailand. Besides development aid, China also considers enhanced trade integration with Southeast Asia (see “ASEAN-China Trade Relations” later in this section) and the establishment of development banks such as the AIIB (see “China-Led Development Banks” later in this section) as components of the Maritime Silk Road.
Development Aid with Chinese Characteristics

Despite China’s rapid growth, its official development assistance (ODA), as defined by the Organization for Economic Cooperation and Development, remains relatively low both globally and in Southeast Asia, specifically. Because China does not follow the international standards defining ODA and does not disaggregate the data it reports by country, accurate data on its traditional aid to Southeast Asia is unavailable. However, estimates suggest Chinese ODA in Southeast Asia still lags significantly behind that of the United States. Yet, because of nontraditional forms of economic assistance, China is considered among the major donor countries to Southeast Asia. According to development experts, China’s foreign assistance predominantly takes the form of export credits, non-concessional loans, and state-sponsored investment support. Infrastructure financing is the main form of Chinese assistance in Southeast Asia, and, when counted as foreign assistance, makes China “one of the largest sources of economic assistance in Southeast Asia.”

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*In 2014, China published a white paper on its foreign aid, which stated that 31 percent, or $4.4 billion, of China’s aid was provided to Asia; there was no breakdown by country. David B. Gootnick, “Southeast Asia: Trends in U.S. and Chinese Economic Engagement,” United States Government Accountability Office, August 2015, 85.

The New Development Bank was formerly known as the BRICS Development Bank because it is operated by the BRICS countries: Brazil, Russia, India, China, and South Africa.

Because Chinese state-sponsored infrastructure financing is counted as foreign direct investment (FDI), it is difficult to measure exactly how much Chinese government funding is going to Southeast Asian economies. However, it is widely known that China’s government is actively funding development projects in many Southeast Asian countries. Burma, Cambodia, and Laos have historically been major recipients of Chinese infrastructure financing. According to a report from the Congressional Research Service, “PRC government entities have financed many infrastructure, energy-related (especially hydropower), agricultural, and other high profile development projects in these countries.” For example, the China Export-Import Bank issued two preferential buyer’s credits of $100 million each to Cambodia (for highway construction) and Burma (for a hydropower station). China is also expanding its nontraditional foreign aid to other countries in Southeast Asia. It has financed railways, hydropower, and shipbuilding facilities in Vietnam as well as infrastructure, energy, agriculture, and mining projects in the Philippines.

China's foreign assistance in Southeast Asia appears designed primarily to serve China’s economic and diplomatic interests. By financing infrastructure projects, China can use “Chinese construction materials, equipment, technical expertise, and labor” to execute development projects. This benefits Chinese firms—often state-owned—that win contracts, but limits opportunities for companies and labor in recipient countries. Moreover, China hopes by financing infrastructure and other development projects in Southeast Asia, it can win goodwill and cooperation in Southeast Asia and advance its interests in the South China Sea. Some analysts argue, though, that the self-serving nature of China’s nontraditional forms of foreign aid have “lessened the intended positive impact” and made recipient countries suspicious of China’s underlying strategic goals. Robert Sutter, professor of practice of international affairs at George Washington University’s Elliot School of International Affairs, noted in testimony before the Commission that the effectiveness of China-funded infrastructure projects in Southeast Asia is largely unknown, and a “comprehensive assessment” of the achievements and failures of these projects is needed.

China-Led Development Banks

The formation of new development banks—namely, the New Development Bank and the AIIB—is another strategy China uses to achieve its economic and diplomatic goals in Southeast Asia. In 2014, Brazil, Russia, India, China, and South Africa (the BRICS countries) signed an agreement to establish the New Development Bank with an initial capital of $50 billion and an emergency reserve fund of $100 billion. With its headquarters in Shanghai and a guarantee that the combined share of the five founding BRICS countries’ capital will never fall below 55 percent, China will play a key role in the bank’s formation and operations. Analysts argue that the bank, which is considered a BRICS-led alternative to the World Bank, is a welcome addition to the options for

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4 The New Development Bank was formerly known as the BRICS Development Bank because it is operated by the BRICS countries: Brazil, Russia, India, China, and South Africa.
investment finance, including in Southeast Asia where funding is in high demand for expensive infrastructure projects. However, many argue that the New Development Bank will—in the words of Vikram Nehru, formerly of the World Bank and now the Bakrie Chair in Southeast Asian Studies at the Carnegie Endowment for International Peace—provide “another avenue to advance the regional and global strategic interests of the bank’s five founders.”

While the New Development Bank could elevate China’s influence in Southeast Asia, the AIIB, which is more directly under China’s control, will likely be China’s primary vehicle for channeling its development aid to the region in hopes of gaining diplomatic leverage. According to the Harvard Kennedy School’s Vietnam Program economist David Dapice, ASEAN countries need about $100 billion per year in infrastructure investment. The World Bank and Asian Development Bank currently lend about $20 billion per year for infrastructure investment in emerging economies, leaving significant unmet demand in Southeast Asia, which the AIIB hopes to meet. Dr. Dapice told the Commission that China’s formation of the AIIB is a “coincidence of interests”—that is, ASEAN’s interest in investing in infrastructure and China’s interest in using its capital and domestic companies and resources to build projects overseas. Moreover, Dr. Dapice noted that obtaining financing through the AIIB may be simpler and more efficient than doing so through traditional international financial institutions like the World Bank, which makes it attractive to ASEAN countries in need of immediate access to funds.

All ten members of ASEAN have signed on to join the AIIB, reflecting Southeast Asia’s interest in the prospective China-led bank. Yet, some observers underscore that the AIIB is still merely an idea, and the sources of funding are not fully understood. Dr. Sutter argues that with the AIIB, the Silk Road Fund, and several other large foreign assistance pledges (the funding sources of which are all unknown), China appears to be seeking momentum toward a political movement with diplomatic objectives, rather than an economic initiative with purely development goals.

### China and the Lower Mekong Region

The Mekong River is a lifeline and vital shared resource for southwestern China and mainland Southeast Asia. With its source in China’s Tibetan Autonomous Region, the 3,000-mile-long river cuts through China’s Yunnan Province before winding its way through Burma, Laos, Thailand, Cambodia, and Vietnam, where its mouth pours into the South China Sea. While the Mekong has been a source of regional integration for most of mainland Southeast Asia, serving as the basis of international initiatives such as the Mekong River Commission and the Asian Development Bank’s Greater Mekong Subregion, the river is increasingly a source of contention between China and the lower Mekong countries. China’s activities on the Mekong show a pattern of unilateral action that is isolating China from its lower Mekong neighbors.
China and the Lower Mekong Region—Continued

The main point of contention between China and the lower Mekong countries has been the construction of Chinese dams along the upper Mekong River and the ecological damage they cause downstream. According to the environmental watchdog International Rivers, “Chinese dams are drastically changing the Lower Mekong River’s natural flood-drought cycle, and reducing the amount of water, sediments, and nutrients that flow into the river basin and surrounding coastal areas.”\(^{194}\) Moreover, the UN Environment Program warned in 2009 that China’s plans for eight dams along the Mekong could pose a “considerable threat” to the river and its resources.\(^{195}\) According to Dr. Dapice, China’s upstream dams dictate the fate of ecological systems along the lower Mekong. In testimony before the Commission, Dr. Dapice said, “How [Chinese] dams are managed . . . will in large part determine China’s contribution to either stabilizing or aggravating dry season shortages” in lower Mekong countries.\(^{196}\) Dr. Dapice also pointed out that while “Chinese dam construction is rightly scrutinized, it is likely to be less important than what is being done or planned by Thailand, Laos and Cambodia.”\(^{197}\)

China’s aspirations for water diversion projects on the upper Mekong are of potentially even greater risk to the lower Mekong region than are its dams (see Figure 4). The Mekong River is the target of the third phase of China’s massive infrastructure plans to divert water from its water-rich south to the relatively dry north. If fully implemented, these water diversion projects would have the most damaging impact on lower Mekong ecological systems to date.\(^{198}\)

China’s unilateral actions along the upper Mekong are undermining multilateral efforts among lower Mekong countries to make decisions that are mutually advantageous for all countries that benefit from the river’s resources. For example, the Mekong River Commission, a multigovernment body whose members include Thailand, Laos, Cambodia, and Vietnam, has a mission to develop “an economically prosperous, socially just, and environmentally sound Mekong River basin.”\(^{199}\) However, as a “dialogue partner,” China plays only a tangential role in the Mekong River Commission, limiting the effectiveness of the organization. For example, as a dialogue partner, China is not obligated to share data on water management with other Mekong nations, which undermines information sharing among all Mekong River Commission members.\(^{200}\) Without a cohesive partnership of Mekong nations, even lower Mekong countries, which are most vulnerable to dam construction, are pursuing environmentally compromising infrastructure projects. As Dr. Dapice told the Commission, “It’s like the left and right hands don’t know what they are doing.”\(^{201}\)

Moreover, international rivers like the Mekong lack any international law or treaty akin to United Nations Convention on the
Law of the Sea to regulate behavior along the river. The Mekong River Commission is the closest alternative to an international treaty, but China’s lack of participation limits the organization’s authority. According to the State Department Special Coordinator for Water Resources Aaron Salzberg, China should join the Mekong River Commission to more effectively address environmental and other problems faced by downstream Southeast Asian nations. As in the case of the South China Sea disputes, China prefers to handle such problems bilaterally rather than via multilateral organizations like the Mekong River Commission.

In the absence of China’s engagement with lower Mekong countries and to enhance U.S. cooperation in the region on Mekong River issues, the State Department in 2009 established the Lower Mekong Initiative (LMI) to support environmental and social development along the lower portion of the river. Currently, the LMI includes the United States, the four member countries of the Mekong River Commission, and, since 2012, Burma. U.S. funding supports the six pillars of the LMI: agriculture and food security, connectivity, education, energy security, environment and water, and health. In 2012, the United States committed to provide $50 million over three years to support an expansion of the initiative, known as LMI 2020.

Law enforcement along the Mekong is one exceptional area where China is cooperating with lower Mekong countries. Over the past three years, China has organized and participated in joint law enforcement patrols along the river with Burma, Laos, and Thailand. Together, these countries established the Safe Mekong Coordination Center in Chiang Mai, Thailand, and engage in intelligence sharing. China’s incentive to cooperate multilaterally on Mekong law enforcement came only after two Chinese cargo ships on the Thai portion of the river were hijacked in 2011. During the attack, 13 Chinese sailors aboard the cargo ships were killed, allegedly by Thai counternarcotics soldiers bribed by a drug smuggling ring. Although the hunt for the Burmese leader of the drug ring was conducted jointly by Burma, China, Laos, and Thailand, China’s Ministry of Public Security reportedly considered—but ultimately refrained from—using an unmanned aerial vehicle to kill the drug kingpin while he was still in Burma.
China’s Investment, Trade, and Financial Relations with Southeast Asia

As a whole, Southeast Asia is growing more economically integrated with China, with two-way trade and investment rising significantly in recent years. China’s growing economic influence in Southeast Asia has raised concerns that ASEAN countries may become overly dependent on China and are at risk of economic coercion. Within Southeast Asia, lesser developed countries, such as Laos and Cambodia, have welcomed enhanced economic relationships with China, while more advanced and emerging economies are more skeptical about the risks of China’s economic dominance in the region. For example, ASEAN’s middle-income and emerging economies, including Malaysia, Indonesia, Singapore, and the
Philippines, have expressed concern about the environmental costs of Chinese infrastructure investment, the prevalence of corrupt practices in Chinese financial dealings, and the “loss of local competitiveness due to the importation of cheap goods from China.” This diversity among individual ASEAN countries’ economic relationships with China makes it more difficult for ASEAN as a group to manage the threat of excessive economic dependence or coercion. However, China’s active steps toward deeper integration in trade, investment, and finance implies positioning itself as the economic core of Southeast Asia is a key part of its strategy.

**Chinese Investment in ASEAN**

China’s outbound FDI to ASEAN countries is an area where economic dependence may be of concern in the future. Although still small in absolute terms, the stock of Chinese FDI in ASEAN has grown rapidly in recently years (see Figure 5). According to ASEAN, FDI flows from China surpassed those of the United States in 2013 (latest data available). While the stock of U.S. FDI in ASEAN far exceeds China’s, the ASEAN share of China’s overall outbound FDI is steadily increasing and has been higher than the ASEAN share of U.S. outbound FDI since 2009 (see Figure 5).

**Figure 5: Foreign Direct Investment in ASEAN**

[Chart showing foreign direct investment in ASEAN with various lines and bars indicating different data points and sources.]

*Note: Latest data available.*

*Source: UN Conference on Trade and Development.*
China's Special Economic Zones in Southeast Asia

In addition to traditional FDI, China is also expanding its economic influence by investing in special economic zones, usually industrial estates, in some Southeast Asian countries. Organized by the Chinese government, which has clearly signaled that “the zones have political importance over and above their economic role,” the zones were constructed and are being operated by Chinese companies that won contracts awarded by China’s Ministry of Commerce. Although officially the contracts were awarded based purely on the financial merits of the companies, China’s Ministry of Foreign Affairs had to sign off on all zone projects “as they were to benefit other countries through official Chinese government subsidies.” China’s government pledged to reimburse Chinese companies at least 30 percent of the cost of constructing the zones. Chinese special economic zones exist in Cambodia, Laos, Indonesia, Thailand, and Vietnam. In many of these zones, China has leased the land for 99 years, and the zones are often governed by committees of Chinese businessmen and former officials, sometimes with local citizens having to show passports to enter the area. Some zones reportedly operate in China’s time zone, use the renminbi (RMB) as the exclusive currency, and use Chinese phone and Internet networks. Even police forces are sometimes supplied by China, serving in cooperation with local police, but often with local police having limited jurisdiction over Chinese-owned businesses.

ASEAN countries welcome Chinese investment as an essential link to the global economy. Developed by China in 2007, Longjiang Industrial Park in Vietnam attracted 11 enterprises and $68.6 million in investment before development of the zone was complete. Other zones in the region attracted similar levels of investment halfway through development, including the Sihanoukville Special Economic Zone in Cambodia ($32.7 million) and the Thai-Chinese Rayong Industrial Zone ($315 million).

More than 95 Chinese companies have invested in Laos’ special economic zones, with total investment from China at $4.2 billion. In the Golden Triangle Special Economic Zone, private companies from China and Hong Kong developed entertainment centers with casinos, resorts, clubs, and golf courses aimed at attracting regional tourism. The zone, which lies in Laos’ northern borderlands, previously had little economic significance, but now attracts foreign visitors from Southern and Eastern Asia. Similarly, the Thai-Chinese Rayong Industrial Zone, a joint effort between Thailand’s Amata Corporation and China’s Holley Group, has integrated Thai companies with the world economy; around 60 percent of the estate’s products, including car parts, electronics, and other machinery, are exported to markets around the world, including the United States and Europe. To make Thai goods easier to transport and to bolster the Rayong zone’s exports, China is also planning to build a rail network running north from Thailand through Laos and into China.
An "early harvest" program allows negotiators in trade talks to immediately lower trade barriers to certain goods and services even before negotiations on the final agreement have concluded.

Southeast Asian countries also see the zones as engines of local growth, creating jobs for the local population and eradicating poverty. The Rayong zone, for example, employs over 10,000 Thai workers, and Laos' zones employ more than 4,000 local workers.

The benefits of these special economic zones do not always trickle down to the local populations. Although the zones increase employment, local workers are often discriminated against. Higher-level positions are given to Chinese workers, while local workers are relegated to low-skill jobs. In addition, harmful narcotics and gambling practices are sometimes introduced into villages from the nearby casinos and clubs. Construction of zones also commonly displaces local villagers, who lose their livelihoods when development begins. In resettlement agreements, governments offer extremely low compensation for locals who have to relocate their homes, and no compensation for those who lose their paddy fields and farmlands.

While the increase in Chinese investment into ASEAN may be politically motivated and raise certain reservations among ASEAN countries, a wider shift in manufacturing FDI diverted from China to Southeast Asia may help diversify the portfolio of FDI hosted in ASEAN. According to global consulting firm McKinsey & Company, "As China shifts from an export-driven economic model to a consumption-driven one, its wages are rising," which is diverting some labor-intensive manufacturing FDI out of China. Cambodia, Indonesia, Laos, Burma, and Vietnam are among the most attractive alternate destinations for manufacturing FDI, given their abundance of low-cost labor. However, relatively low productivity and poor infrastructure may limit the ability of these countries to attract manufacturing FDI out of China.

ASEAN-China Trade Relations

Trade liberalization has been an important element of China’s economic engagement with Southeast Asia. Following the 1997–1998 Asian financial crisis, China sought to forge a closer economic relationship with Southeast Asia by forming the ASEAN-China Free Trade Area (FTA). Although the ASEAN-China FTA touts mutually beneficial economic relations, the reality has been a dramatic shift in ASEAN-China trade relations in China's favor. Prior to 2004, when an Early Harvest version of the ASEAN-China FTA went into effect, ASEAN countries collectively enjoyed a growing trade surplus with China (see Figure 6). With implementation of the Early Harvest agreement, ASEAN’s surplus began a steady decline until the 2008–2009 global financial crisis, when it disappeared altogether.

*An “early harvest” program allows negotiators in trade talks to immediately lower trade barriers to certain goods and services even before negotiations on the final agreement have concluded.
In 2010, the full ASEAN-China FTA went into effect and saw a temporary rebound in ASEAN’s trade surplus with China over the next two years. However, analysts did not attribute this temporary shift to the ASEAN-China FTA, but rather to growing Chinese demand for imports bolstered by its 2008 $586 billion stimulus package and for imports of components from elsewhere in Asia to assemble final products for export to the world as it recovered from the financial crisis. Since 2012, in the absence of large economic stimulus and with a gradual slowdown in China’s economy, ASEAN has seen a large and rapidly increasing trade deficit with China, reaching nearly $90 billion in 2014.

Figure 6: ASEAN-China Trade Balance

ASEAN’s rapidly increasing trade deficit with China has coincided with the slowdown of China’s economy, as shown in Figure 6. Some ASEAN countries have raised concerns that trade liberalization with China has led to ASEAN’s growing vulnerability to fluctuations in China’s economy. For example, Indonesia, which exports coal, tin, rubber, cocoa, and palm oil to China, saw these exports decline and prices fall as Chinese demand weakened. Even more advanced economies that are less dependent on China economically, such as Singapore, are worried that some high-value exports (like electronics and pharmaceuticals) as well as its investments in China may be affected.

Despite these concerns, ASEAN has been leading negotiations toward a Regional Comprehensive Economic Partnership (RCEP), which would combine five of its individual FTAs with Australia and New Zealand, China, India, Japan, and South Korea, and would further advance trade liberalization between China and ASEAN.
RCEP negotiations were launched in November 2012, and are officially slated for completion by the end of 2015, though it seems unlikely the parties will meet this deadline given the current state of the negotiations. Proponents of RCEP argue it could deepen economic integration in Asia, the region that has been the focal point of global trade growth over the past decade. Skeptics claim that despite China’s official policy to defer to ASEAN as the leader of the arrangement, China may come to dominate the development of RCEP. Critics also counter that RCEP is likely to be a shallow agreement amenable to ASEAN’s heterogeneous member states, and as such will not make a major impact on regional economic ties. RCEP excludes many of the advanced trade provisions promoted by the United States, such as those governing regulatory convergence, digital goods and services, and intellectual property. Yet, according to Senior Vice President of Trade, Economic, and Energy Affairs at the National Bureau of Asian Research Meredith Miller, “For ASEAN, RCEP is important not only in terms of the potential economic gains and engagement with China, but also because . . . it helps to solidify their position as the organizer of broader regional cooperation.”

The Trans-Pacific Partnership (TPP) is another prospective FTA that may afford ASEAN countries the opportunity to diversify the organization’s trade liberalization strategy beyond an exclusive focus on China. Four ASEAN countries—Brunei, Malaysia, Singapore, and Vietnam—are party to the TPP negotiations. As Ms. Miller told the Commission, TPP is envisioned to have greater scope, depth, and coverage than RCEP, and notably does not include China. While some observers argue that RCEP and TPP are mutually exclusive (or potentially complementary), others claim the agreements are a competition between China and the United States to win diplomatic leverage in Southeast Asia. According to Ms. Miller, “It’s very important at this juncture for the [United States] to continue to support ASEAN’s [trade] diversification strategy.”

Regional Financial Relations

China is also gaining greater monetary influence in Southeast Asia. ASEAN’s increased trade and investment with China has expanded the use of the RMB in regional economic transactions. In a study by the Peterson Institute for International Economics, researchers found that seven out of ten Asian currencies move more closely with the RMB than with the dollar, which is attributed to regional trade integration. Figure 7 illustrates the correlation between growing ASEAN-China trade and the frequency of RMB-denominated cross-border transactions worldwide. According to the Asian Development Bank, in addition to the increase in RMB-denominated trade and investment, RMB internationalization has been a result of targeted Chinese government policies such as increased offshore RMB-denominated bonds (also known as dim sum bonds) and bilateral currency swap agreements, including those with Thailand, Malaysia, Singapore, and Indonesia.

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*Five of the seven currencies were Southeast Asian currencies: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The other two were South Korea and Taiwan.*
Figure 7: Cross-Border RMB Settlement and ASEAN-China Trade

Although monetary integration is not considered a near-term goal in Southeast Asia, the region has taken steps toward an Asian financial architecture in which China would be only one of several key players. The region’s first major step toward monetary cooperation came in the aftermath of the 1997–1998 Asian financial crisis, when five ASEAN countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) established bilateral currency swaps with one another. In 2000, the remaining ASEAN members as well as China, Japan, and South Korea joined the arrangement in what became known as the Chiang Mai Initiative.

In March 2010, the bilateral currency swap mechanism was converted into a multilateral reserves pooling mechanism known as the Chiang Mai Initiative Multilateralization. The Chiang Mai Initiative Multilateralization’s initial value was $120 billion, which was doubled in 2012 to $240 billion. Under the Chiang Mai Initiative Multilateralization, China is an equal with Japan and is one of several contributors to the fund. China and Japan are the largest contributors, with 32 percent shares each; ASEAN as a whole contributes 20 percent, while South Korea contributes 16 percent. However, in their combined 15-year history, the Chiang Mai Initiative Multilateralization and its predecessor, the Chiang Mai Initiative, have never been used by any member country. Moreover, the Chiang Mai Initiative Multilateralization is not a common, centralized fund; it is merely a set of promises among the members to lend funds as needed in a crisis, with the majority of reserve funds disbursable only after the requesting member has al-

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† Under a reciprocal currency swap arrangement, a country’s central bank agrees to provide liquidity to another country’s central bank.

†† A crisis prevention mechanism known as the Chiang Mai Initiative Multilateralization Stability Fund was also established to provide short-term liquidity support to address sudden but temporary liquidity shortages.
ready appealed to the International Monetary Fund.251 The procedures for borrowing funds are cumbersome, and the amounts that members may borrow are still very low in comparison to other sources of finance.252 Although it is a major contributor to the Chiang Mai Initiative Multilateralization, China appears to have few incentives to improve upon the effectiveness of the fund or use it as a basis for future monetary cooperation with Southeast Asia.253 With the increase in RMB-denominated transactions in Southeast Asia, China does not need to rely on existing arrangements such as the Chiang Mai Initiative Multilateralization, which has ties to the International Monetary Fund, to elevate its own currency. Moreover, given China’s equal status to Japan in the currency swap, some claim China worries a strong Chiang Mai Initiative Multilateralization would curb the growing influence of the RMB (relative to the Japanese yen) and “preclude future Chinese currency hegemony in East Asia.”254 In addition, through the BRICS-led New Development Bank, China has pledged to finance more than 40 percent of a $100 billion emergency swap fund, a mechanism that could shift emergency borrowing away from the International Monetary Fund and Chiang Mai Initiative Multilateralization and toward a more China-centric arrangement.255 (For more analysis of China’s financial statecraft, including the New Development Bank, see Chapter 1, Section 1, “Year in Review: Economics and Trade.”)

**China’s Security Engagement with Southeast Asia**

Defense and security cooperation between China and countries in Southeast Asia has grown over the last 15 years, despite mistrust of China in Southeast Asian capitals arising from China’s support for communist insurgencies in Southeast Asia during the Cold War and its actions in the South China Sea.256 China and Southeast Asian countries have many shared security interests. These shared interests include maritime security, humanitarian assistance and disaster relief (HA/DR), search and rescue, countering piracy, open and secure sea lines of communication, counterterrorism, border security, and combating transnational crime and drug trafficking. China’s security cooperation with Southeast Asian countries is designed largely to advance these interests; it is also designed to strengthen bilateral relations with those countries and reassure its neighbors that it seeks to be a peaceful and cooperative regional partner. Cooperation between China and Southeast Asian countries now includes joint and multilateral exercises, military aid, training, arms sales, meetings between defense officials, educational exchanges, and cooperation in areas of nontraditional security and HA/DR.257

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251 According to the U.S. Department of Defense, China participated in bilateral or multilateral exercises with Southeast Asian countries on 19 occasions between 2008 and 2014. These included exercises with Thailand (six), Singapore (six), Indonesia (six), Vietnam (two), Brunei (two), Malaysia (two), and the Philippines (one). During this timeframe, the only countries with which China participated in more exercises were the United States (7), Pakistan (7), and Russia (12). U.S. Department of Defense, *Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2015*, April 2015, 76–77.
On July 15, 2015, Thailand’s Defense Minister Prawit Wongsuwan said, “We will wait for now and not introduce the deal to the cabinet for approval.” He added, “For now, the navy must inform itself and educate itself on whether the submarines are worth it and how much they will add to the Thai navy.” Reuters, “Thailand Puts $1 Billion Chinese Submarines on Hold,” July 15, 2015; Wassana Nanuam, “Prawit Delays Sending Sub Purchase to Cabinet,” Bangkok Post, July 15, 2015.

China-Southeast Asia Defense Ties

China’s defense cooperation with Southeast Asia is most prominent with Burma, Cambodia, Laos, and Thailand, countries that are among China’s nearest neighbors and that, with the exception of Thailand, have less developed militaries, have weak defense relations with the United States, and are more economically dependent on China than are other Southeast Asian countries.258 For example, in Cambodia, China funded the majority of the construction of the country’s Army Institute building, Chinese advisors oversee the institute’s teaching staff, and students at the institute are required to spend six months at a Chinese military academy. China also donated military trucks and uniforms to Cambodia and provided a loan for Cambodia to purchase Chinese helicopters.259 According to Dr. Thayer, China’s aid to Cambodia’s Army Institute is “the beginning of a long-term strategy of winning influence in the Cambodian military by cultivating these people. And China keeps very, very deep intelligence files on [the Cambodian military officers with whom China interacts].”260

China-Thai defense ties are particularly robust. The Chinese and Thai militaries have conducted joint exercises almost every year since 2008, more than most other Southeast Asian militaries.261 In 2015, the two sides agreed to establish more mechanisms for defense cooperation, including educational exchanges and training. They also agreed to hold more exercises between the Chinese and Thai air forces.262 This announcement came amid a downturn in relations between Bangkok and Washington that began after the 2014 coup that brought a military junta to power in Thailand. The Thai Navy in July 2015 announced it was considering purchasing three submarines from China in a $1 billion deal, which would amount to one of the most lucrative Chinese arms sales to date. Thai officials subsequently said the decision to procure the submarines would be postponed; however, it is unclear what prompted the announcement or Thailand’s apparent reconsideration.263 Enhanced ties between Thailand and China may yield dividends for Beijing over time in the form of influence within the Thai military as young Thai officers receive Chinese military education and training and rise through the ranks.264

In Thailand and other countries in Southeast Asia, China has been quick to offer military aid when the United States withdraws its own military support. After the Thai military overthrew the government of Thaksin Shinawatra in 2006, for example, the U.S. government stopped $24 million in military aid to Thailand. Several months later, China offered Thailand $49 million in military aid.265 In 2010, the United States stopped a shipment of 200 surplus U.S. military vehicles to Cambodia in protest over Cambodia’s decision to repatriate to China 20 Uyghurs who were seeking asylum. A few weeks later, China promised Cambodia a package of 257 new military vehicles, 50,000 military uniforms, and $15 mil-

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258On July 15, 2015, Thailand’s Defense Minister Prawit Wongsuwan said, “We will wait for now and not introduce the deal to the cabinet for approval.” He added, “For now, the navy must inform itself and educate itself on whether the submarines are worth it and how much they will add to the Thai navy.” Reuters, “Thailand Puts $1 Billion Chinese Submarines on Hold,” July 15, 2015; Wassana Nanuam, “Prawit Delays Sending Sub Purchase to Cabinet,” Bangkok Post, July 15, 2015.
lion in military aid. Neither of these examples likely resulted in a major loss of U.S. influence in either country, but they illustrate how China is able to nimbly exploit tensions in the United States' relations in the region to its own advantage.

China has weaker defense ties with countries in maritime Southeast Asia. Most of these countries have stronger defense relations with the United States and are also involved in maritime territorial disputes with China. Nonetheless, China continues to develop its defense ties with maritime Southeast Asia. For example, China and Malaysia held their first combined military exercise in December 2014, a tabletop HA/DR exercise. The PLA and Malaysian Armed Forces held an exercise in the Strait of Malacca in September 2015, focusing on operations including maritime escort, search and rescue, HA/DR, and counterhijacking. According to Chinese state-run media outlet Xinhua, the exercise was “the largest bilateral military exercise between China and a country from ASEAN.”

China views arms transfers as a means of strengthening bilateral relations and enhancing its influence in Southeast Asia while also growing its defense export industry. Chinese arms transfers to countries in Southeast Asia primarily consist of low-end Chinese equipment, and account for a small percentage of its global arms transfers. Although China has begun to sell more advanced equipment—such as C-802 antiship missiles sold to Indonesia—to Southeast Asian countries, China’s sales in the region are still primarily comprised of equipment such as K-8 trainer aircraft and JIANGHU-class frigates. According to data gathered by the Stockholm International Peace Research Institute, between 2010 and 2014, Burma was the largest recipient of Chinese arms in Southeast Asia, followed by Indonesia, Thailand, Cambodia, Laos, and Timor Leste. During this time, China transferred $1.3 billion in arms to these seven countries, comprising 16.6 percent of the value of China’s global arms transfers.

China’s arms sales to Burma reflect the robust military-to-military ties the two countries have enjoyed since the late 1980s, when China provided military aid and sold arms to the country after the Burmese junta’s 1988 crackdown on prodemocracy demonstrations led to international isolation; these sales also speak to China’s interest in encouraging stability and political continuity in its southern neighbor, with which it shares a long and often troubled border. Between 2010 and 2014, China supplied 56 percent of Burma’s arms imports (Russia provided 40 percent). Although the United States and European countries have strengthened their political and economic relations with Burma in recent years, they continue to maintain restrictions on the export of defense equipment due to continuing concerns about abuses by the Burmese military. For its part, the United States has limited military-to-military engagement to meetings between senior officials and training on military legal affairs.
Conflict on the China-Burma Border

China is involved in a long-simmering conflict in northern Burma between the Burmese military and several armed rebel groups. Some of these rebel-controlled territories, by virtue of their location near the Chinese border, have many connections to China. In addition to their large ethnic Chinese populations, these areas are heavily economically integrated with China’s Yunnan Province, though this economic relationship is often fraught with tension. For example, some stalled Chinese-backed economic projects, like the Myitsone Dam, are symbolic of resistance to China’s presence in the region. Additionally, China’s massive demand for northern Burma’s vast jade reserves has spawned a corrupt and predatory industry associated with rampant intravenous heroin use by miners, often enabled by Chinese precursor chemicals. As a result, HIV is a significant health concern in northern Burma.279

Further complicating the relationship, northern Burmese rebel groups are apparent beneficiaries of Chinese arms (although the Chinese government denies this).280 Under then Chairman of the CCP Mao Zedong, China openly supported communist rebels in Burma, but in recent decades it has cultivated ties with the ruling Burmese government and has sought to help broker a ceasefire agreement among the Burmese government and various rebel groups. Nevertheless, it appears some of the rebel groups are enabled by some degree of Chinese military assistance—if not sanctioned by Beijing, then possibly orchestrated by Chinese officials or other actors in Yunnan Province.281 Among Chinese arms reported to be used by rebel forces are man-portable air defense systems, armored vehicles, and infantry support weaponry.282

In 2015, the intermittent conflict between the Burmese military and rebels became particularly intense, leading to heightened tensions between China and Burma. In March 2015, China criticized the Burmese military for accidentally dropping bombs on the Chinese side of the border and killing four Chinese citizens.283 China threatened a “decisive response” if Burmese bombing in China’s territory continued, and sent fighter aircraft to patrol the affected area.284 Then, in June 2015, China announced it would conduct live-fire military exercises on the China-Burma border.285 Retired PLA colonel Yue Gang said “live-fire military exercises by the PLA are very rare in this region” and asserted that the exercises are intended to “show that there is a bottom line to China’s tolerance. When [Burma] crosses the line China must strike back to defend itself, not to start a war.” 286 Around this same time, as a result of growing violence, as many as 60,000 Burmese refugees reportedly crossed the border into China.287

It is unclear how Beijing will seek to balance what appear to be competing Chinese interests in Burma going forward. Maintaining positive ties with the Burmese government has become
**Conflict on the China-Burma Border—Continued**

even more important to China now that the United States and European countries have expanded relations with Burma. According to *Jane's Intelligence Review*, China's apparent recent support for rebel groups near the border may even be intended as a “warning” to Naypyidaw, the Burmese capital, that its thawing relations with the United States and the West “not jeopardize Beijing's long-standing strategic and economic interests” in Burma.\(^{288}\)

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**Nontraditional Security Cooperation**

**Counterterrorism**

Counterterrorism is an important area of cooperation for China and Southeast Asia; it has been the focus of almost half of China's military exercises with Southeast Asian countries between 2008 and 2014.\(^{289}\) Terrorism is a growing security challenge for China. In addition to Beijing's concerns about domestic terrorism, new external threats such as the Islamic State in Iraq and the Levant (ISIL, also known as ISIS) are emerging. ISIL has publicly identified China as a country where “Muslims' rights are forcibly seized.”\(^{*}\) In July 2014, China's Middle East Envoy Wu Sike acknowledged that approximately 100 Chinese citizens may be fighting or receiving training in the Middle East.\(^{290}\) Mr. Wu did not specify whether those individuals undergoing training are being trained by ISIL or other groups. As violent attacks on government and civilian targets in China allegedly carried out by militant Uyghurs have increased, the Chinese government is concerned that individuals within China could draw inspiration from ISIL, or that Chinese citizens fighting with ISIL or receiving training from the organization could return to China to carry out attacks.\(^{291}\) In addition, hailing from countries on China's periphery, there reportedly are more than 500 Indonesians and dozens of Malaysians fighting for ISIL.\(^{292}\) More than being a source of fighters, Southeast Asia could also become a safe haven from which ISIL could initiate terror attacks, a concern raised by Singapore's Prime Minister Lee during his speech at the 2015 Shangri-La Dialogue.\(^{293}\) Given these concerns, China may increase counterterrorism cooperation with Southeast Asian countries. (For a discussion of China's counterterrorism cooperation with Central Asian countries, see Chapter 3, Section 1, “China and Central Asia.”)

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\(^*\)In July 2014, Abu Bakr al-Baghdadi, the leader of ISIL, listed China among the countries where “Muslims' rights are forcibly seized,” and called on Muslims to take action, saying, “Your brothers all over the world are waiting for your rescue, and are anticipating your brigades.” SITE Monitoring Service, “Islamic State Leader Abu Bakr al-Baghdadi Encourages Emigration, Worldwide Action,” July 1, 2014.

\(^{1}\)While terrorism is a real and growing threat to peace and security in China, the Chinese government tends to employ an excessively broad definition of and approach to terrorism, often conflating terrorism with extremism, criminality, or peaceful political protest. This, along with the opacity of China’s counterterrorism policies, makes it difficult to assess the legitimacy of some of China's terror threat assessments. U.S.-China Economic and Security Review Commission, 2014 Annual Report to Congress, November 2014, 367; Andrew Small, *The China-Pakistan Axis: Asia's New Geopolitics*, Oxford University Press, 2015, 73.
In addition, the August 2015 bombing of Thailand’s Erawan Shrine may mean that terrorism will become a larger issue in China-Thailand relations. In September 2015, Thai police announced that two suspects—a man of unknown nationality and a Uyghur man from China—had confessed to carrying out the attack, which killed 20 people, including tourists from mainland China and Hong Kong. The police alleged that their primary motive was retaliation for the Thai government’s crackdown on a network that helped to smuggle Uyghurs out of China through Thailand. However, this allegation has yet to be independently confirmed.

**Humanitarian Assistance and Disaster Relief**

China also seeks to enhance cooperation with Southeast Asian countries in the area of HA/DR, cooperation through which Beijing can try to reassure its Southeast Asian neighbors of its intentions and support its efforts to present China as a contributor to international security. HA/DR exchanges between the PLA and regional militaries also are a relatively nonsensitive area of cooperation. In 2014, China sent military personnel to participate in an ASEAN HA/DR exercise in Thailand, and later in the year signed a memorandum of understanding with ASEAN on disaster management. The agreement includes a grant from the Chinese government to support ASEAN disaster management programs. Moreover, following the March 2014 disappearance of Malaysia Airlines Flight 370, on which most of the passengers were Chinese citizens, China deployed a large number of military assets, including transport aircraft, guided-missile frigates, and helicopters, to conduct search and rescue operations. In 2013, China deployed the PLA Navy hospital ship the Peace Ark to the Philippines in response to Typhoon Haiyan. This deployment was the first time China sent a naval vessel overseas for a medical HA/DR relief operation.

**Trafficking and Infectious Diseases**

China cooperates with Southeast Asian countries to combat other nontraditional security threats, including human and drug trafficking and the spread of infectious diseases. Among the examples of this collaboration is China-Vietnam cooperation to crack down on human trafficking rings in China and rescue Vietnamese women who had been promised work in China but were later sold to brothels. The Chinese government partners with the Burmese military and police to try to counter drug trafficking activities between Burma and China. Joint health initiatives have included China’s partnership with Malaysia in fighting the spread of severe acute respiratory syndrome (SARS) in 2003 and later avian influenza; China also collaborated with Indonesia, Thailand, and Viet-

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*In addition, Vietnamese are being smuggled into China to work in factories. It is unclear, however, whether the Chinese and Vietnamese governments are working together to stop these smuggling operations. James Pomfret, “Special Report: How Smuggled Workers Power ‘Made in China,’” Reuters, August 6, 2015.
†The U.S. and Chinese governments also have cooperated to combat drug trafficking originating in the Golden Triangle, the area where the borders of Burma, Laos, and Thailand meet. One of the most prominent examples of such cooperation was the dismantling of the “125” drug-smuggling ring, which was trafficking heroin produced in Burma to the United States via China, in 2003. Zhang Yongan, “Asia, International Drug Trafficking, and U.S.-China Counternarcotics Cooperation,” *Brookings Institution*, February 2012; 2, 12, 16; Susan Saulny, “China’s Help Is Credited in Tripping up Drug Ring,” *New York Times*, May 17, 2003.
Piracy

Piracy has increased in maritime Southeast Asia and could have major implications for China as the majority of its oil imports transit through Southeast Asia by way of the Strait of Malacca. During the first three months of 2015, 55 percent of all armed robbery and piracy incidents occurred in Southeast Asia, including the hijacking of five oil tankers. In addition, in 2014, of the seafarers who were the victims of piracy in Southeast Asia and whose nationalities were known to the International Maritime Bureau, 10.8 percent were Chinese, the third-largest percentage among all nationalities identified.

Despite the threat of piracy in maritime Southeast Asia, however, the PLA's antipiracy operations are focused on the Gulf of Aden in the western Indian Ocean. Since piracy is declining in the Gulf of Aden and is on the rise in the Gulf of Guinea and maritime Southeast Asia, PLA Navy antipiracy operations may shift to these areas. China's cooperation with Southeast Asia in combating piracy includes its membership in the Regional Cooperation Agreement on Combating Piracy and Armed Robbery against Ships in Asia, and its assignment of a Chinese liaison officer to the Information Fusion Center; both organizations are based in Singapore. Furthermore, as discussed earlier, the PLA and Malaysian Armed Forces' combined exercises held in the Strait of Malacca in September 2015 included maritime escort and counterhijacking drills.

China-Vietnam Relations: A Case Study

China-Vietnam relations are among the most complex of China's bilateral relationships in Southeast Asia. China and Vietnam share communist ideology and history, a border, cultural ties, and more than 1,000 years of imperial Chinese control over Vietnam. Although China supported the North Vietnamese during their war with the United States, Vietnam's toppling of the China-backed Khmer Rouge in Cambodia in 1978 and Vietnam's security links to the Soviet Union prompted China to invade Vietnam in 1979, sparking a month-long war. Estimates of the casualties among the two sides' militaries range as high as 26,000 Chinese soldiers and 30,000 Vietnamese soldiers killed. According to an article in the New York Times, 10,000 Vietnamese civilians were killed. In the South China Sea, China seized control of the Paracel Islands in 1974 and Johnson South Reef in 1988 using military force against Vietnamese military personnel. Although the bilateral relationship improved after the two countries normalized relations in 1991, they did not reach an agreement on the demarcation of their border until 2009, 30 years after the 1979 border war.

Today, bilateral cooperation between China and Vietnam spans a broad range of areas. China-Vietnam memoranda of understanding cover topics such as human trafficking, educational exchanges, and nuclear energy exchanges. For example, the Vietnam National University of Agriculture has more than 15 agreements on a study regarding enhancing surveillance and early detection of avian influenza.
with Chinese universities on student exchange and educational programming.\textsuperscript{313}

The two countries also have strong economic ties—China is the third-largest destination for Vietnam’s exports, Vietnam’s largest source of imports, and a growing source of investment in Vietnam. In late 2013, Beijing and Hanoi signed a memorandum of understanding to increase trade and economic cooperation by creating four new economic zones along the Vietnam-China border by 2020.\textsuperscript{314} However, economic cooperation between China and Vietnam is not free from tension.\textsuperscript{315} For example, during the Commission’s trip to Vietnam in 2015, multiple observers noted problems with the construction of an urban rail system in Hanoi by a Chinese company. China Railway Sixth Group Co., Ltd. is the main contractor for the ongoing construction of the urban rail system, a project which has experienced delays, cost overruns, and safety problems.\textsuperscript{316} The rail system was originally scheduled to become operational in 2013, but that date has been extended to 2016; the cost of construction has been $339 million more than expected; scaffolding has collapsed, and steel bars and reels have fallen on cars and motorcycles, with a steel reel killing one person and injuring two others.\textsuperscript{317} In January 2015, Vietnam’s Minister of Transportation described the project as the “worst” in Vietnam.\textsuperscript{318}

Disputes over sovereignty in the South China Sea remain a major source of friction in China-Vietnam relations, as discussed earlier, and Vietnam is one of the most vocal Southeast Asian countries in criticizing China’s assertive behavior in the South China Sea.\textsuperscript{319} Amid the PLA’s rapid modernization and China’s efforts to consolidate its claims, Vietnam has also taken measures to enhance its military capabilities to deter potential Chinese coercion.\textsuperscript{320} During many of the Commission’s meetings with the Vietnamese government, the Communist Party of Vietnam, and academic organizations in Hanoi, interlocutors expressed their concerns about China’s activities in the South China Sea, including the view that China seeks to control part or all of the South China Sea.\textsuperscript{321} Reflecting these concerns, an interlocutor from the Institute for Defense Strategy at Vietnam’s Ministry of Defense told the Commission that Vietnam seeks a peaceful and stable relationship with China rather than an “unreal, verbal peace.”\textsuperscript{322} Interlocutors from the Diplomatic Academy of Vietnam told the Commission that China’s approach to the South China Sea dispute suggests China has a long-term strategy to dominate Vietnam.\textsuperscript{323} In addition, interlocutors from the Communist Party of Vietnam Central Committee said that, should China announce an ADIZ over the South China Sea, it would be capable of enforcing the ADIZ, and “freedom of navigation will be no more.”\textsuperscript{324} During several of the Commission’s meetings in Hanoi, interlocutors expressed their view that the United States should be more assertive in response to China’s actions in the South China Sea.\textsuperscript{325}

One of the worst crises in China-Vietnam relations since 1979 ensued when Chinese state-owned oil company China National Petroleum Corporation deployed its ultradepthwater oil rig \textit{Haiyang Shiyou 981} to waters disputed by China and Vietnam between May
Concerns about China in Vietnam are not limited to the South China Sea. According to U.S. officials in Hanoi, Vietnam views China's construction of dams on the Mekong River as part of China's effort to "pinch" Vietnam from the West. These officials also said that Vietnam is concerned neighboring Laos no longer "needs" Vietnam due to its relationship with China.\(^{330}\)

**Vietnam-U.S. Relations**

The oil rig crisis appears to have motivated Vietnam to pursue more vigorous outreach to third-party countries, particularly the United States.\(^{331}\) Since Vietnam and the United States restored diplomatic relations in 1995, the two countries have gradually strengthened bilateral relations, a process that has gained momentum from the U.S. rebalance to Asia policy and China's actions in the South China Sea.\(^{332}\) During his visit to Vietnam in June 2015, U.S. Secretary of Defense Ashton Carter announced the United States will provide Vietnam $18 million to procure U.S.-made patrol vessels and will station a U.S. peacekeeping expert at the U.S. embassy in Vietnam, with the aim of assisting Vietnam in pursuing its goal of participating in UN peacekeeping operations. In addition, the two sides pledged to expand defense trade, potentially to include coproduction of defense equipment.\(^{333}\) In another sign of growing ties, Secretary Carter visited a Vietnamese military base and toured a Vietnamese Coast Guard ship, marking the first time the Vietnamese military had invited a U.S. secretary of defense to visit a military base and set foot on a coast guard vessel.\(^{334}\) Following Secretary Carter's visit to Vietnam, in July 2015, General Secretary Nguyen Phu Trong, Vietnam's most powerful political leader, visited the United States, the first time a Communist Party of Vietnam general secretary has done so. General Secretary Trong belongs to the conservative faction of the Communist Party of Vietnam, a group within the party that traditionally has viewed the United States with suspicion.\(^{335}\)

\(^{326}\) Although the two sides appear to have stabilized bilateral relations since then, the oil rig crisis may have a far-reaching impact on Vietnam’s view of China and its approach to the relationship. A U.S. embassy official who met with the Commission in Hanoi described the crisis as “paradigm-shattering,” causing Vietnam to feel “very betrayed” by China.\(^{327}\) Murray Hiebert, senior fellow and deputy director of the Sumitro Chair for Southeast Asian Studies at the Center for Strategic and International Studies, stated in his written testimony to the Commission that “as a result of the oil rig crisis, even party stalwarts in Hanoi have become disillusioned with China’s treatment of Vietnam. Strategic trust has been weakened.”\(^{328}\)

As further evidence of this shift, in July 2014, 61 members of the Communist Party of Vietnam, including a former Vietnamese ambassador to China and former vice minister of Vietnam's Ministry of Science and Technology, sent a letter to Vietnam’s leaders in which they called for Vietnam to “escape” from what they described as the country’s dependence on China.\(^{329}\)

London, assistant professor at the City University of Hong Kong, the visit indicates that “even the most conservative, doctrinaire elements of the Communist Party have now come to recognize the practical indispensability of strong Vietnamese-U.S. ties.”

As Vietnam continues to develop its relations with the United States to balance its relations with China, limits on the U.S.-Vietnam partnership may arise from the misgivings of senior Vietnamese officials who fought against the United States in the Vietnam War. Vietnamese officials and strategists are concerned that if Vietnam becomes too close to the United States, China will respond negatively. A further complication exists regarding the U.S. restriction on selling weapons to Vietnam. Although the United States eased such restrictions in 2014 to allow for the transfer of maritime security equipment, Washington still bans the sale of lethal weapons to Vietnam due to concerns about Vietnam’s human rights record. Vietnam is seeking a removal of the remaining restrictions.

**Implications for the United States**

China’s relations with Southeast Asian countries and its activities in Southeast Asia have important implications for the United States related to regional stability, U.S. commitments to allies, freedom of navigation, economics and trade, and nontraditional security threats.

China’s land reclamation and construction activities in the South China Sea, once completed, likely will have significant implications for U.S. interests in Southeast Asia.

First, military infrastructure on the land features China controls in the Spratly Islands could enhance China’s antiaccess/area denial capabilities, potentially challenging the U.S. military’s ability to freely operate in the region. Ms. Glaser writes that “in peacetime and in a crisis, [these land features] will provide China with the capability to hold U.S. forces at risk at a farther distance than it can at present. This could have implications for a U.S. effort to come to Taiwan’s defense. A U.S. carrier battle group sailing from the Arabian Gulf or Indian Ocean that was coming to Taiwan’s aid would have to pass through the South China Sea.”

Second, tensions between China and the other claimant states, namely the Philippines and Vietnam, have the potential to spark an armed clash, which would threaten regional stability and the global economy and could involve the United States. The United States maintains the 1951 Mutual Defense Treaty with the Philippines, and though it has affirmed its commitment to the treaty, the United States has not officially articulated the specific geographic areas that would trigger a mutual defense response. Thus, a potential military clash between China and the Philippines that begins in the South China Sea could lead to involvement by

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*According to the U.S. Department of Defense, “antiaccess” actions are intended to slow the deployment of an adversary’s forces into a theater or cause them to operate at distances farther from the conflict than they would prefer. “Area denial” actions affect maneuvers within a theater, and are intended to impede an adversary’s operations within areas where friendly forces cannot or will not prevent access. China, however, uses the term “counterintervention,” reflecting its perception that such operations are reactive. U.S. Department of Defense, Military and Security Developments Involving the People’s Republic of China 2013, 2013, 1, 32, 53; U.S. Department of Defense, Air Sea Battle: Service Collaboration to Address Anti-Access & Area Denial Challenges, May 2013, 2.*
the U.S. military. In the current climate of China-Philippines relations, as China becomes bolder in its efforts to secure control over Philippines-claimed waters, the potential for miscalculation, crisis, and conflict is high.

Third, the South China Sea is also a major irritant in U.S.-China relations and is the most likely location of a dangerous encounter, whether intended or unintended, between the U.S. and Chinese militaries. Once the airstrip on Fiery Cross Reef is operational, China could send fighter aircraft to challenge U.S. surveillance flights near its reclaimed land features, increasing the chance of a collision and a political crisis. Likewise, the growing presence of the PLA Navy and Chinese maritime law enforcement ships in the South China Sea raises the risk of a maritime incident between the U.S. and Chinese ships.

**U.S. Patrols near China’s Land Reclamation Projects in the South China Sea**

On May 20, 2015, a U.S. Navy P-8A Poseidon surveillance aircraft flew from Clark Air Base in the Philippines to airspace near Subi Reef, Mischief Reef, and Fiery Cross Reef. CNN reporter Jim Sciutto accompanied the crew and reported on the mission. Over the course of the flight, the PLA Navy ordered the crew of the Poseidon to leave the airspace eight times. The radio transmission also included the following directive: “You are approaching our military alert zone. Leave immediately.” At one point, the Chinese radio operator’s warnings grew more urgent, and he yelled, “You go!” It is unclear how the PLA Navy defines a military alert zone, which is not an internationally recognized military term.

Publicizing U.S. surveillance flights near China’s reclaimed land features in the South China Sea appears to be part of an effort by the United States to impose reputational costs on China as its land reclamation and construction activities continue. In his keynote speech at the 2015 Shangri-La Dialogue, Secretary
U.S. Surveillance Flights over the South China Sea—Continued

Carter asked for “a lasting halt” to land reclamation in the South China Sea and harshly criticized China’s land reclamation, saying, “Turning an underwater rock into an airfield simply does not afford the rights of sovereignty or permit restrictions on international air or maritime transit.” He also reaffirmed the United States’ right and intention to “fly, sail, and operate wherever international law allows.” U.S. surveillance flights have continued since then, including one on which Admiral Scott Swift, commander of the U.S. Pacific Fleet, was aboard.

The United States’ response to China’s activities in the South China Sea continues to evolve. On May 12, the Wall Street Journal reported that Secretary Carter was contemplating sending U.S. Navy surveillance aircraft and ships within 12 nm of China’s land reclamation projects, citing “growing momentum within the Pentagon and the White House for taking concrete steps in order to send Beijing a signal that the recent buildup in the Spratlys went far enough and needed to stop.” After much deliberation by the Obama Administration, on October 27 a U.S. Navy guided missile destroyer conducted a freedom of navigation patrol within 12 nm of Subi Reef, an artificial island created from a low-tide elevation, appearing to signal that the United States does not consider Subi Reef to have a territorial sea. According to a U.S. official quoted by the Washington Post, the patrol “was completed without incident,” though the PLA Navy sent at least one ship to monitor the U.S. destroyer, and a Chinese Ministry of Foreign Affairs spokesperson warned that, “If the relevant party keeps stirring things up, it will be necessary for China to speed up its construction activities.” As of the writing of this Report, Chinese officials had not otherwise publicly reacted to the patrol.

China’s security cooperation with mainland Southeast Asia may have implications for U.S. influence in the region as well. This is particularly the case in Burma, where China appears to believe it is in a contest for influence with the United States (and to a lesser extent, other major powers). While the U.S.-Thai alliance remains in place and Washington and Bangkok are mending ties after a period of tension, China’s security ties with Thailand are also growing. It remains to be seen how Thailand will manage this dynamic, but U.S.-China competition for influence in the country almost certainly will grow in the future.

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*According to UNCLOS, low-tide elevations, which are submerged at high tide, may not generate a territorial sea unless they are located within the territorial sea of an island or mainland coastline. See also Gregory Poling, “Carter on the South China Sea: Committed and (Mostly) Clear.” Center for Strategic and International Studies, Asia Maritime Transparency Initiative, June 3, 2015.

In its economic relations with Southeast Asia, China is actively expanding its foreign assistance in the region through mechanisms such as its 21st Century Maritime Silk Road initiative and the AIIB in order to serve its own diplomatic and economic interests. Although this assistance is primarily in the form of infrastructure investment versus traditional official development assistance, the value of its pledges exceeds estimates of infrastructure aid to Southeast Asia from U.S.-backed development organizations such as the World Bank and the Asian Development Bank. If China follows through on its pledges and outpaces the United States and U.S.-backed aid organizations in foreign assistance to Southeast Asia, this could undermine U.S. development goals in the region, including promoting democracy, human rights, governance, gender equality, and sustainable development. At the same time, China's continued unilateral activities along the Mekong River—activities that are having detrimental environmental and socioeconomic effects on downstream countries—provide an opportunity for the United States to expand its cooperation with lower Mekong countries through programs such as the Lower Mekong Initiative.

Furthermore, as Southeast Asia becomes increasingly reliant on trade with China and vulnerable to fluctuations in China's economy, the region has an incentive to diversify its trade and investment partners, including closer cooperation with the United States. Current U.S.-led trade negotiations, such as the Trans-Pacific Partnership, focus on developing “21st century standards” in intellectual property, labor protection, and environmental conservation—goals that may be difficult for some lesser developed Southeast Asian countries to achieve. U.S.-funded training programs, such as intellectual property enforcement training by the U.S. Patent and Trademark Office and the U.S. State Department’s international visitor program, may be mechanisms for helping Southeast Asia prepare for enhanced trade cooperation with the United States.

A bright spot in China-Southeast Asia relations is the growing cooperation on shared security threats like terrorism, piracy, natural disasters, trafficking, and infectious diseases. The United States should welcome and encourage these activities, as it too has a stake in countering these threats and an interest in the convergence of interests between China and its Southeast Asian neighbors on regional security issues.

Conclusions

- China's approach to Southeast Asia involves both consolidating its territorial claims in the South China Sea and seeking to improve economic ties with countries in Southeast Asia. China's leaders seem to believe that striking a balance between these two endeavors enables China to protect its perceived sovereignty in the South China Sea and benefit from economic engagement with the region, while ensuring tensions along its periphery do not become intolerably high for Beijing.

- Since late 2013, China has conducted dramatic land reclamation and construction activities on the land features it controls in the Spratly Islands. These rapid activities appear to be driven by several factors: China's desire to unilaterally impose its claims
and avoid arbitration or negotiation with other parties over the disputes; China’s ambition to enhance its ability to project power into the South China Sea; and, potentially, China’s intention to establish an air defense identification zone over part of the South China Sea.

- Southeast Asian countries have reacted with increasing alarm to China’s activities in the South China Sea. They continue to enhance their military and civilian maritime patrol capabilities and to strengthen security relations with the United States and other countries in the Asia Pacific. However, despite growing worry among Southeast Asian countries about China, and rising assertiveness in expressing these concerns, they still seek to preserve positive relations with China and appear to still be balancing their relationships with China and the United States.

- Although historical animosities and China’s actions in the South China Sea continue to hamper trust of China in Southeast Asian capitals, defense and security cooperation between China and countries in Southeast Asia has grown over the last 15 years. China’s most prominent defense ties in Southeast Asia are with countries in mainland Southeast Asia: Burma, Cambodia, Laos, and Thailand, all of which are among its nearest neighbors. China has also increasingly engaged with Southeast Asian countries in the areas of nontraditional security and humanitarian assistance and disaster relief.

- China is vastly expanding its foreign assistance and investment programs in Southeast Asia as a means of achieving its foreign policy goals in the region, including efforts to defuse tensions surrounding contentious disputes such as those in the South China Sea. Chinese foreign assistance to Southeast Asia comes primarily in the form of infrastructure investment, and projects are frequently implemented by Chinese firms using Chinese labor, limiting the benefits for local communities.

- The Association of Southeast Asian Nations’ (ASEAN) trade liberalization with China from 2004 to 2010 has led to a large and growing bilateral trade deficit. Economic integration has also increased the association’s vulnerability to fluctuations in China’s economy, with China’s recent economic slowdown exacerbating ASEAN’s trade deficit with China.

- Use of the renminbi (RMB) in international transactions is expanding rapidly in Southeast Asia and paving the way toward more extensive use of the currency regionally. Limited progress in advancing multilateral monetary cooperation in Southeast Asia, such as through the Chiang Mai Initiative Multilateralization, may allow for the RMB’s increased circulation in the region.

- China continues to unilaterally construct dams along the Mekong River without any obligation to share information about water management with downstream Mekong countries. China’s actions on the Mekong are causing major fluctuations in water levels in the Mekong Basin, but China has expressed little interest in cooperating with its southern neighbors by joining the Mekong
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SECTION 3: TAIWAN

Introduction

Cross-Strait relations in 2015 were essentially stable. At the same time, concern in Taiwan about increasing cross-Strait economic integration with China intensified—as manifested in the 2014 Sunflower Movement, during which Taiwan citizens occupied the legislature in part to protest expanding cross-Strait economic ties. Taiwan citizens’ wariness of China, spurred by the Mainland’s increasing economic interconnectedness with Taiwan, appears to be partially responsible for flagging public confidence in Taiwan’s Kuomintang (KMT)-led government. With Taiwan’s national elections approaching in January 2016, and the Democratic Progressive Party (DPP), Taiwan’s opposition and traditionally pro-independence party, leading in presidential polls, China-Taiwan relations may be facing a major shift. Meanwhile, China’s continued military modernization poses a growing threat to Taiwan, and the balance of power in the Taiwan Strait continues to shift strongly in China’s favor.

Outside the cross-Strait relationship, Taiwan is making progress addressing several economic and security challenges. Despite China’s restrictions on Taiwan’s participation in multilateral institutions, Taiwan continues to attempt to expand its status and legitimacy in international affairs by actively pursuing both regional economic integration and fisheries agreements with its maritime neighbors. U.S.-Taiwan relations also remain strong, with annual bilateral trade reaching a record high of $67.4 billion in 2014 and continued growth expected in 2015. In the security realm, increased U.S.-Taiwan security cooperation demonstrates the U.S. commitment to Taiwan’s defense.

This section examines the state of cross-Strait ties, Taiwan’s international engagement, Taiwan military and security issues, and U.S.-Taiwan relations, and ends with a discussion of the implications of these developments for the United States. It is based on the Commission’s meetings with Taiwan officials in Washington, consultations with U.S. and foreign nongovernmental experts, and open-source research and analysis.

Cross-Strait Relations

A series of events that occurred in Taiwan in 2014 continue to shape its political environment and the cross-Strait relationship. The first of these events, and perhaps the most influential for cross-Strait ties, was the Sunflower Movement. The Sunflower Movement started as a grassroots student-led occupation of Tai-
Taiwanese citizens' affinity for and identification with mainland China appears to be decreasing. According to a 2014 survey of Taiwanese citizens conducted by National Chengchi University in Taipei, when asked how they view their national identity, over 60 percent of respondents—an all-time high since the survey was first conducted in 1992—said they self-identified as Taiwanese instead of Chinese or a combination of the two. Those who identified as both Taiwanese and Chinese comprised 32.5 percent. By comparison, the survey conducted in 2013 found about 57 percent identified themselves as Taiwanese (35.8 percent as Taiwanese and Chinese), and in 2008, when President Ma was first elected, it found that less than 50 percent identified themselves as Taiwanese (43.1 percent as Taiwanese and Chinese). The survey results suggest that Taiwanese citizens in general view identity more in terms of citizen-
The Mainland Affairs Council is a cabinet-level agency in Taiwan's executive branch that is responsible for overseeing Taiwan's cross-Strait policies. This trend shows that China's efforts to move Taiwan politically and culturally closer to the Mainland are not necessarily successfully promoting cross-Strait cultural integration or affinity for the Mainland by Taiwan citizens. It also seems to reflect Taiwan citizens' increasing skepticism about China.

Informing Taiwan's growing pessimism about the Mainland's political encroachment is the ongoing political turmoil in Hong Kong. In a July 2015 speech at the Brookings Institution, Mainland Affairs Council (MAC) Minister Andrew Hsia said, "... Obviously we are also concerned with the level and the latitude of freedom and democracy given to the people of Hong Kong. We are disappointed, of course, and we certainly hope that the Beijing regime will respect the people of Hong Kong and its freedom to choose." Hong Kong's fight for democracy serves as a warning that, if Taiwan were reunified with China, Beijing would not likely adhere to any promise it might make to protect Taiwan's civil liberties. (For more information on recent developments in Hong Kong, see Chapter 3, Section 4, "Hong Kong.")

China also has taken unilateral actions that appear to be designed to move Taiwan closer to the "one country, two systems" framework that Beijing uses for interacting with Hong Kong and Macau. Through these measures, Beijing seeks to move Taiwan closer politically to the Mainland and further constrain its sovereignty. For example, China in July 2015 passed a National Security Law that states, "The sovereignty and territorial integrity of China cannot be encroached upon or divided. Maintenance of national security and territorial integrity is a shared obligation of all the Chinese people, including compatriots from Hong Kong, Macau, and Taiwan." The Ma Administration responded by issuing a formal protest with the Chinese government, and the DPP called the law a "disrespectful decision" toward the Taiwan people. China also announced a new requirement for Taiwan citizens traveling to the Mainland to use entry permit cards similar to those used by Hong Kong residents in place of passports. Opponents of the decision in Taiwan criticized it as a "downgrade" of Taiwan's status.

Cross-Strait Political Relations

As the KMT and DPP vie for power, the Chinese government appears to be increasingly uneasy about the prospect of the DPP winning Taiwan's presidency in the January 2016 elections. With the DPP's chairperson and presidential candidate Tsai Ing-wen leading all other candidates in the polls, observers assess that Beijing is worried that if DPP Chairperson Tsai is elected, she may not accept the notion that the Mainland and Taiwan are part of one country and may seek to steer Taiwan toward de jure independence. Bonnie Glaser, senior advisor for Asia at the Center for Strategic and International Studies (CSIS) and Jacqueline Vitello, program associate at CSIS, assert that this fear is based on Chair-
person Tsai’s unwillingness to agree to the “one China” principle* and her role in creating the “two states theory”† when she served as a senior advisor in the Taiwan government in 1999.17 Despite Beijing’s perception that Chairperson Tsai would damage cross-Strait ties, her stated position of “maintaining the status quo” in cross-Strait relations indicates a pragmatic approach.18

Beijing is also concerned, in part, because the last time the DPP held power (from 2000 to 2008), the administration of then president Chen Shui-bian pursued a pro-independence policy.19 Throughout 2015, Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping, Premier Li Keqiang, and other senior officials have made statements insisting that Taiwan follow the “1992 Consensus,”20 a tacit understanding reached between the two sides that interprets the “one China” principle such that each side maintains its own definition of “one China.”21 While President Ma has cited the 1992 Consensus as the basis for seven years of positive cross-Strait relations, the DPP has rejected the term.22

### KMT and DPP Views on Cross-Strait Relations

Although it is unclear how cross-Strait issues will influence the outcome of Taiwan’s elections, the two leading political parties’ cross-Strait policies will have important implications for future relations between Taiwan and the Mainland.

President Ma has defended the KMT’s adherence to the 1992 Consensus and “Three No’s”—no unification, no independence, and no use of force—as the keys to successfully reaching cross-Strait agreements on trade and investment.23 The KMT appears to be trying to sell Taiwan citizens on its accomplishments in deepening and stabilizing cross-Strait ties, warning that any changes to cross-Strait policy would invite instability. In an April 2015 speech at Taiwan’s MAC, President Ma said, “By adhering to the [1992 Consensus], cross-Strait relations are bound to flourish. Divergence is sure to result in deterioration. And opposing the 1992 Consensus is sure to create turmoil.”24

Facing low poll numbers and the prospect of losing both the presidential election and the majority of seats in the Legislative Yuan, the KMT in October 2015 decided to replace its presidential candidate, eight term legislator Deputy Legislative Speaker Hung Hsiu-chu, with KMT chairman and mayor of New Taipei

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*The “one China” principle states that both Taiwan and China are a part of a single “China.”

†In 1999, then Taiwan president Lee Teng-hui proposed the “two states theory,” which considered Taiwan a separate state from the Mainland, leading to the suspension of cross-Strait talks and political discord. Tsai Ing-wen served as senior advisor on Taiwan’s National Security Council at the time and is said to be one of the key architects of the theory. Goh Sui Noi, “Tsai Ing-wen: The ‘Doc’ who Nursed DPP Back to Health,” Straits Times (Singapore), July 27, 2015; Taiwan Panorama, “A Woman of Many Parts: Tsai Ing-wen,” July 1, 2012.
KMT and DPP Views on Cross-Strait Relations—Continued

City Eric Chu. Ms. Hung upon her July 2015 nomination as the KMT’s presidential candidate was seen by some KMT party members as a controversial choice due to statements she made that were viewed as more pro-China and pro-unification than the KMT mainstream. Mr. Chu, by contrast, is a popular KMT centrist who has pledged to uphold the 1992 Consensus and follow President Ma’s cross-Strait policy. A KMT government in 2016 probably would continue to pursue a strategy of rapprochement with Beijing and seek improved economic, cultural, and people-to-people ties, though it would likely face the same obstacles that the Ma Administration has encountered in recent years.

Meanwhile, DPP Chairperson Tsai has left her party’s cross-Strait policy purposefully vague, stating the DPP supports “maintaining the status quo” without agreeing to the 1992 Consensus or any form of the “one China” principle. In a speech during her visit to the United States in June 2015, Chairperson Tsai said, “[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 . . . .” Her comments suggest that she will not seek to reverse the accomplishments of the 1992 Consensus. By leaving ambiguity in the DPP’s cross-Strait policy, Chairperson Tsai appears to be seeking to avoid alienating both the DPP’s staunch pro-independence base and mainstream Taiwan voters who seek stability in the cross-Strait relationship. A DPP government in 2016 likely would seek to create greater transparency in cross-Strait negotiations. If elected, Chairperson Tsai could also slow the pace of rapprochement with Beijing due to Taiwan citizens’ fear of the Mainland’s increasing influence in Taiwan.29

*On October 17 at a special party congress, 812 out of 891 KMT delegates voted to remove Ms. Hung as the party’s presidential candidate. A majority of delegates then voted to replace Ms. Hung with Mr. Chu, and he accepted, though he had previously said he would not run for president. Stacy Hsu, “Presidential Campaign: KMT’s Eric Chu Takes Over Campaign,” Taipei Times, October 18, 2015; Yuan-Ming Chiao, “Hung Ouster Settled, Chu Begins Bid,” China Post (Taiwan), October 18, 2015; and Austin Ramzy, “Fearing Election Losses, Taiwan’s Governing Party Drops Its Presidential Candidate,” New York Times, October 17, 2015.

†In May 2015 when Ms. Hung was a prospective candidate, she proposed a framework for cross-Strait relations, “one China, same interpretation,” which interpreted the “one China” principle such that each side agrees to the same definition of “one China,” which was widely viewed as inconsistent with the party’s 1992 Consensus. As a prospective candidate she also made provocative comments, such as denying the existence of Taiwan, calling for ending arms procurement from the United States, and proposing a peace agreement with China. In July 2015 prior to the KMT party congress where party delegates nominated their candidate, Ms. Hung agreed to drop her “one China, same interpretation” stance and instead follow the KMT’s party platform. Goh Sui Noi, “Hung Hsiu-chu: KMT’s Little Chilli Spices Up Race,” Straits Times (Singapore), July 27, 2015; Ricky Yeh, “The Challenging Road for Taiwan’s Newest Presidential Candidate,” Diplomat, July 19, 2015; Loa Lok-sin, “Hung Vows to Drop ‘Same Interpretation’; Lawmakers,” Taipei Times, July 10, 2015; Yuan-Ming Chiao, “Hung Draws Criticism for Her ‘Can’t Say ROC Exists’ Stance,” China Post (Taiwan), July 4, 2015; and Central News Agency (Taiwan), “‘One China, Same Interpretation’ Is Cross-Strait Status Quo: KMT’s Hung,” May 7, 2015.
Cross-Strait Agreements and Diplomatic Relations

Since April 2014, progress on major cross-Strait negotiations has slowed and Taiwan’s ratification of signed cross-Strait agreements has stalled, in large part due to President Ma’s waning public support and political gridlock in the Legislative Yuan. In March 2014, protestors occupying the Legislative Yuan during the Sunflower Movement demanded the government adopt an oversight mechanism to enhance transparency in the approval process of future cross-Strait agreements. The protestors proposed a mechanism to grant the Legislative Yuan the right to manage and engage in negotiations on all cross-Strait agreements with China.30 This effort remains stalled in the Legislative Yuan, which has yet to debate the nine proposed draft versions of the bill. Much of the political logjam is the result of disagreement over the respective roles of the Legislative Yuan and the Executive Yuan (Taiwan’s executive branch of government) in the oversight process.31 Although implementing the oversight mechanism is one of President Ma’s top priorities before leaving office, it appears increasingly unlikely that he will achieve this goal.32 Nevertheless, when this oversight mechanism is eventually adopted, it will have significant implications for all future cross-Strait agreements.

Major cross-Strait agreements pending completion include the following:

• **Cross- Strait Services Trade Agreement (CSSTA):** Awaiting ratification in the Legislative Yuan, the CSSTA, signed in 2013, was designed to open up the services sectors of China and Taiwan to cross-Strait trade. The agreement is one of the most important cross-Strait economic deals promoted by the Ma Administration under the 2010 Economic Cooperation Framework Agreement (ECFA), the main framework for cross-Strait economic integration.3 If ratified, the services agreement would have a significant impact on Taiwan’s services industries, a key driver of Taiwan’s economy, accounting for over 62 percent of its gross domestic product (GDP) and 59 percent of its workforce.33 By eliminating investment restrictions and other barriers across 64 service industries in Taiwan and 80 services industries in China, the CSSTA would primarily benefit Taiwan’s financial and retail industries, according to observers.34 However, public and legislative opposition to the agreement has effectively stalled the ratification process. The DPP and other opponents argue the CSSTA will create unfair competition, marginalize Taiwan’s low-end service sector businesses, and expose Taiwan to increased economic and political influence from the Mainland.35

• **Cross-Strait Trade in Goods Agreement:** Progress on the proposed cross-Strait trade in goods agreement under the ECFA...
The China-South Korea free trade agreement has a significant impact on the Taiwan-China trade in goods negotiations and other free trade negotiations under the ECFA. Taiwan competes with South Korea in key industries, particularly liquid crystal display (LCD) panels, petrochemicals, and steel. Taiwan’s Ministry of Economic Affairs estimates Taiwan exporters could lose up to $6 billion over the next 20 years as a result of the China-South Korea free trade agreement. Other sources estimate much higher losses. Tang Pei-chun and Scully Hsiao, “Cabinet Urges Faster Trade Talks as China, S. Korea Sign FTA,” Focus Taiwan, June 1, 2015; Amy Chyan, “China-S. Korea FTA to Hurt Taiwan,” China Post (Taiwan), November 11, 2014.

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

Despite this slow progress on cross-Strait deals, low- and high-level meetings continued over the past year, covering a broad range of cross-Strait issues, including party-to-party, economic, and security concerns. These meetings included the following:

- In May 2015, KMT Chairman Eric Chu, prior to being nominated as his party’s presidential candidate, in a party-to-party capacity met CCP General Secretary Xi in Beijing. Chairman Chu was the highest ranking KMT official to meet with a top CCP official since 2008. The meeting strengthened high-level cooperation between political parties and promoted the 1992 Consensus as the guiding framework for cross-Strait ties. For Beijing, the meeting appeared to serve as an opportunity to endorse the KMT’s cross-Strait policies and emphasize the need to continue along this path for continued stability in the relationship. At the meeting, CCP General Secretary Xi underscored the “political foundation” of cross-Strait relations as acceptance of the 1992 Consensus and opposition to Taiwan independence.

- In May and October 2015, MAC Minister Andrew Hsia and Taiwan Affairs Office † Director Zhang Zhijun met in Kinmen, Taiwan and Guangzhou, China respectively. The talks built on the historic February 2014 meeting between the heads of those offices held in Nanjing, China—the first between government officials from each side of the Taiwan Strait since Taiwan and South Korea compete for the Chinese market in several industries. (Some reports indicate that during talks concluded in April 2015 mainland authorities rejected Taiwan’s efforts to obtain preferential status over South Korea.) Though Taiwan officials hope to conclude the agreement by the end of 2015, lack of progress on this crucial issue casts doubt on an agreement being reached in the near term.
China split in 1949 following the Chinese civil war. The meetings in 2015 did not result in considerable progress on key diplomatic agreements, but helped reinforce this channel as a high-level cross-Strait policy dialogue.44

- After an 18-month pause between meetings, in August 2015 Taiwan’s Straits Exchange Foundation and China’s Association for Relations Across the Taiwan Strait met for the 11th round of cross-Strait talks in Fuzhou, China. The two sides signed agreements on double taxation and aviation safety. Under the taxation agreement, any business based in Taiwan that invests in the Mainland, including via a third country, will not have to pay extra taxes to China. In addition, foreign companies with subsidiaries in Taiwan can now access the Chinese market without incurring additional taxes. Meanwhile, the flight safety agreement allows Taiwan and Chinese carriers with cross-Strait flights to use each other’s technicians and maintenance facilities for routine aircraft inspections.45 Notably, the two sides decided shortly before the meeting to set aside a proposed agreement that would allow Chinese flights to make transit stops in Taiwan.46

- After five rounds of talks, Taipei and Beijing in March 2015 settled a dispute over one of China’s four new civilian aircraft routes in the Taiwan Strait.47 One of the routes, M503, announced in January, would pass as close as 8 kilometers (km), or approximately 5 miles (mi), away from Taiwan’s air space (the median line of the Taiwan Strait). Taiwan found M503 problematic due to its proximity to Taiwan air traffic and the potential security risks to Taiwan’s airspace. China agreed to a compromise, relocating the route 18–19 km (about 11 mi) west and suspending the three other flight routes along the Chinese coast that would have intersected with M503.48

**Cross-Strait Trade and Investment**

As of August 2015, China remains Taiwan’s largest trading partner, top source of imports, and biggest export market.† In 2014, annual cross-Strait trade reached $130.2 billion, comprising 22.1 percent of Taiwan’s total trade. Since President Ma took office in 2008, bilateral trade has increased by over 32 percent (see Figure 1).49

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*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.

†Based on purchasing power parity, China’s GDP in 2014 was $17.6 trillion, while Taiwan’s GDP was $1.07 trillion. China’s GDP per capita was $12,880 that year; Taiwan’s was $45,853. Although GDP and GDP per capita figures can be estimated in different ways, purchasing power parity helps minimize the effect of exchange rates on the calculations. International Monetary Fund, “World Economic Outlook Database,” Bureau of Foreign Trade (Taiwan), “Trade Statistics.”
Taiwan’s exports to China in 2014 were $82.1 billion, comprising 26.2 percent of Taiwan’s exports to the world. Year-on-year, Taiwan’s exports to China grew less than one percent in 2014, and Taiwan’s trade surplus with China for that year was $34.1 billion, the lowest since 2009. The declining growth of Taiwan’s exports is explained in part by the rise of Chinese competitors, pricing Taiwan’s exports out of the market. Semiconductor-related products dominate exports to China, supporting Taiwan’s largest industry. In 2014, three of the top five exports—microchips, semiconductors, and printed circuit boards—made up over a quarter of total exports to China. While exports of all of these products increased in 2014, microchips, Taiwan’s largest export to China, grew by nearly 17 percent from 2013 to 2014.

In 2014, China’s exports to Taiwan reached an all-time high, exceeding $48 billion and comprising a record 17.5 percent share of Taiwan’s imports. That year, China replaced Japan as Taiwan’s largest source of imports and remains in the same position as of August 2015. Just as microchips dominate Taiwan exports to China, they are also China’s top export to Taiwan. (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.) However, Taiwan’s other top imports from China are more diverse than Taiwan’s exports to China; they are cell phones,

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† In 2014, microchips alone accounted for nearly 20 percent of all Taiwan exports to China. Bureau of Foreign Trade (Taiwan), “Trade Statistics.”
According to official Taiwan data, Taiwan foreign direct investment (FDI) to the Mainland in 2014 was approximately $10.3 billion, nearly double U.S. FDI to China that year. However, analysts believe this amount grossly understates the actual scale of investment. According to a 2011 study by Daniel H. Rosen and Zhi Wang, many Taiwan firms use third-party companies, primarily in Hong Kong, to invest in the Mainland, which accounts for the discrepancy. Official Taiwan FDI flows have nevertheless been declining since 2010, with the exception of a 13 percent increase in 2014. Much of the increase in 2014 was due to new Taiwan FDI in China’s electronic parts manufacturing and computer manufacturing sectors, which together comprised over a quarter of all out-bound Taiwan FDI that year. Aside from semiconductor-related manufacturing, in 2014 Taiwan FDI in the Mainland was concentrated in the financial and insurance industry (16.1 percent) and wholesale and retail trade (10.7 percent). In 2015, Taiwan FDI into China from January to August was approximately $6.8 billion, slightly exceeding 2014 numbers through August. Taiwan’s decision in August 2015 to lift restrictions on Taiwan firms from owning more advanced semiconductor manufacturing plants in China (for 12-inch wafer fabrication) could help stimulate greater investment flows into the Mainland.

Meanwhile, official Taiwan statistics on Chinese FDI into Taiwan showed FDI flows in 2014 remaining steady at $335 million, largely unchanged since 2012. In 2014, the main sectors of Chinese FDI in Taiwan were wholesale and retail trade (40 percent), banking services (18.3 percent), and chemical products manufacturing (12.9 percent). Despite restrictions on inbound FDI from the Mainland, Chinese FDI to Taiwan more than tripled between 2010 and 2012, due in large part to the Ma Administration’s loosening of investment caps and regulations on mainland investment into Taiwan. However, with negotiations on cross-Strait economic agreements at a standstill, Taiwan’s easing of its restrictions on Chinese inbound investment has slowed down, limiting increases in FDI flows. From January through August 2015, mainland investment in Taiwan was $79.2 million, dropping nearly 67 percent compared to the same period in 2014 when it was $239 million. But according to some reports, mainland investment in Taiwan could still recover to reach record-high levels if several large potential deals are finalized.
Taiwan's International Engagement

Beijing’s insistence on the “one China” principle precludes any country or international organization from simultaneously recognizing China and Taiwan, thereby restricting Taiwan’s full participation in the international community. Taiwan as a result of Chinese pressure in the UN and other international organizations is unable to participate in the UN Framework Convention on Climate Change, the International Atomic Energy Agency, the International Civil Aviation Organization, the International Maritime Organization, and the International Criminal Police Organization (Interpol), among others. Such restrictions limit the existing few diplomatic levers at Taiwan’s disposal to engage on important issues.

For example, Nepal in April 2015 rejected Taiwan's offer to provide search and rescue teams to help look for survivors following its massive 7.8 magnitude earthquake, though the Nepalese government eventually worked with Taiwan officials to arrange delivery of monetary and medical aid through Taiwan nongovernmental organizations. The Nepal government reportedly cited the lack of diplomatic relations and the “great distance” between Nepal and Taiwan as reasons for its initial decision. As a result, Taiwan delivered a $300,000 donation check through Nepal's embassy in India due to Nepal's refusal to accept the funds in country. Although Chinese pressure on Nepal was not explicit, Nepal probably did not want to anger China by accepting official assistance from Taiwan.

Nevertheless, Taiwan actively pursues greater international space through its official diplomatic relations with 22 countries, expanding participation in international organizations that do not require members to be recognized as sovereign states, and strengthening economic and unofficial diplomatic partnerships with countries other than China. Examples of Taiwan's progress over the past year include the following:

• In March 2015, President Ma visited Singapore, a country that has official diplomatic relations with China, to pay his respects to deceased Singapore founding father and former prime minister Lee Kwan Yew. The visit was the first to Singapore by a Taiwan president since 1989 and President Ma's first overseas travel to any country with diplomatic relations with China aside from transit stops in the United States.

• Taiwan and Japan in March 2015 signed an updated fisheries agreement, following their landmark 2013 deal to jointly manage fishing in the East China Sea near the disputed Senkaku Islands. The updated agreement established new regulations on sharing fisheries and could serve as an example of successful dispute resolution to other claimants involved in disputes in the East and South China seas. For more information about the agreement and Taiwan's other helpful efforts to promote cooperation in the region, see “Taiwan's Response to Chi-

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*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, the Solomon Islands, Swaziland, and Tuvalu. Taiwan’s Ministry of Foreign Affairs, “Diplomatic Allies.”
Taiwan Explores Regional Economic Integration

The Taiwan government has expressed interest in joining regional trade and investment regimes to encourage economic growth and new market opportunities and expand its international footprint. President Ma has supported Taiwan becoming a member of the Regional Comprehensive Economic Partnership (RCEP), led by the Association of Southeast Asian Nations (ASEAN), the U.S.-led Trans-Pacific Partnership (TPP),* and China’s Asian Infrastructure Investment Bank (AIIB), emphasizing the benefits of regional economic integration for Taiwan’s economy.72 Meanwhile, KMT Chairman Eric Chu during his visit to Beijing in May 2015 voiced support for Taiwan’s participation in China’s 21st Century Maritime Silk Road, part of President Xi’s “One Belt, One Road” initiative.73

Announced in 2013 with negotiations planned to conclude this year, ASEAN’s Regional Comprehensive Economic Partnership (RCEP) is a proposed free trade agreement among the countries of ASEAN and six additional Asian countries† that currently account for over half of Taiwan’s annual trade.74 China is among the most influential participants in the RCEP negotiations, and insists Taiwan conclude all ECFA-related agreements before join-

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* For more information on Taiwan’s aspirations to participate in TPP, see “The Role of Taiwan in the U.S. Rebalance to Asia” later in this section.
† ASEAN’s members are Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. The other six RCEP negotiators are Australia, China, India, Japan, New Zealand, and South Korea.
Taiwan Explores Regional Economic Integration—Continued

Taiwan thus is unlikely to accede to the RCEP in the near term, given the delays in finalizing cross-Strait economic agreements with China.

In contrast to RCEP’s initial closed membership, the AIIB had an open application process with the opportunity to become a founding member if applications were submitted before March 31, 2015. Under the terms of the AIIB, only founding members have the ability to propose new rules. On the day of the AIIB’s deadline for founding members, Taiwan submitted its application, which faced pushback from the DPP and other opposition groups.† On April 16, China announced 57 founding members of the AIIB, but rejected Taiwan’s application over its implicit status. In Beijing’s view, by using an “improper name” (“Taiwan”), Taiwan’s application implied independence from China.

If Taiwan joins the AIIB when China admits a new round of members, as Chinese officials have said is likely, membership could lead to increased Taiwan regional investment opportunities and could widen Taiwan’s international economic presence. For example, the Taiwan Ministry of Finance stated that successfully joining the financial institution would increase Taiwan’s chances of joining RCEP and other free trade agreements. Through the AIIB, Taiwan could strengthen dialogue with other regional and global partners, which would help expand its visibility. Many questions remain, however. It is still unclear what Taiwan’s status in the AIIB would be and whether it would have the same access and influence within the institution compared to other members. The DPP and other opposition parties warn that Taiwan should proceed cautiously and carefully examine the political and economic implications of acceding to the bank. With the AIIB set to begin operating by the end of 2015, Taiwan will have an opportunity to observe the institution in action and study how it could impact Taiwan prior to submitting a revised application.

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*For more information about the AIIB, see Chapter 1, Section 1, “Year in Review: Economics and Trade.”
†The DPP and other opposition groups were upset that the Ma Administration failed to consult with the legislature prior to submitting the application. They also protested the Ma Administration’s handling of the application submission; the Taiwan government used the same channel it uses for cross-Strait agreements instead of the channel it normally uses when applying for membership in an international organization. Apple Daily (Taiwan), “Entering the Asian Infrastructure and Investment Bank, Ma: If Restricted, We Will Drop Out,” April 1, 2015. Staff translation; Chu Pu-ching, “Asian Infrastructure and Investment Bank Controversy, Tsai Ing-wen: The Government is Making International Affairs a Cross-Strait Issue,” Taiwan People News, April 1, 2015. Staff translation.
‡Taiwan often participates in international organizations under creative names to avoid opposition from China. For example, Taiwan joined the World Bank as “Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu.” After China joined the Asian Development Bank, Taiwan was required to participate under a different name, “Taipei, China.” Jenny W. Hsu, “China Thwarts Taiwan’s Bid to be a Founding Member of AIIB,” Wall Street Journal, April 13, 2015; Tseung Ying-ju, Lawrence Chu, and Lilian Wu, “Taiwan Submits Letter of Intent to Join AIIB,” Focus Taiwan, March 31, 2015; and Heh-Song Wang, “Taiwan and the Asian Development Bank,” ABA Journal (2007).
Taiwan Explores Regional Economic Integration—
Continued

Proposed by President Xi in 2013, the 21st Century Maritime
Silk Road aims to enhance regional connectivity through trade
and investment in maritime Asia. (See Chapter 3, Section 2,
“China and Southeast Asia” for further discussion of China’s
21st Century Maritime Silk Road.) Beijing has encouraged Tai-
wan to participate in this initiative, in contrast to its rejections
of Taiwan’s other efforts to participate in RCEP and the AIIB.
This is probably because the “One Belt, One Road” project is Bei-
jing's diplomatic initiative and not a formal international institu-
tion that would allow Taiwan a greater voice in the international
community. So far, Taiwan officials have been cautious in ap-
proaching the initiative, as it is unclear if Beijing will tie polit-
cal conditions to Taiwan’s participation.

Taiwan’s Response to China’s Assertiveness in the East and
South China Seas

While China has been increasingly assertive in the East and
South China seas, Taiwan has proposed diplomatic frameworks
and signed agreements with other claimants to encourage the
shelving of territorial disputes and promotion of joint resource de-
velopment. (See Chapter 3, Section 2, “China and Southeast Asia,”
for further discussion of the territorial disputes in the South China
Sea.) In addition, Taiwan has taken steps to clarify its own claims
according to international law and thereby differentiate its claims
from those of China. Despite overtures from the Chinese govern-
ment, Taiwan has refused to support China’s expansive sovereignty
claims on disputed territory in the region, though, to Beijing, Tai-
pei’s claims are the same as its own.

Since 2012, Taiwan has played a role in promoting cooperation
in the East China Sea. Taiwan is one of three claimants to the
Senkaku Islands (known as the Diaoyutai in Taiwan and Diaoyu
in China) and has long considered the waters around the islands
important fishing grounds to support its fishing industry, one of
the world’s largest. In August 2012, President Ma announced an
East China Sea Peace Initiative calling for all parties with con-
flicting claims “to replace confrontation with dialogue, shelve terri-
torial disputes through negotiations, formulate a Code of Conduct
in the East China Sea, and engage in joint development of re-
sources.” The initiative led Taiwan and Japan to sign a land-
mark fisheries agreement in 2013 to set aside sovereignty claims;
share fishing grounds between their respective overlapping exclu-
sive economic zones; and extend the fishing area for both sides by
1,400 square nautical miles (nm). The international community
praised the agreement as a constructive model for jointly managing
resources in disputed waters. U.S. Secretary of State John Kerry

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* Other claimants of the Senkaku Islands are Japan and China.
† An exclusive economic zone is a 200 nm zone extending from the coastline of a state’s main-
land and from the coastline of any territorial land features. UN Convention on the Law of the
Sea, “Part 5: Exclusive Economic Zone.”
in a 2014 speech said, “Japan and Taiwan . . . showed last year it’s possible to promote regional stability despite conflicting claims.”

In an updated fisheries agreement reached in March 2015, each side agreed to several amendments designed to avoid frictions by taking turns operating in certain contested areas of the East China Sea and increasing the distance between boats. Taiwan's fisheries agreements with Japan provide an example for other claimants in the region of setting aside disputes and realizing mutual benefits through sharing resources.

Over the past two years as tensions in the South China Sea increased, Taiwan has made helpful contributions to encourage cooperation among claimants. As one of six claimants of islands and features in the South China Sea, Taiwan administers and occupies Itu Aba Island (also known as Taiping)—the largest natural land feature in the Spratly Island archipelago and the wider South China Sea—and Pratas Island (also known as Dongsha). In May 2015, President Ma announced the South China Sea Peace Initiative, a proposed framework similar to his 2012 initiative in the East China Sea. This new framework calls for all claimants in the South China Sea to exercise restraint; respect the spirit of international law and seek peaceful settlement through dialogue; ensure all concerned parties are involved; shelve sovereignty disputes and establish a regional mechanism for joint resource development; and establish coordination and cooperation mechanisms.

The South China Sea Peace Initiative demonstrates Taiwan's goodwill and cooperative intentions with its maritime neighbors while making China's position look increasingly recalcitrant. As the East China Sea Peace Initiative contributed to finalizing a Taiwan-Japan fisheries agreement, this new Initiative could help lead to a breakthrough in negotiations that have been ongoing since 2013 between Taiwan and the Philippines on a similar fisheries agreement.

Taiwan also has taken steps to clarify its claims in the East and South China seas in accordance with the UN Convention on the Law of the Sea and international law. For example, Taiwan recently asserted its claims are derived from land features with the surrounding waters granted through the Law of the Sea, as opposed to China's expansive sovereignty claims to nearly all of the land and sea within its nine-dash line claim.

* Other claimants in the South China Sea are Brunei, China, Malaysia, the Philippines, and Vietnam.
† DPP Chairperson Tsai has not addressed all of Taiwan's claims within its 11-dash line, but she has said that she would pursue dialogue with all claimants in the South China Sea and defend Taiwan's claims of the Senkaku Islands and Itu Aba Island. Ralph Jennings, “Taiwan Candidate Proposes Dialogue on S. China Sea,” Voice of America, September 22, 2015; Lao lok-sin, “Tsai Reiterates DPP Stance on Diaoyutai Islands,” Taipei Times, July 30, 2015; and Ko Shu-ling, “FOCUS: Taiwan Ponders Dash-line Claim Over South China Sea,” Kyodo News (Japan), June 29, 2015.
‡ Although China's claim in the South China Sea is often depicted by a nine-dash line, Beijing in recent years has issued new maps with ten dashes. Ishaan Tharoor, “Could this Map of China Start a War?” Washington Post, June 27, 2014; Euan Graham, “China’s New Map: Just another Dash?” Australian Strategic Policy Institute (Strategist blog), September 17, 2013.
§ In a September 2014 speech, President Ma said, “[T]he 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.” Other official statements reflect Taiwan's increasing clarity on its own claims within its 11-dash line—serving as the basis for Taiwan's claims in the South China Sea since 1947. Lynn Kusk, “Times of Change: Taiwan’s Evolving Position in the South China Sea and Why Other Actors Should Take Notice,” Brookings Institute.
can help encourage other claimants to follow international law and define their own claims, thereby clarifying intentions and avoiding misunderstanding. Some observers have noted that Taiwan could contribute more to managing territorial disputes in the South China Sea by clarifying its 11-dash line in a way that puts political pressure on China to clarify its own claims, benefiting other claimants and the United States.\footnote{Bonnie Glaser, senior advisor for Asia at CSIS, argued in her testimony to the Commission, “... [If] Taiwan were to say, ‘We claim the following land features,’ which would probably be all of them within the dashed line, ... it would not include all of the waters. It would not provide jurisdiction over all of the energy exploitation or all of the fishing, for example.” According to Ms. Glaser, taking such a position would make China’s expansive claim appear all the more extreme by comparison.} Some analysts argue, however, that the Taiwan military is superior to the PLA in certain areas. Ian Easton, research fellow at the Project 2049 Institute, asserts that the Taiwan military has a qualitative advantage over the PLA due to the Taiwan military’s training alongside the United States, the PLA’s lack of professionalism, and widespread corruption in the PLA.\footnote{Ian Easton (Research Fellow, Project 2049 Institute), August 11, 2015, interview with Commission staff.}

### Taiwan Military and Security Issues

#### Cross-Strait Military Balance

Although relations between Taipei and Beijing have improved since 2008, China’s military modernization continues to focus on improving its ability to conduct military operations against Taiwan and deter the United States from assisting with Taiwan’s defense.\footnote{Official U.S. and Taiwan estimates of China’s number of SRBMs and LACMs vary. For example, Defense Intelligence Agency Director Lieutenant General Vincent R. Stewart in his February 2015 testimony to Congress said, “[China has] more than 1,200 conventional short-range ballistic missiles deployed opposite Taiwan ... .” According to the Taiwan Ministry of National Defense’s (MND) August 2015 report on China’s military power for the Legislative Yuan, China increased its ballistic and cruise missile force from 1,600 to 1,700 over the past year and increased the number of missiles deployed against Taiwan from 1,400 to 1,500. H.H. Lu and Lilian Lin, “MND Reports China Deploying More Missiles Against Taiwan,” Focus Taiwan, August 31, 2015; Senate Armed Services Committee, Hearing on Worldwide Threats, oral testimony of Vincent R. Stewart, February 26, 2015.}

China’s offensive missile forces, known as the Second Artillery, have a large and sophisticated arsenal of ballistic and cruise missiles, including more than 1,200 short-range ballistic missiles (SRBM) and 200–500 ground-launched land-attack cruise missiles (LACM)\footnote{Some analysts argue, however, that the Taiwan military is superior to the PLA in certain areas. Ian Easton, research fellow at the Project 2049 Institute, asserts that the Taiwan military has a qualitative advantage over the PLA due to the Taiwan military’s training alongside the United States, the PLA’s lack of professionalism, and widespread corruption in the PLA. Ian Easton (Research Fellow, Project 2049 Institute), August 11, 2015, interview with Commission staff.} that are designed primarily to strike Taiwan.\footnote{Ian Easton (Research Fellow, Project 2049 Institute), August 11, 2015, interview with Commission staff.} Although China’s inventory of SRBMs has only increased slightly since the late 2000s after a rapid expansion earlier in the decade, the force has become more lethal as China has gradually replaced older missiles lacking a true precision-strike capability with new SRBMs and more recent generations of existing SRBMs that feature longer ranges and improved accuracies and payloads. In a potential military conflict,
China could quickly conduct SRBM and LACM attacks against Taiwan’s key defense nodes, including its air defense systems, air bases, naval ports, and command and control infrastructure.97 (For more information on China’s missile forces, see Chapter 2, Section 3, “China’s Offensive Missile Forces.”)

- The People’s Liberation Army (PLA) Air Force and Navy have about 2,100 combat aircraft, 330 of which operate from permanent bases in the eastern half of China, allowing them to conduct operations around Taiwan without aerial refueling.98 About 600 of China’s combat aircraft are modern,† while fewer than 330 of Taiwan’s combat aircraft are modern.98 In addition, Russia in April 2015 confirmed the sale of four to six Russian S–400 surface-to-air missile systems to China and plans to deliver them in 2017.99 The S–400 will increase the range of China’s surface-to-air missile force from 300 km (approximately 186 mi) to 400 km (approximately 249 mi)—enough to cover all of Taiwan ‡—and likely will feature an improved ballistic missile defense capability over China’s existing surface-to-air missile systems, though the platform has yet to demonstrate such a capability.100 As China pursues the S–400, it also is developing its next-generation indigenous surface-to-air missile, the HQ–19, which likely will have features and range similar to the S–400.101

- The PLA Navy has more than 300 surface combatants, submarines, and missile-armed patrol craft.102 As China’s naval modernization continues, an increasing percentage of these ships will be modern § and feature advanced weaponry. Taiwan, on the other hand, has 92 naval combatants, comprised of 4 submarines and 88 surface ships.103 Taiwan’s submarine

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† “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.

‡ China would have to deploy the battalions opposite Taiwan to have the range necessary to cover Taiwan. It is unclear whether the sale included the missiles themselves, and if so, what their capabilities are. J. Michael Cole, “Alarm over China’s S–400 Acquisition is Premature,” Diplomat, April 22, 2015; Zackary Keck, “Putin Approves Sale of S–400 to China,” Diplomat, April 11, 2014; Wendell Minnick, “China’s New Jet, Radar Complicate U.S. Posture,” Defense News, July 6, 2013; and Wendell Minnick, “Time Running Out for Taiwan if Russia Releases S–400 SAM,” Defense News, May 25, 2013.

§ In reference to China’s submarine force, the term “modern” is used in this Report to describe a second-generation submarine that is capable of employing antisubmarine cruise missiles or submarine-launched intercontinental ballistic missiles. These include the SHANG nuclear attack submarine (SSN), YUAN SSN, SONG diesel attack submarine (SS), KILO 636 SS, and JIN nuclear ballistic missile submarine (SSBN). In reference to China’s surface force, the term “modern” is used to describe a surface ship that possesses a multi-mission capability, is armed with more than a short-range air defense capability, and has the ability to embark a helicopter. These include the following: LUHAI destroyer (DD), LUHAI DD, LUZHOU guided missile destroyer (DDG), LUYANG I/II/III DDG, Sovremenny 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.
fleet is particularly weak compared to that of China; it includes two former U.S. boats that were built in the 1940s and transferred to Taiwan in the 1970s. In a military contingency with Taiwan, China could use its more numerous and advanced platforms to conduct a range of military courses of action, including a maritime blockade or quarantine, air and missile attacks, and amphibious invasions of Taiwan-held islands in the Taiwan Strait and South China Sea. China is actively pursuing amphibious capabilities, but does not have the necessary platforms needed to conduct a large-scale amphibious invasion of Taiwan.

China continues to prepare for a Taiwan contingency through a variety of exercises involving amphibious platforms, missiles fired into Taiwan’s nearby waters, and combat aircraft flying close to Taiwan’s airspace. In July 2015, one exercise involved PLA soldiers raiding a building similar in appearance to Taiwan’s presidential palace. In addition to a formal protest by the Taiwan government, a Taiwan Ministry of National Defense (MND) spokesperson said, “[The exercise was] unacceptable for the Taiwanese public and the international community.” J. Michael Cole, editor-in-chief of Thinking Taiwan, said that the exercise

strikes at the heart of what is recognizable to ordinary Taiwanese—downtown Taipei. … By making the threat more recognizable and immediate than missiles fired off Taiwan’s northern and southern tips, or drills simulating an amphibious assault, Beijing may hope to engage ordinary Taiwanese not at the intellectual and abstract level, but on an emotional one.

Despite its growing military disadvantage relative to China, Taiwan’s defense budget has stagnated. Over the last decade, China has boosted its defense budget in nominal terms by double digits almost every year, increasing the official defense spending gap between Taiwan and China in 2015 to more than $132 billion (see Figure 2). Taiwan’s announced 2015 defense budget increased, albeit slightly, for the first time since 2012. From 2009 to 2014, Taiwan’s defense budget declined by an average of 1.6 percent annually. Despite a further increase in Taiwan’s announced 2016 defense budget, spending on the military is projected to fall to 1.8 percent of GDP, the lowest such level in over a decade. This stagnation is due to a number of factors, including warming cross-

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* For more information on Taiwan’s submarine fleet and indigenous production plans, see additional discussion later in this section.
† 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, research and development programs, and local government support to the PLA. For more information, see Chapter 2, Section 1, “Year in Review: Security and Foreign Affairs.”
‡ China’s announced defense budget in 2015 was RMB 886.9 billion ($141.9 billion) compared to Taiwan’s budget of NTD (New Taiwan dollars) 319.3 billion ($10.7 billion). Xinhua (English edition), “China 2015 Defense Budget to Grow 10.1 Pct., Lowest in 5 Years,” March 5, 2015; China Post (Taiwan), “Taiwan’s Proposed Defense Budget for 2015 Sees $330 Million Increase,” August 30, 2014.
§ According to Mr. Easton, Taiwan’s defense budget, like China’s, is significantly underreported. However, unlike China’s defense budget, there are no outside estimates of Taiwan’s real defense budget. Ian Easton (Research Fellow, Project 2049 Institute), interview with Commission staff, August 11, 2015.
Strait ties that have reduced public perceptions of 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 budgets but are not completed due to delays resulting from unresolved issues on both sides.\textsuperscript{111}

![Figure 2: Gap between Announced Defense Budgets of China and Taiwan (2005–2015)](Fig2.eps)

\textit{Note:} These numbers represent both China’s and Taiwan’s announced official defense budgets, not actual aggregate defense spending. China’s figures are converted from RMB into U.S. dollars based on China’s year-end nominal exchange rate.


Furthermore, Taiwan’s unique status and China’s insistence on the “one China” principle make it difficult for Taiwan to procure arms from most producers. Taiwan also lacks the ability to indigenously design and produce certain weapons systems.\textsuperscript{112} Under such constraints, Taiwan has mainly relied on the United States for arms and military equipment.

Nevertheless, Taiwan has sought to improve its position vis-à-vis China in recent years by producing or acquiring military platforms and weapon systems. Major indigenous programs under development or recently completed include the following:

- \textbf{Surface-to-Air Missiles:} In December 2014, Taiwan’s Chung-Shan Institute of Science and Technology confirmed it will upgrade the Tien Kung III, the third-generation of its family of
indigenous surface-to-air missiles, to extend the missile’s range from 150 km (approximately 93 mi) to over 200 km (approximately 124 mi), potentially reaching mainland China. Production of the missile, which is capable of defending against short- and medium-range ballistic missiles, is scheduled to occur from 2015 through 2024. The Tien Kung III will complement Patriot missile systems, which Taiwan acquired from the United States to defend Taiwan's air space, providing Taiwan greater air coverage in a potential cross-Strait conflict.

- **Combat Support Ships:** In January 2015, the Taiwan Navy commissioned its second supply vessel, the Panshih. The ship has improved functionality and versatility over Taiwan’s other supply ship, including its advanced medical equipment that could be used for humanitarian assistance and disaster relief missions. In a cross-Strait military conflict, this ship would enable Taiwan to better replenish its frigates and destroyers with ammunition, fuel, and other supplies.

- **Missile Corvette:** In March 2015, the Taiwan Navy commissioned the TUO JIANG, its first ship in a new class of catamaran-style missile corvettes. Taiwan may build up to 11 more of these ships. The new corvette has better range, endurance, and sea-keeping ability than Taiwan’s other patrol ships, and is equipped with 16 antiship cruise missiles. The ship enhances the survivability and lethality of Taiwan’s antisurface force in a potential cross-Strait conflict and increases the Taiwan Navy’s ability to patrol the East and South China seas.

- **Coast Guard Cutters:** In June 2015, the Taiwan Coast Guard Administration commissioned two helicopter-capable cutters. These ships are the largest of Taiwan’s eight-ship Coast Guard fleet, and each is armed with one 40 millimeter gun, two 20 millimeter guns, and a water cannon. The cutters will enhance the Coast Guard’s maritime patrol capabilities with the range necessary to conduct missions in the East and South China seas.

- **Unmanned Aerial Vehicles (UAVs):** In August 2015 at the biennial Taipei Aerospace and Defense Technology Exhibition, Taiwan’s Chung-Shan Institute of Science and Technology unveiled a prototype of its largest UAV to date—more than double the size of any model in service. Although its specific technical details were not disclosed, the UAV has a medium range and long endurance; can carry multiple payloads; and is designed for intelligence, surveillance, and reconnaissance (ISR) missions. When it enters service, the UAV will complement Taiwan’s operational fleet of 32 UAVs and will enhance Taiwan’s ISR capabilities.

Select military equipment Taiwan is acquiring or seeking to acquire from the United States includes the following (see also the discussion on arms sales, military-to-military contact, and U.S.-Taiwan defense relations in “U.S.-Taiwan Relations,” later in this section):
The Taiwan Navy will probably outfit the ships with a combination of indigenous and foreign weapons systems, including surface to air missile systems, antiship missiles, and artillery. Notably, five of Taiwan’s eight domestically built CHENG KUNG-class frigates, based on PERRY-class frigates, already carry advanced Hsiung Feng III antiship cruise missiles that reportedly have a range of 81 nm.\textsuperscript{123} According to a Taiwan Army official, the UH–60s will replace the aging UH–1H helicopter fleet and will be used primarily to transport supplies and personnel. Taiwan’s National Airborne Service Corps reportedly will use 15 of the Black Hawks for humanitarian assistance and disaster relief missions.\textsuperscript{124} In a potential PLA invasion of Taiwan territory, the helicopters could be used to counter a PLA landing force and coordinate command and control and special operations missions.\textsuperscript{125}

**OLIVER HAZARD PERRY-Class Guided-Missile Frigates:** In December 2014, U.S. President Barack Obama signed legislation authorizing the sale of four decommissioned and unarmed PERRY-class frigates to Taiwan, but the Administration has not formally notified Congress of the sale as of the writing of this Report.\textsuperscript{126} Taiwan in April 2014 announced that it would only buy two ships due to budget constraints.\textsuperscript{127} The ships, scheduled to arrive in Taiwan starting in 2016, will modernize and supplement Taiwan’s fleet of six KNOX-class frigates. They will also help offset the retirement of two KNOX-class frigates and the eventual decommissioning of all KNOX-class frigates.\textsuperscript{128} The PERRY-class frigates, depending on the equipment and arms with which they are outfitted,\textsuperscript{9} could be used for antisubmarine, antisurface, and limited antiaircraft warfare in a conflict.\textsuperscript{129}

**F–16 Fighter Upgrade:** Over the past year, the United States and Taiwan have moved forward with the planned mid-life upgrade of Taiwan’s existing fleet of 145 F–16 A/B fighter aircraft. In December 2014, the United States awarded Lockheed Martin a $308 million contract to supply active electronically scanned array radars for Taiwan’s F–16s.\textsuperscript{130} According to the development plan, the Taiwan Air Force will send two F–16s to Lockheed Martin to install and test the radar before upgrading the rest of Taiwan’s fleet in Taiwan over the second half of 2016.\textsuperscript{131} With these upgrades, Taiwan’s F–16 fleet will be better able to track China’s advanced combat aircraft and ground-based targets.\textsuperscript{132}

**Submarines:** In March 2015, President Ma reiterated his support for Taiwan to pursue an indigenous submarine program, following more than a decade of attempts to acquire diesel-elec-
tric submarines from abroad.* The indigenous submarine program enters its three-year project design phase in 2016, but Taiwan has already identified over 20 U.S. and European companies interested in assisting Taiwan shipbuilding companies.† As mentioned previously, Taiwan has four submarines; two are decommissioned U.S. Navy GUPPY-class submarines (they have undergone upgrades since the 1940s) used only for training. The Taiwan Navy’s already limited ability to conduct undersea warfare against China’s expanding fleet of modern surface ships and submarines will continue to erode as Taiwan’s submarine force ages.

- **P–3C Orion Maritime Patrol Aircraft:** Taiwan is scheduled to accept its final delivery of four P–3C antisubmarine aircraft by the end of 2015, which follows its first shipment of eight that arrived in 2013. Originally purchased from the United States in 2007, the P–3Cs will replace the Taiwan Air Force’s fleet of 11 S–2T antisubmarine aircraft that have been in service for over 40 years. The P–3C will increase the capabilities and endurance of the military’s fixed-wing maritime patrol aircraft force, improving Taiwan’s ability to perform antisubmarine warfare and ISR missions.136

**Status of Taiwan’s Defense Reforms**

As part of its military modernization effort, Taiwan is transitioning its conscripted military force to an all-volunteer army by 2017. The goal of this effort is to create a “small but smart and strong force” in response to “the requirement for high quality manpower under advanced technological conditions and economic and social changes.” Taiwan’s transition has been far more costly than expected, increasing budgetary pressure on research and development (R&D) as well as operations and maintenance. To find additional savings, Taiwan in 2013 decided to reduce its active duty force from 275,000 to 215,000 by 2015, and now plans to reduce the force to 170,000 by the end of 2019.

Reversing the trend of missing recruitment goals for its active duty force by wide margins from 2011 to 2013, Taiwan in 2014 recruited over 15,000 men and women, exceeding its target of about 10,500. Yet, Taiwan will still need to exceed goals through 2017 to meet the already reduced active duty target of 170,000. To encourage enrollment and retention, Taiwan has announced a variety of new incentives, such as increased wages, service-extending stipends, and expanded base privileges. Although these new benefits show promise in reaching recruitment goals, they could also further increase the financial burden of the all-volunteer force by

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*In 2001, then U.S. President George W. Bush proposed to help Taiwan acquire eight diesel-electric submarines, but the proposal has been delayed due to political and cost disagreements on both sides. The United States also has not built a conventional submarine in over 40 years.  
†Taiwan had originally planned to complete the transition at the end of 2014, but shifted the timeline to 2017 due to lower than anticipated recruitment numbers. As part of the transition, men born after 1994 are now required to undergo four months of active duty military service and then enter Taiwan’s reserve system. Previously, Taiwan conscripts served one year as active duty. Ministry of National Defense (Taiwan), National Defense Report 2013, October 2013, 95–96; Chris Wang, “Date for All Volunteer Military Delayed,” Taipei Times, September 13, 2013.
comprising a larger percentage of the overall defense budget. In a setback to Taiwan’s planned transition, the MND in August 2015 announced it would be unable to end conscription in 2016 for men born before 1994, as previously announced. The ministry said that recruitment goals fell short for voluntary enlistees in 2015 and therefore decided to conscript in 2016 approximately 23,100 men for one year of compulsory active duty service to meet defense needs.144

The DPP Unveils Its Defense Reform Strategy in Defense Policy Blue Papers

In May 2015, the New Frontier Foundation, a think tank established by the DPP, released four new defense policy blue papers* articulating the DPP’s views on Taiwan defense reform. The blue papers, along with eight others released since June 2013, outline a defense strategy that focuses on revitalizing Taiwan’s indigenous defense industry, supporting the all-volunteer force transition with increased funding, and building and acquiring asymmetric platforms.145 The DPP particularly emphasizes the need to invest in R&D to upgrade Taiwan’s military equipment. Complementing its pledge of restoring defense spending to 3 percent of GDP annually;† the DPP advocates for 70 percent of all new defense spending to go toward “military investments,” including procurement of weapons and equipment, defense construction, and R&D.146

The DPP by 2020 aims to have no less than 60 percent of these “military investments” spent on indigenous R&D.147 Like the KMT, development of the indigenous submarine program is the DPP’s top priority for the defense industry; the DPP has outlined a 23-year development plan.148 In addition, the DPP prioritizes other indigenous solutions, such as unmanned aerial vehicles, unmanned underwater vehicles, and short take-off and vertical landing fighter aircraft.149

To strengthen Taiwan’s asymmetric capabilities, the DPP supports creating a new cybersecurity service for the military; 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.150 Should the DPP win the January 2016 presidential election, it plans to initiate an open defense policy discussion and issue its own quadrennial defense review within a year.151

†This pledge restates the DPP’s commitment outlined in its first blue paper in June 2013. The KMT similarly pledged to raise defense spending to three percent of GDP prior to the 2008 election, but did not fulfill its promise. New Frontier Foundation, Defense Blue Paper #1: DPP’s Defense Agenda, June 2013, 19; Ralph Jennings, “Taiwan’s Ma Wins Election,” Reuters, March 22, 2008.
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 2015, select major exercises and activities included the following:

- **Naval Combat Readiness Exercise:** On January 1–2, Taiwan conducted an exercise with 13 vessels and 2 attack helicopters off its southwest coast primarily to test its new Tuo Jiang-class stealth missile corvette that had been commissioned into service just one week before the exercise. The exercise simulated countering invading enemy naval forces, such as submarines and attack boats.

- **Planned Air Surveillance Patrols:** According to Taiwan’s MND, P–3C antisubmarine aircraft currently conduct ISR missions close to Taiwan’s coast and in airspace within its air defense identification zone. In April, the MND for the first time confirmed P–3C antisubmarine aircraft patrols would eventually extend to areas in the South China Sea without providing a specific timeline. The expanded mission would enhance Taiwan’s ability to monitor Chinese naval activity in the South China Sea.

- **Han Kuang Exercises:** Han Kuang is Taiwan’s most important set of joint exercises; they have been held annually at the national level since 1984. For the first phase of the exercise in May, the Taiwan military simulated rapid battle preparation, electronic warfare, and cyber attacks. In the second phase of the exercise in September, Taiwan conducted live-fire drills simulating countering a Chinese invasion. The drills included an anti-amphibious landing exercise and tested Taiwan’s most advanced platforms.

Previously, U.S. military representatives only observed the exercises. The senior MND official said, “The U.S. will advise in strategic planning and operational development of combat units for Taiwan’s defense against hostile actions in the Taiwan Strait.”

Cross-Strait Espionage

Expanding cross-Strait ties promote not only increasing economic cooperation with China but also increase Taiwan’s vulnerability to Chinese espionage. Increased travel between Taiwan and China
heightens the risk of Taiwan defense secrets being compromised, as China has improved access to Taiwan with better opportunities to conduct intelligence operations against Taiwan citizens both in Taiwan and China.\(^8\)

After 15 cases of alleged spying in 2014, nearly all involving active or retired Taiwan military officers, espionage continues to proliferate.\(^{160}\) The September 2014 arrest of retired PLA captain and intelligence officer Zhen Xiaojiang—the first mainland Chinese spy to be apprehended in Taiwan in decades—uncovered the largest cross-Strait spy ring in years.\(^{161}\) In September 2015, Mr. Zhen received a four-year prison sentence, while five retired Taiwan military officers recruited by Mr. Zhen to spy for the Mainland were handed more lenient sentences.\(^{162}\) Since 2005, Mr. Zhen allegedly acquired classified information on Taiwan’s Mirage 2000 aircraft, ultra-high frequency radar systems, and other weapons platforms.\(^{163}\) In another case, a retired vice admiral and deputy commander of the Taiwan Navy Ko Cheng-sheng was found guilty of espionage and sentenced in October 2014 to 14 months in prison. Vice Admiral Ko was one of the highest-ranking retired Taiwan military officers to be caught spying for China.\(^{164}\)

China’s increased efforts to acquire Taiwan defense secrets have significant implications for Taiwan’s security. In January 2015, Taiwan Defense Minister Kao Kuang-chi said, “[T]he military [should] heighten its guard against spies, as China has not relented in its efforts to infiltrate Taiwan’s military as exchanges across the Taiwan Strait increase.”\(^{165}\) As noted by retired Vice Minister of National Defense Lin Chong-pin, exposure of Beijing’s successful infiltration of Taiwan defense systems supplied or marketed by the United States could give pause to U.S. defense officials regarding future arms sales to the island.\(^{166}\) Aside from traditional reasons for espionage, China also seeks to weaken the morale of the Taiwan military. Each spy case revealed by Taiwan has the potential to achieve psychological benefits for Beijing, creating an environment where China’s capture of Taiwan’s defense secrets could be perceived as an inevitability.\(^{167}\)

**Computer Network Security**

Taiwan faces a growing problem of cyber attacks—that threaten the security of sensitive information. According to U.S. cybersecurity firm FireEye, Taiwan in 2014 was the third most targeted country in the Asia Pacific region in terms of hacking attempts to steal data.\(^{†}\) In March 2015, senior Taiwan intelligence officials publicly identified what appears to be a PLA cyberespionage unit based at China’s Wuhan University responsible for cyber activities against Taiwan. The unit is reportedly part of the Sixth Bureau of the PLA General Staff Department’s Third Department, one of the 12 bureaus under the Third Depart-

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\(^†\) Only South Korea and Hong Kong faced a higher volume of attempted cyber intrusions in 2014. Want China Times (Taiwan), “Taiwan Third Most Targeted Country by Cyber Attacks in Asia,” April 3, 2015.
ment whose mission is technical reconnaissance and digital information warfare. According to the National Security Bureau, one of Taiwan's major intelligence agencies, cyber attacks linked to China in 2013 alone targeted the agency over seven million times and the MND over one million times. This marked a significant increase in volume from previous years.

In response, Taiwan is working to improve its defenses by creating a new cybersecurity department responsible for securing the government’s information security and key network infrastructure that would also have authority over military cyber defense. Moreover, Taiwan has asked to join U.S.-led Cyber Storm, a multinational cybersecurity exercise held every two years. Taiwan Vice Premier Simon Chang in a March 2015 interview noted that Taiwan’s participation could help improve its ability to protect against Chinese cyber intrusions. The first Cyber Storm exercise in 2006 involved only U.S. government and private sector participants, but it has since expanded in size and scope to become the most extensive government-sponsored cybersecurity exercise of its kind. In Cyber Storm IV, the most recent exercise held in several stages between 2011 and 2014, participants aimed to “assess and strengthen cyber preparedness, examine incident response processes in response to ever-evolving threats, and enhance information sharing among federal, state, international, and private sector partners.”

The exercise involved 11 countries that are all members of the International Watch and Warning Network (a framework for cooperation on cyber situational awareness and incident response), of which Taiwan is not a member.

U.S.-Taiwan Relations

Diplomatic Affairs

The U.S. and Taiwan governments continue to make progress on bilateral initiatives and areas of mutual interest. In February 2015, the United States issued new license plates to Taiwan’s representatives in the United States similar to those granted to foreign diplomats, as a follow-on to an agreement reached in 2013. The license plates provide previously unavailable immunity privileges to Taiwan representatives. U.S. and Taiwan officials in June 2015 signed a memorandum of understanding to increase cooperation in international public health, humanitarian assistance, and other global issues. The United States also hosted DPP Chairperson Tsai on her June 2015 U.S. visit, and the U.S. government has said it would welcome other candidates if they visit the United States. In addition to meeting with senior members of Congress, Chairperson Tsai visited the White House and U.S. Department of State for a series of “very successful, very positive” closed-door meetings. In response to the visit, a spokesperson

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†Due to the unofficial nature of the U.S.-Taiwan relationship, the U.S. government limits contacts between U.S. and Taiwan officials at certain levels (for example, the United States rarely sends cabinet-level officials to Taiwan, and the Commission has been told that some senior-level U.S. government officials are unable to visit Twin Oaks, Taiwan’s de facto embassy in Washington, DC).
for China’s Taiwan Affairs Office said, “The [meetings] went against the peace and stability of the Taiwan Strait and harmed peaceful development of cross-Strait ties. [They] sent a wrong signal to the island’s separatist forces.” Beijing’s response demonstrated its uneasiness regarding the DPP.

**Economic and Trade Relations**

In 2014, U.S.-Taiwan trade reached a record high, increasing by 6 percent to $67.4 billion. Also in 2014, Taiwan became the tenth largest trading partner of the United States, passing both India and Saudi Arabia. In addition, the United States moved ahead of Japan to become Taiwan’s second largest trading partner. Taiwan exports to the United States mostly consist of manufactured parts and accessories, including cell phones, motor vehicle parts and accessories, and office machine parts and accessories. By contrast, U.S. exports to Taiwan are diversified across a number of sectors; they mainly include machinery to manufacture semiconductors and liquid crystal display (LCD) panels; agriculture; and arms sales. (For more information on arms sales, see “Military and Security Relations” below.)

Although U.S.-Taiwan economic ties remain strong, substantive progress on ongoing trade and investment negotiations has slowed. In the absence of official relations, both sides discuss bilateral economic issues through the Trade and Investment Framework Agreement (TIFA), a framework established in 1994. Taiwan Economic Affairs Minister John Deng said the U.S. focus on completing TPP and trade promotion authority negotiations postponed the TIFA meeting scheduled for April 2015. Nevertheless, Assistant Secretary of State for Economic and Business Affairs Charles Rivkin, the most senior State Department official to visit Taiwan since his predecessor visited in 2012, said in a June 2015 visit to Taipei that unofficial talks about how to enhance bilateral economic cooperation occur daily. TIFA talks had been on hold from 2007 to 2012 due to Taiwan’s refusal to import U.S. beef containing ractopamine, a common feed additive, but resumed in 2013 when the Taiwan legislature partially lifted restrictions.

In October 2015, U.S. and Taiwan officials held a TIFA meeting in Taipei, which included discussions on a range of bilateral economic issues, including agriculture, pharmaceuticals and medical devices, intellectual property rights, trade barriers, and investment. In addition to these issues, the talks also covered a potential bilateral investment agreement and Taiwan’s aspirations to join TPP. The meeting reportedly did not include a discussion about Taiwan’s restrictions on U.S. pork imports, which remains a contentious area in ongoing negotiations. Although Taiwan loosened some restrictions on residual levels of ractopamine in U.S. beef imports, it maintains these restrictions on pork imports. Since 2012, members of Congress have raised concerns about Taiwan restrictions on U.S. pork. 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. Progress on TIFA negotiations could be further constrained by Congressional demands for the removal of Taiwan’s pork restrictions.
Military and Security Relations

Taiwan continues to be one of the world’s largest buyers of U.S. defense exports. Over the last decade, Taiwan has agreed to buy U.S. arms worth approximately $22.7 billion (see Table 1). However, the Obama Administration has not notified Congress of any arms sales to Taiwan since 2011. In December 2014, President Obama signed legislation authorizing the transfer of four PERRY-class frigates to Taiwan, but as of the writing of this Report, the Administration has yet to notify Congress and, per Taiwan’s request, complete the sale of two of the frigates worth approximately $179 million.188

Table 1: U.S. Arms Sales to Taiwan (2005–2015)

<table>
<thead>
<tr>
<th>Year of Notification to Congress</th>
<th>Weapon, Item, or Service *</th>
<th>Projected Value (US$ millions) †</th>
<th>Status ‡</th>
<th>Delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007 218 AMRAAMs and 235 Maverick air-to-ground missiles for F–16 fighters</td>
<td>421 Delivered 2012</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007 60 AGM–84L Harpoon Block II antiship missiles</td>
<td>125 Delivered 2010–2012</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007 12 P–3C maritime patrol/antisubmarine warfare aircraft</td>
<td>1,960 In progress 2012–2015 189</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007 Patriot configuration 2 ground systems upgrade</td>
<td>939 Unknown Unknown</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008 330 PAC–3 missiles and firing units</td>
<td>3,100 In progress Began in 2014 190</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008 32 UGM–84L sub-launched Harpoon Block II antiship missiles</td>
<td>200 Delivered 2013 191</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008 Spare parts for F–5E/F C–130H, F–16A/B, and Indigenous Defense Fighter aircraft</td>
<td>334 In progress N/A</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*These are the weapons, items, and services as presented to Congress at the time of notification, which may differ from the actual weapons, items and services that the United States ultimately sells to Taiwan.
†These values represent amounts as presented to Congress at the time of notification, which may differ from the actual amount Taiwan pays for the weapon, item, or service.
‡This indicates the most current status as notified to Congress or indicated in media reports, which may differ from the actual status of the sale.
Table 1: U.S. Arms Sales to Taiwan (2005–2015)—Continued

<table>
<thead>
<tr>
<th>Year of Notification to Congress</th>
<th>Weapon, Item, or Service *</th>
<th>Projected Value (US$ millions)†</th>
<th>Status ‡</th>
<th>Delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>182 Javelin missiles and command launch units</td>
<td>47</td>
<td>Delivered</td>
<td>2011</td>
</tr>
<tr>
<td>2008</td>
<td>Four E–2T aircraft refurbishment and upgrades</td>
<td>250</td>
<td>Delivered</td>
<td>2011–2013 192</td>
</tr>
<tr>
<td>2008</td>
<td>30 AH–64 Apache helicopters and related ordnance</td>
<td>2,532</td>
<td>Six delivered</td>
<td>2013</td>
</tr>
<tr>
<td>2010</td>
<td>114 PAC–3 missiles and firing units</td>
<td>2,810</td>
<td>In progress</td>
<td>Began in 2014 193</td>
</tr>
<tr>
<td>2010</td>
<td>60 UH–60M Black Hawk utility helicopters</td>
<td>3,100</td>
<td>In progress</td>
<td>2014–2019 194</td>
</tr>
<tr>
<td>2010</td>
<td>12 ATM–84L and RTM–84L Harpoon Block II antiship telemetry missiles</td>
<td>37</td>
<td>Unknown</td>
<td>Unknown</td>
</tr>
<tr>
<td>2010</td>
<td>60 MIDS/LVT–1 terminals to improve F–16A/B C4ISR § systems</td>
<td>340</td>
<td>Unknown</td>
<td>Unknown</td>
</tr>
<tr>
<td>2010</td>
<td>2 OSPREY-class mine hunting ships (refurbishment and upgrades)</td>
<td>105</td>
<td>Delivered</td>
<td>2012 195</td>
</tr>
<tr>
<td>2011</td>
<td>145 F–16AB aircraft refurbishment and upgrades</td>
<td>5,300</td>
<td>Not delivered</td>
<td>2016–2017</td>
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<tr>
<td>2011</td>
<td>F–16 pilot training</td>
<td>500</td>
<td>In progress</td>
<td>N/A</td>
</tr>
<tr>
<td>2011</td>
<td>Spare parts for F–16A/B, F–5E/F, C–130H, and IDF aircraft</td>
<td>52</td>
<td>In progress</td>
<td>N/A</td>
</tr>
</tbody>
</table>

* These are the weapons, items, and services as presented to Congress at the time of notification, which may differ from the actual weapons, items and services that the United States ultimately sells to Taiwan.
† These values represent amounts as presented to Congress at the time of notification, which may differ from the actual amount Taiwan pays for the weapon, item, or service.
‡ This indicates the most current status as notified to Congress or indicated in media reports, which may differ from the actual status of the sale.
§ C4ISR refers to command, control, communications, computers, intelligence, surveillance, and reconnaissance.


In 2014, military collaboration between the United States and Taiwan continued to increase. More than 3,000 U.S. Department of Defense personnel visited Taiwan in 2014,196 a 50 percent increase over 2013. In 2012, only 1,500 officers conducted visits to Taiwan.197 However, as Russell Hsiao, former non-resident senior fellow at the Project 2049 Institute, points out,
Unfortunately, few U.S. military officers conduct in-country training in Taiwan, and there are no known [U.S. military officers] attending Taiwan’s National Defense University or other intermediate and senior service schools. More educational exchanges between the two defense establishments are warranted, particularly for junior and noncommissioned officers. 198

Nevertheless, momentum on increased military cooperation continued over the past year. As of September 2015, nearly 2,000 U.S. defense personnel conducted visits to Taiwan, on pace with 2014 numbers. 199 In addition to visits, the U.S. military in June 2015 established two “sister units” to increase exchanges between units in the U.S. military and their counterparts in the Taiwan military. 200

Some observers assert the United States could do more to support Taiwan’s defense in order to fulfill U.S. obligations under the Taiwan Relations Act, which requires the United States to provide “defense articles and defense services in such quantity as may be necessary to enable Taiwan to maintain sufficient self-defense capabilities.” 201 For example, Van Jackson, visiting fellow at the Center for a New American Security, proposed shifting U.S. arms sales from F–16 upgrades and similar platforms to weapons that enable antiaccess/area denial capabilities, such as undersea mines, air and missile defense, and land-based antiship cruise missiles. According to Mr. Jackson, this would be relatively inexpensive for Taiwan; have a lower profile, which would be less likely to anger China; and provide Taipei with more effective options to impose costs on China in a potential conflict. 202 Aside from arms sales, Randall Schriver, president and chief executive officer of the Project 2049 Institute, and Ian Easton, research fellow at the Project 2049 Institute, argue that the United States should increase its defense engagement with Taiwan by taking a range of actions, such as supporting Taiwan’s indigenous submarine program by signaling its intentions to approve licenses for potential U.S. defense industry participants; inviting Taiwan to the biannual multinational Rim of the Pacific Exercise (RIMPAC) and other bilateral and multilateral exercises; and sending high-level military officials to visit their counterparts in Taiwan. 203

The Role of Taiwan in the U.S. Rebalance to Asia

In response to written questions from the House Foreign Affairs Committee in March 2015 on the 36th anniversary of the Taiwan Relations Act, U.S. Secretary of State John Kerry described Taiwan as “a key component of U.S.-Asia Pacific policies, including the Asia rebalance.” 204 Since the Obama Administration announced its rebalance to Asia strategy in 2011, other U.S. officials have mentioned Taiwan’s role in the rebalance but have not detailed how

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9 According to the U.S. Department of Defense, “antiaccess” actions are intended to slow the deployment of an adversary’s forces into a theater or cause them to operate at distances farther from the conflict than they would prefer. “Area denial” actions affect maneuvers within a theater, and are intended to impede an adversary’s operations within areas where friendly forces cannot or will not prevent access. China, however, uses the term “counterintervention,” reflecting its perception that such operations are reactive. U.S. Department of Defense, Air Sea Battle: Service Collaboration to Address Anti-Access & Area Denial Challenges, May 2013, 2; U.S. Department of Defense, Military and Security Developments Involving the People’s Republic of China 2013, 2013, i, 32, 33.
Taiwan fits into the strategy. This lack of clarity could be due to concerns about how China would perceive U.S. officials’ calls for increased U.S. engagement with Taiwan, particularly on military issues. The Obama Administration may feel constrained by the unofficial nature of U.S.-Taiwan relations and concerned about the impact on U.S.-China relations of openly emphasizing Taiwan in the rebalance policy.

Some analysts and security experts in the United States and Taiwan argue the United States is not fully leveraging Taiwan's strengths in the rebalance and could benefit from further cooperation. According to Mr. Easton and Mr. Schriver, Taiwan can play an important maritime role in the rebalance:

Large numbers of maritime domain awareness capabilities fielded by Taiwan have the potential to contribute important [indications and warning] information. However, it is not clear how closely Taiwan's capabilities are linked to, and integrated with, U.S. Navy and other allies' systems in the Western Pacific. ... Taiwan's ISR could drastically improve U.S. and other allied nations' situational awareness in the Taiwan Strait and South China Sea where their capabilities are constrained by distance and basing limitations ... [but] there are significant shortcomings when it comes to human “software” components ...

In addition to improving maritime cooperation, the United States can tap Taiwan's strengths by reimagining U.S.-Taiwan defense policy coordination, according to Andrew Yang, Taiwan deputy minister of defense from 2009 to 2013 and minister of national defense briefly in 2013. Mr. Yang outlines three levels of his proposed new military-to-military coordination dialogue: (1) policy-level: developing shared views of the security environment and identifying policy guidelines to deal with the evolving security situation; (2) planning-level: based on Taiwan's 2013 quadrennial defense review, evaluating Taiwan's defense needs and, if needed, planning for U.S. assistance; and (3) service-level: focus on jointness between the U.S. and Taiwan militaries with particular emphasis on Taiwan's role in participating in regional humanitarian assistance and disaster relief operations.

Together with defense cooperation, increasing U.S. trade and investment in the Asia Pacific is an important piece of the rebalance strategy. President Ma has called for Taiwan to join TPP by 2020, but has not provided a detailed roadmap to achieve that goal. Although senior U.S. officials said they welcome Taiwan to join TPP, potential roadblocks could impede Taiwan's entry as a member. Taiwan would probably face Chinese opposition, complicating Taiwan's entry. While Taiwan has made significant progress reforming its economy in recent years, Taiwan's economy would likely need to further reform and open to accommodate the trade terms of TPP. The U.S. Chamber of Commerce in Taipei’s “2015 Taiwan White Paper” cites problems in Taiwan's regulatory process, including rules that deviate from standard global business practices and a lack of transparency, that still require reform.
Implications for the United States

The U.S.-Taiwan relationship remains robust, despite the limitations posed by the lack of formal relations between the two governments. It is built on common democratic values, strong commercial ties, and a U.S. commitment under the Taiwan Relations Act to aid in Taiwan’s defense. Taiwan remains vital to U.S. geopolitical interests in Asia and important for regional security. For example, the United States relies on Taiwan as a bastion of democracy in East Asia and as a like-minded force for peace and security. From providing humanitarian assistance and disaster relief resources in a region that often faces natural disasters to peacefully managing its maritime disputes in the East and South China seas, Taiwan contributes to regional security and the maintenance of peace and prosperity in the Asia Pacific.

Since 2008, Taipei and Beijing have taken steps to reduce cross-Strait tension and increase economic, cultural, and educational ties. Seven years of cross-Strait rapprochement have been beneficial to the United States by reducing cross-Strait tensions and allowing U.S. policymakers to address other priorities in the U.S.-China and U.S.-Taiwan relationships.

Two factors could change cross-Strait ties, however, complicating U.S. interests, its important security ties with Taiwan, and its relationship with China.

- The inherent uncertainty surrounding the transition to a new administration in Taiwan makes China uneasy, and it is unclear how Beijing would approach relations with Taipei if the DPP wins the upcoming presidential election. Should the DPP win, it is unclear how it might pursue cross-Strait relations differently from the current KMT government. According to Ms. Glaser and Ms. Vitello, “All of [DPP Chairperson Tsai’s] statements indicate that she is unlikely to pursue provocative policies. ... She has made a concerted effort to articulate a strategy aimed at maintaining the status quo.” Chairperson Tsai’s comments suggest a pragmatic approach that, in a departure from the last DPP president, would not seek to overtly promote pro-independence policies. On the other hand, Alan Romberg of the Stimson Center argued that “[Chairperson Tsai] will not embrace the “1992 Consensus” (or any other explicit form of ‘one China’) and will not oppose Taiwan independence, as Beijing insists.” He noted that, “In this circumstance, Beijing’s anxiety regarding a Tsai government could result in a measured approach continuing to support [certain] people-to-people aspects of cross-Strait ties while [simultaneously] taking a hardline approach reducing government-level cross-Strait interactions.”

- China’s modernizing military presents a significant challenge to Taiwan’s ability to defend itself and to the U.S. military’s ability to effectively intervene in a cross-Strait conflict should it decide to do so. With the cross-Strait military balance of power continuing to shift in Beijing’s favor, Taipei’s stagnating defense budget and capabilities, and China’s improving antiaccess/area denial capabilities threatening to keep U.S.
forces farther from China's shores, Beijing has increasing advantages in a Taiwan contingency, raising the cost for the United States to intervene in a crisis or conflict.

Conclusions

- Taiwan and China have enjoyed seven years of increased economic and trade ties, but fears among Taiwan citizens about economic coercion and China's political encroachment over Taiwan are more widespread than in the past.

- The younger generation of Taiwan citizens appears to view itself increasingly as Taiwanese rather than Chinese, and to be willing to take visible and substantial steps to assert their national identity. This has the potential to disrupt the diplomatic narrative that has allowed China and Taiwan to coexist without armed conflict. At the same time, Taiwan may not have the will or ability to counterbalance the growing Chinese military advantage. In view of China's growing power in the region as a whole, these trends have the potential to create stress on the ability of the United States to meet its obligations to Taiwan under the Taiwan Relations Act.

- Although China restricts Taiwan's ability to join multilateral institutions, Taiwan continues to make some progress on issues affecting its international space. Were Taiwan to succeed in its efforts to participate in emerging regional economic mechanisms like the Asian Infrastructure Investment Bank, Regional Comprehensive Economic Partnership, and Trans-Pacific Partnership, its integration in the region and ability to make a positive contribution to the international community would increase further.

- In response to China's increasingly assertive actions in the East and South China seas, Taiwan has initiated diplomatic frameworks and signed agreements with claimants to encourage the shelving of territorial disputes and promotion of joint resource development. Through an updated fisheries agreement with Japan and steps taken to clarify its claims in the South China Sea over the past year, Taiwan continues to play a role in helping preserve regional stability.

- The United States and Taiwan share a close relationship based on common democratic values, strong commercial ties, and a U.S. commitment to aid in Taiwan's defense. U.S.-Taiwan trade is at a record high, underlying Taiwan's increasing importance as a close economic partner. Furthermore, the United States continues to support Taiwan's defense through increasing military-to-military contact and other discreet defense cooperation.

- China's military modernization continues to focus on its ability to conduct military operations against Taiwan and deter the United States from defending Taiwan in a potential conflict. Although Taiwan has improved its defense capabilities through a combination of domestic production and acquisition of arms from the United States, the cross-Strait military balance of power continues to shift strongly in China's favor.
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80. Ministry of Economic Affairs, Overseas Chinese and Foreign Investment Commission (Taiwan), Monthly Report, August 2015.


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84. Ministry of Economic Affairs, Overseas Chinese and Foreign Investment Commission (Taiwan), Monthly Report, August 2015.


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SECTION 4: HONG KONG

Introduction

In the wake of political turmoil and widespread protests surrounding implementation of reform in Hong Kong’s 2017 chief executive election, Hong Kong society remains politically divided. This section examines developments in Hong Kong’s electoral reform process; declining press, expression, and academic freedoms; and the deepening economic relationship between Hong Kong and mainland China. Findings in this section are based on the Commission’s July trip to Hong Kong, meetings with government officials and experts, think tank and media reports, and official statistics. The section concludes with a discussion of the implications of Hong Kong’s political and economic development for the United States.

Constitutional Relationship between Hong Kong and Mainland China

Constitutionally, Hong Kong is a special administrative region of the People’s Republic of China (PRC). While central authorities in Beijing are explicitly charged with managing Hong Kong’s foreign affairs and defense, Hong Kong is otherwise entitled to conduct its own administrative affairs in accordance with the Basic Law, the region’s mini-constitution, which grants it a “high degree of autonomy.” This autonomy allows Hong Kong to exercise executive, legislative, and independent judicial power. Hong Kong’s autonomy was established in accordance with the “one country, two systems” principle—introduced by Deng Xiaoping to realize the peaceful reunification of China—under which the region’s capitalist system and “way of life” would remain unchanged for 50 years after the 1997 turnover from British rule. Taken together, the laws and policies that govern the relationship between Hong Kong and mainland China dictate that the region’s autonomous powers are authorized through the Basic Law in accordance with the PRC constitution—the ultimate legal and political ground for Hong Kong’s high degree of autonomy.

Under this constitutional framework, provisions in the Basic Law that govern the democratic development of Hong Kong’s electoral process are subject to interpretation by the Standing Committee of the National People’s Congress (NPC), China’s de facto legislative body. According to the Basic Law, Hong Kong’s leader, the chief executive, is to be selected “by election or through consultations held locally,” but is accountable to and appointed by China’s central government. While the precise method for selecting the chief executive was left legally ambiguous at the time the Basic Law was implemented, the law set forth the intention to one day select the region’s leader “by universal suffrage upon nomination by a broadly
representative nominating committee in accordance with democratic procedures.”

**Developments in Hong Kong’s Electoral Reform**

In 2007, the NPC Standing Committee first announced that universal suffrage—defined by the Hong Kong and central governments as election on a “one person, one vote” basis—may be instituted in the 2017 chief executive election. Current Chief Executive Leung Chun-ying (known as CY Leung) in July 2014 formally initiated the five-step process for amending the Basic Law when he submitted a report to the Standing Committee affirming the need to reform Hong Kong’s electoral method in the 2017 chief executive election. In August 2014, the Standing Committee completed the second step of the constitutional development process when it put forth an electoral framework with strict conditions on the adoption of universal suffrage, intensifying widespread and politically charged protests that grew out of public anger over a June policy paper. According to one Hong Kong lawmaker, the policy paper, which was published by China’s State Council, “eliminate[d] the possibility that the state would restrain itself” and “sent[ed] a clear message to Hong Kong that Beijing is omnipotent—all power comes from the National People’s Congress.”

The conditions on universal suffrage under the Standing Committee’s framework included a restrictive nomination mechanism that effectively precluded the nomination of prodemocracy candidates. Under the Standing Committee’s framework, only two or three candidates could be nominated to stand for election, and each candidate must be supported by more than 50 percent of the nominating committee, compared with 12.5 percent in the 2012 election. Because the new “broadly representative” nominating committee was to be formed “in accordance with the number of members, composition, and formation method of the [current] election committee,” it was expected to maintain the same Beijing-friendly bias as the current election committee. The Standing Committee’s framework also stipulated that the chief executive must be a “patriot” who “loves the country and loves Hong Kong.”

These constraints were met with fierce opposition among prodemocracy voices in Hong Kong. After Beijing unveiled its framework, all of Hong Kong’s 27 prodemocracy legislators (known in Hong Kong as pan-democrats) vowed to vote down what they believed to be a “fake” democratic model. Prodemocracy activists participated in extended protests throughout Hong Kong starting in mid-2014, with some arguing the proposed “rigid” voting framework was “unacceptable to the average voter.” As the protests dragged on, however, public frustration with the disruption caused by protests resulted in a partial loss of support and splintering of political views. The movement successfully delayed to January the second round of public consultation, but failed to cause the central government to alter or scrap the plan. Hong Kong Chief Secretary for Administration Carrie Lam stated, “There is no room for any concessions or compromises to be made” with regard to the NPC.
Standing Committee’s decision. In the aftermath, actors across the political spectrum in Hong Kong have become further fragmented in their interpretations of the concept of universal suffrage and its application in the 2017 and future chief executive and Legislative Council (LegCo) elections.

**Legislative Council Rejects Electoral Reform Proposal**

After the protests dispersed in December 2014, the impetus for electoral reform shifted from grassroots activists to members of LegCo. After a second round of public consultation, Chief Secretary Lam on April 22 announced the main elements of the electoral reform legislation that would be introduced to LegCo and would require support from two-thirds of members to pass. Building on the Standing Committee’s framework, the legislation included the following elements:

- The composition of the nominating committee shall follow the current composition of the 1,200-member election committee, in which seats are divided among four “sectors” and 38 “sub-sectors.” Allocation of seats among subsectors, the method for selecting the members of each subsector, and the electorate of each subsector shall remain largely unchanged.

- The nominating committee shall approve nominees in two stages: first, potential candidates shall be recommended for consideration; second, the two or three individuals who garner the most recommendations shall be selected as official candidates and stand for election. This procedure differs from the current arrangement, under which members of the election committee jointly nominate candidates.

  - In the first stage, each committee member may recommend one person for consideration to become a candidate. To be eligible, a potential candidate must be endorsed by 120—or 10 percent of—nominating committee members. Under this system, at least five and at most ten potential candidates can seek nomination.

  - In the second stage, each committee member shall vote for at least two candidates from among those who secured the recommendation of 10 percent of the committee. The two or three candidates who win the most votes and secure endorsement of more than half of members shall be the official candidates to stand election.

- All eligible Hong Kong voters shall select a chief executive from among the two or three candidates chosen by the nomination committee in accordance with the “first-past-the-post” system (i.e., the candidate with the most votes wins).

Hong Kong government officials and other pro-establishment voices argued that even with its limitations, the reform package should be approved in LegCo to serve as the foundation from which further democratic reform of the electoral process in future elections could be pursued. Although the April reform package—by re-

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quiring a lower endorsement threshold for potential candidates—presented a slightly greater chance over the Standing Committee framework that a democratic candidate could be nominated. Pan-democrats still considered the plan tantamount to giving the central government a backdoor to screen out candidates it does not like.26 During the Commission’s July trip to Hong Kong, former Hong Kong Chief Secretary for Administration Anson Chan said allowing Hong Kong voters to choose only among candidates approved by Beijing is not true universal suffrage, but rather “gives fake legitimacy to the whole election process.”27 According to Martin Lee, founder of Hong Kong’s Democratic Party and a former legislator, even if there were one acceptable candidate to emerge under the Standing Committee’s framework, “it would not be enough” to grant the chief executive any true legitimacy.28

On June 18, 2015, all 27 pan-democrats—a bloc representing just over one-third of the legislators—and one pro-establishment lawmaker voted against the motion, rejecting the package as promised in August 2014. Shockingly, only eight pro-establishment lawmakers voted in favor of the plan, allegedly due to a miscommunication when 31 LegCo members walked out in a botched attempt to delay the vote while they waited for a prominent pro-establishment member who was stuck in traffic.29 The failure of pro-establishment LegCo members to vote was considered an “embarrassing joke,” according to one pro-establishment legislator who met with the Commission in July.30

As a result of LegCo’s defeat of the electoral reform proposal, the current election framework—whereby the chief executive is chosen by a committee representing only 0.02 percent of eligible voters—will be used in the 2017 chief executive election.31 China’s NPC blamed pan-democrat lawmakers for “insisting on their stubborn confrontation against the central authorities,” and reiterated that its August decision on Hong Kong’s electoral reform “will remain in force in the future.”32

The governments of the United States and United Kingdom (UK) both expressed disappointment at the outcome of the electoral reform process. Scott Robinson, spokesman for the U.S. consulate in Hong Kong, reiterated the U.S. government position that “the legitimacy of the chief executive would be greatly enhanced if the chief executive were selected through universal suffrage and if Hong Kong’s residents had a meaningful choice of candidates.”33 Likewise, a UK government representative called for a “constructive dialogue on future reforms … reflecting the aspirations of the people of Hong Kong and in accordance with the Basic Law.”34

**Looking Ahead: Shifting Priorities**

Hong Kong’s 2017 chief executive election is no longer open to substantial, if any, amendment, and the 2022 electoral method—likely to resemble the plan vetoed in June, according to the central government—is a distant thought for some Hong Kongers. Now, political actors in Hong Kong face the question of how to move forward with constitutional development. Chief Executive Leung and Zhang Xiaoming, director of the Liaison Office of the Central People’s Government in Hong Kong, suggested Hong Kong should not continue to debate its political reforms, but instead refocus on eco-
nomic and livelihood issues. Public opinion in Hong Kong appears to reflect a similar sentiment: according to a survey conducted by the University of Hong Kong Public Opinion Program from June 2014 to July 2015, the number of respondents who named political developments as their top concern fell 4 percentage points, from 21.8 percent to 17.7 percent, while the number of respondents who listed livelihood problems as their top concern rose 5 percentage points, from 55.1 percent to 60.8 percent.

Because the window has closed for amending Annex I to the Basic Law, which governs the method for choosing the chief executive, constitutional reform of Hong Kong’s electoral method will not be possible in time for the 2017 chief executive election or the 2020 LegCo elections. The Hong Kong government, should it choose to do so, could make the 2017 election more inclusive through local legislation—thereby sidestepping the constitutional development process and not requiring approval from the central government. During the Commission’s trip to Hong Kong, Mrs. Chan proposed the election committee could be reconfigured to be somewhat more representative by widening the voting base and opening up seats to underrepresented groups; alternatively, the government could reduce the number of directly elected seats on the election committee, with the aim of “eventual abolition of functional constituencies.” Several LegCo members expressed pessimism about the prospect of achieving any progress on electoral reform before the 2017 election. Alice Mak, legislator with the pro-establishment Federation of Trade Unions party, explained that because two-thirds consensus in LegCo is needed to make any changes to the composition of the election committee as Mrs. Chan suggested, “it would not be easy to get support.” According to Ms. Mak, there are “no steps forward” on a timetable for achieving universal suffrage in future elections because the central government may not offer it again. Lee Cheuk-yan, pan-democrat LegCo member with the Labor Party, expressed concern that pan-democrats may not be able to promote further electoral reform legislation if they lose their one-third minority in LegCo in 2020.

Even Hong Kong’s organized university students, the driving force behind the prodemocracy protests, are shifting their priorities. Nathan Law, president of the Hong Kong Federation of Students, explained to the Commission that members of the student organization are no longer focused on 2017, but rather are looking ahead to 2047 when the “one country, two systems” arrangement governing Hong Kong’s handover to the PRC will expire. Those students who are concerned with the relationship between the PRC and Hong Kong are more focused on ideological discourse regarding Hong Kong’s future than on concrete action plans. Mr. Law said many students are now focusing on threats to academic freedom in Hong Kong.

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*The respondent sample size in June 2014 was 1,018, and in July 2015 was 1,037.
† Under the Basic Law, 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).
Press, Information, and Academic Freedoms under Pressure

Declining Freedom of Press

Although local media remain relatively active in criticism of the region’s government and, to a lesser extent, China’s central government, press freedom in Hong Kong continued an overall downward trend in 2015, according to a number of press freedom watchdog organizations (see Figure 1).43 Freedom House, a U.S.-based independent advocacy organization, found Hong Kong fell nine spots to 83rd worldwide in its press freedom ranking in 2015, noting the enormous economic and political influence Beijing wields to exert indirect pressure on media, resulting in growing self-censorship.44 Reporters Without Borders, an international nonprofit, also reported a nine-position decline from 2014, ranking Hong Kong 70th among 180 countries and regions evaluated, primarily due to erosions of information and press freedoms throughout the prodemocracy protests in late 2014.45 Major contributors to the lower ranking include increasing violence against journalists, cyberattacks on politically active media outlets, and businesses withdrawing advertising from openly prodemocracy media outlets.46

![Figure 1: Hong Kong's Global Press Freedom Ranking, 2005–2015](image)

Note: Due to a change in methodology, Reporters Without Borders (RWB) published one set of global scores for 2011–2012 rather than two separate sets of scores. RWB published its first world press freedom index report in 2002, while Freedom House did not consistently report the status of press freedom in Hong Kong until 2005.


Legally, press freedom in Hong Kong is safeguarded by the Basic Law, the Hong Kong Bill of Rights, and the International Covenant

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on Civil and Political Rights. Specifically, Article 27 of the Basic Law provides for “freedom of speech, of the press and of publication; freedom of association, of assembly, of procession, and of demonstration; and the right and freedom to form and join trade unions, and to strike.” Hong Kong’s Bill of Rights incorporates the International Covenant provisions on press freedom into Hong Kong law; under those provisions, freedom of expression protects both “the dissemination of news and the process of newsgathering,” as well as informal journalism such as blogging.

**Violence against Journalists**

Local journalists and members of the general public in Hong Kong highlighted violence in reports of the deteriorating press freedom environment there. Slightly more than half of respondents surveyed by the Hong Kong Journalists Association (HKJA) expressed concern about increasing reports of violence against journalists. More than 90 percent of Hong Kong journalists surveyed said they perceived an increase in the number of attacks by law enforcement officers in 2014 compared with the previous year, while 87 percent perceived an increase in the number of attacks by pro-establishment supporters.

The uptick in violence and violations of freedom of press and expression in 2014 coincided with local media coverage and support of the prodemocracy movement Occupy Central and criticism of the Hong Kong and central Chinese governments. While attacks against journalists and press members have seemingly escalated in Hong Kong for decades—the HKJA last year pointed to unresolved prior attacks on media actors in 1985, 1994, 1996, 1998, and 2013—the February 2014 maiming of Kevin Lau, then editor of Chinese-language newspaper *Ming Pao*, and the March 2014 beating of two news media executives brought concern over Hong Kong’s press freedoms to new heights.* Mr. Lau’s two attackers were found guilty of “causing grievous bodily harm” and stealing a motorcycle, and on August 21 were sentenced to 19 years in prison for accepting around $12,900 to carry out the attack, though it was never disclosed who ordered the attack and why. The four individuals arrested for the March attack pleaded not guilty; the case is still pending. Failure to adequately address physical violence against journalists and other media actors in Hong Kong has contributed to a worsening environment for press members there, especially those associated with the prodemocracy movement.

The HKJA recorded accounts of 24 alleged attacks on journalists from September 22, 2014, to October 29, 2014, in connection with the protests, with physical and verbal assaults inflicted by actors ranging from unidentified assailants to police. † Aside from outright attacks, the HKJA reported continuous, unjustified “violent behav-

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† A full list of the alleged attacks reported to the HKJA can be found in PEN American Center, “Threatened Harbor: Encroachments on Press Freedom in Hong Kong,” January 16, 2015, 40–44. The Hong Kong Government maintains the Hong Kong Police Force is politically neutral and does not consider the political stance of arrestees in carrying out duties. Letter from Millie Ng (Secretary for Security, Hong Kong Security Bureau) to Betty Ma (Clerk to the LegCo Panel on Security), June 1, 2015.
ior” by police, including arrests without cause, assault, and use of pepper spray against journalists carrying out legitimate reporting duties during the protests.65 Another prominent target is Jimmy Lai, outspoken prodemocracy supporter and former head of outlet Next Media and news tabloid Apple Daily, whose home and Next Media headquarters were attacked with firebombs in January 2015.66 Mr. Lai had previously suffered various threats and attacks, including a failed assassination attempt, presumably for his prodemocracy stance.57

**Politically Motivated Censorship**

Since the outbreak of prodemocracy protests in mid-2014, news media outlets and journalists in Hong Kong continue to face political and economic pressure to self-censor, sometimes at the risk of shutting down or job loss. Journalists are particularly concerned: 537 journalists surveyed by the HKJA rated self-censorship in Hong Kong as averaging 7 out of 10, with 10 denoting the problem is very common.58 Seventy-one percent of those surveyed stated the Hong Kong government was one of the sources of press freedom suppression.59 Some media organizations, including television and print news outlets, faced accusations of self-censorship over coverage of the prodemocracy movement, raising concerns about the publications’ credibility.60 This trend is highlighted by the shuffling of senior management and editors and controversial editorial practices at several of Hong Kong’s most prominent news outlets, as described below:

- In 2013, the *Hong Kong Economic Journal*, one of the more influential publications in Hong Kong, underwent major senior-level staffing changes after receiving letters of complaint about critical reporting on the chief executive.61 Throughout 2014, several *Journal* reporters and columnists reported receiving editorial guidance to withdraw or alter content critical of the chief executive or related to political matters.62

- In May 2014, Chong Tien-siong became de facto principal editor of *Ming Pao*, a position formerly held by Mr. Lau (who was assaulted shortly after his departure from the publication), raising suspicion that Mr. Chong’s appointment was related to his status as a prominent businessman on the Mainland.63 Under Mr. Chong’s management, an editorial director violated standard editorial procedures by making middle-of-the-night changes to the headline of a front-page story about the July 1, 2014, rally for universal suffrage. The headline wording—originally composed by the editing team in accordance with established practice—was altered to downplay the politically sensitive event. More than 190 *Ming Pao* staff members signed a joint statement calling on the editor to apologize for violating editorial practices, and the HKJA and the Independent Com-

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65 For example, seven Hong Kong police officers on October 15 were charged with causing bodily harm and common assault for the beating—which was caught on video—of Ken Tsang, a prodemocracy activist and Civic Party member, during the 2014 prodemocracy demonstrations. Alan Wong, “Hong Kong Police Officers Are Charged in Beating of Protester,” *New York Times*, October 15, 2015.
mentators Association in Hong Kong condemned the editor’s action for “seriously undermining” editorial independence at the paper.  

- In February 2015, Mr. Chong was responsible for a unilateral editorial decision at Ming Pao to drop a front-page story on a Canadian government report about the 1989 Tiananmen Square Massacre and run it on an inside page, despite strong objections from senior editorial staff.

- In April 2015, it was announced that an undisclosed stake in Young Lion Holdings—the controlling shareholder of 26 percent of shares of Television Broadcasts (TVB), the dominant free-to-air televised news channel in Hong Kong known for its pro-Beijing reporting—was sold to a company controlled by Li Ruigang, nicknamed “China’s Rupert Murdoch” for his status as a media mogul. Acquisition of the TVB shares by Mr. Li, former deputy secretary general of the Shanghai Communist Party’s administration office, marks a further injection of mainland capital into the local media, according to the HKJA.

- In May 2015, Wang Xiangwei, chief editor of prominent English-language newspaper South China Morning Post, notified all columnists featured on its Opinion and Insight pages that regular column submissions were no longer required, and that columnists must instead submit proposals for topics to the op-ed editor for preapproval, marking a departure from the paper’s long-established policy of allowing regular columnists ample scope to decide what to write. As a result, several widely read regular columns have disappeared. After more than 40 years combined writing for the Post, four veteran columnists—three of whom had written government-critical columns in the past—were reportedly dismissed from the paper in May. The Post cited its updated op-ed policy as the reason for the change.

Control of the media in Hong Kong is influenced by ownership. According to HKJA’s 2013 annual report, the influence of the Chinese and Hong Kong governments over major news outlets in Hong Kong is on the rise—media owners “controlled,” directly or indirectly, by the Hong Kong or central government hold leading positions in an estimated 86.7 percent of Hong Kong’s 30 major media outlets. Moreover, as of 2013, the owners of 36.7 percent of outlets had been appointed to China’s main political assemblies, the NPC and the Chinese People’s Political Consultative Conference. The HKJA’s research shows only four of the 30 outlets “escape[d] mainland or Hong Kong government favor” as of 2013; two of these four outlets were published by Next Media Group, known for its prodemocracy stance. Revelations that “some China-funded companies had pulled their advertisements from some Chinese-language newspapers,” including Apple Daily, the free daily am730, and the Hong Kong Economic Journal, stoked concerns about growing mainland interference in Hong Kong’s media.
In a positive development, some newly established Hong Kong news outlets are pursuing crowdfunding in order to avoid the political and economic influence associated with media ownership. These outlets include bilingual investigative news agency FactWire, English-language news website Hong Kong Free Press, and Chinese-language site Initium Media, which seeks to “provide neutral, free, and professional news to the Chinese community around the globe.”

**Freedom of Information Legislation**

No law in Hong Kong governs the management of official archives, which results in stifled government transparency and accountability and generates concerns that certain documents and records made during the Occupy Central movement may be destroyed. Local journalists have consistently and strongly supported implementation of freedom of information legislation to ensure they and the general public have a legal right to access information held by the government and public entities; 89 percent of media workers surveyed by the HKJA indicated the government needed to protect press freedom through enactment of the legislation. In a 2014 report released after concluding a year-long study, Hong Kong’s Office of the Ombudsman recommended the enactment of such legislation after finding key components of freedom of information laws are “missing or are not adequately manifested” in the existing administrative code governing public requests for information. Despite this report, the legislative process has been held up by two relevant subcommittees, which were established by the Law Reform Commission of Hong Kong to make recommendations on options for reform. According to Freedom House, the Hong Kong government stated it would defer a decision on such legislation until the release of a report on the issue from a Law Reform Commission subcommittee. Stephen Wong Kai-yi, secretary of the Law Reform Commission, said the subcommittee’s report was expected before 2016. Despite signing a pledge to do so, Chief Executive Leung has not taken any action to promote freedom of information legislation.

**Academic Freedom Challenged**

Unlike in mainland China, universities in Hong Kong enjoy a high degree of academic freedom, autonomy, and freedom of expression. But the role of academics has come under government scrutiny following last year’s prodemocracy protests, organized by student groups and other academics. In 2015, this treatment extended to leadership at Hong Kong’s most prestigious university. In December 2014, a University of Hong Kong (HKU) search committee unanimously recommended former HKU law school dean Johannes Chan Man-mun for the position of pro-vice chancellor at the university. Mr. Chan was critical of the government during the prodemocracy protests (Benny Tai, leader of the Occupy Central movement, was one of Mr. Chan’s law school faculty members), and is a member of Hong Kong 2020, a prodemocracy group led by Anson Chan. But Mr. Chan’s appointment was postponed twice and ultimately blocked in September 2015 at the insistence of HKU’s 24-
member governing council, seven of whom—including the chairman—are appointed by the chief executive, and up to 80 percent of whom are members of the pro-establishment camp, according to Fung Wai-wah, president of the Professional Teachers’ Union in Hong Kong. The Hong Kong chief executive not only serves as chancellor of all eight Hong Kong higher education institutions funded by the University Grants Committee (UGC), which advises the government on university funding and development, but also appoints members of the UGC.

According to one student representative present during the council’s deliberations, Mr. Chan was not appointed based on criticisms that he was not qualified because he lacked a Ph.D., had not published a sufficient number of academic works, and lacked integrity. However, some council members, academics, and students have claimed the prolonged delay and ultimate rejection of Mr. Chan’s appointment involved interference from the central and Hong Kong government. In February, Mr. Lau wrote that “some extremely influential people in the government” had contacted HKU council members, urging them to reject Mr. Chan’s promotion. The same month, two central government-run newspapers in Hong Kong, Wen Wei Po and Ta Kung Pao, published “Cultural Revolution-style” attacks on Mr. Chan spanning several pages, premature releasing an “extremely confidential” assessment by the UGC that HKU faculty’s research quality was lower than that of the Chinese University of Hong Kong, and attacking Mr. Chan for his “poor performance.” One Hong Kong journalist estimated the two newspapers alone published more than 300 articles targeting Mr. Chan since November 2014.

Students, professors, and alumni of Hong Kong’s universities have shown strong opposition to the council’s delay and ultimate rejection of Mr. Chan’s appointment and the flawed governance structure at higher education institutions there. On July 29, a group of students stormed the council’s meeting room after the council again voted to delay Mr. Chan’s appointment, while more than 100 alumni gathered there in support of academic freedom. More than 1,400 HKU alumni and members of the public signed a petition titled “Safeguard HKU,” calling for the preservation of the university’s independence and timely resolution of Mr. Chan’s appointment. In August, nearly 300 academics voiced opposition in a joint petition—at least the third major petition filed—in support of Mr. Chan out of concern that the government is interfering in university affairs. During the Commission’s July trip to Hong Kong, Nathan Law, president of the Hong Kong Federation of Students, expressed that the student organization wants to pursue reform of the university governance structure, but that such legislation is unlikely to garner LegCo or chief executive support. At an annual convocation of HKU alumni in September, 9,298 alumni overwhelmingly voted to revise the law so the Hong Kong chief executive is no longer chancellor of the university.

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*The chief executive is chancellor of all eight UGC-funded institutions in Hong Kong. The UGC is a non-statutory advisory committee responsible for advising the Hong Kong Government on the development and funding needs of its funded institutions. Its members are appointed by the chief executive and comprise local and overseas academics, higher education administrators and community leaders. University Grants Committee, “Brief History.” [http://www.ugc.edu.hk/eng/ugc/about/overview/history.htm](http://www.ugc.edu.hk/eng/ugc/about/overview/history.htm).
The controversy surrounding alleged government interference in HKU’s appointment procedures is only one example of Beijing’s interference in Hong Kong academia. Hong Kong legislators told the Commission that the central government is worried about Hong Kong universities producing “rebellious” students, especially after seeing the impact scholars like Benny Tai and student protest leaders like Joshua Wong had on the prodemocracy movement. As a result, there appears to be an effort to control the research topics, activities, and funding of liberal academics in Hong Kong. Joseph Cheng Yu-shek, a political science professor at the City University of Hong Kong, describes a phenomenon whereby pressure on academics to toe the Party line “trickles down” from top-level management to influence faculty promotion. Meanwhile, according to Mr. Cheng, academics loyal to Beijing are rewarded with honors and posts at mainland universities, but “if [academics] are perceived unfavorably, there are distinct difficulties.” Mr. Cheng, who founded a group called Alliance for True Democracy that was active during the Occupy Central protests, was attacked in Wen Wei Po and demoted from his position as chairman of the political science department at his university three months before his retirement.

Hong Kong’s Economic Ties with Mainland China

For the 21st consecutive year, Hong Kong in 2015 retained its ranking as the world’s freest economy for its efficient regulatory framework, simple and low taxation, and sophisticated capital markets, according to the U.S. think tank Heritage Foundation. With global foreign direct investment (FDI) inflows of $103 billion in 2014, Hong Kong was the second-largest recipient of FDI in Asia after China ($129 billion), while FDI outflows from Hong Kong reached $143 billion, ranking second highest behind U.S. outflows. Due to its status as a global financial hub, Hong Kong’s total stock of inward FDI by the end of 2013 reached $1.34 trillion—about 4.9 times its gross domestic product (GDP) that year—largely driven by incoming capital from tax haven economies like the British Virgin Islands (33.7 percent), the Netherlands (6.6 percent), and Bermuda (5.9 percent). Overall, Hong Kong’s economic growth moderated in 2014—real GDP growth fell from 3.1 percent in 2013 to 2.5 percent in 2014, and is projected to land between 2 and 3 percent in 2015—primarily due to the global economic recovery, slowing growth in China, and weaker tourist arrivals and spending, including on luxury goods, in Hong Kong.

The bilateral economic relationship between the United States and Hong Kong is strong. During the Commission’s July trip to Hong Kong, U.S. Consulate officials reported 85,000 Americans are living in Hong Kong, and around 1,300 U.S. businesses operate there. U.S. companies have 800 regional headquarters and offices in Hong Kong—the largest number of any country.

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*The Index of Economic Freedom is measured based on four categories of factors—rule of law, limited government, regulatory efficiency, and open markets—and is calculated by the Heritage Foundation, a conservative U.S. think tank based in Washington, DC.
†In accordance with the Basic Law, Hong Kong maintains its status as a free port and separate customs territory. However, it participates in international economic agreements as “Hong Kong, China,” as in the World Trade Organization. Hong Kong Special Administrative Region, “Hong Kong as Asia’s World City,” in The Basic Law and Hong Kong—The 15th Anniversary of Reunification with the Motherland, 142–143.
2014, cumulative U.S. FDI in Hong Kong measured $66.2 billion, according to official U.S. data, while total Hong Kong FDI into the United States measured $7.6 billion. Additionally, Hong Kong is a key U.S. trading partner. The United States maintains its largest trade surplus with Hong Kong: at $35.1 billion in 2014, the U.S. surplus with Hong Kong measured more than $12 billion greater than its trade surplus with the Netherlands, the second largest. Hong Kong is the tenth-largest market for U.S. exports and a top ten export market for U.S. agricultural products, led by tree nuts, beef, pork, fruit, and wine.

The region’s economy remains highly integrated with that of mainland China in terms of bilateral trade and investment. Hong Kong is the second-largest trading partner of mainland China after the United States, accounting for 8.7 percent of China’s total trade in 2014, according to China’s Customs statistics. Hong Kong plays the most important role in intermediating trade between China and the rest of the world by distributing a large fraction of China’s exports: according to Hong Kong government statistics, in 2014, 60 percent of re-exports were of Chinese origin, and 54 percent were destined for the Chinese mainland. Cross-border investment shows an even stronger trend: in 2014, Hong Kong was the largest source of overseas FDI in mainland China, with cumulative capital inflow from Hong Kong reaching $745.9 billion, or 49.3 percent of total FDI on the Mainland. Similarly, mainland China remains a leading investor in Hong Kong, with $428 billion in Chinese investment—or 31.9 percent of the total stock—flowing into Hong Kong at the end of 2013.

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

Historically, Hong Kong has played a pivotal role in pushing through mainland China’s economic and financial reform objectives. Aside from its significant role as a trade and direct investment partner, Hong Kong is the center for cross-border renminbi (RMB) trade settlement and offshore RMB business. In addition, mainland Chinese enterprises increasingly pursue listings on the Stock Exchange of Hong Kong (SEHK) to access foreign capital. In its capacity as an international financial center and offshore RMB hub, Hong Kong is being used by the Mainland to push through reforms, including development of its domestic financial market, improvement of the international competitiveness of its firms, and managed liberalization of its capital account. These developments are expected to enhance market transparency and foreign investor access on the Mainland, and enhance cross-border fund flows and complement the mature financial services industry in Hong Kong. Moreover, growing trade between the two markets will accelerate the RMB’s internationalization. But increasing Hong Kong’s exposure to the risks inherent in China’s underdeveloped equity market, such as recent stock market volatility and subsequent policy intervention by the central government, calls into question the pace of China’s future financial reforms and presents operational risks for some investors. Aside from systemic risks, foreign investment into mainland markets through Hong Kong faces structural limitations, especially given the incremental deployment of reform programs.
Trade Settlement

As the premier offshore RMB hub, Hong Kong plays a vital role in the Mainland’s capital account liberalization. (For more on China’s financial reforms, see Chapter 1, Section 3, “China’s State-Led Market Reform and Competitiveness Agenda,” of this Report.) In China’s 12th Five-Year Plan for financial development and reform (2011–2015), the central government set policy directives for freer cross-border capital flow and a higher degree of RMB capital account convertibility, with the ultimate aim of internationalizing the RMB. To achieve these goals, Chinese financial authorities employ Hong Kong as a testing ground for use of the RMB as a settlement, investment, and funding currency. As of December 2014, a total of 149 authorized banking institutions in Hong Kong engaged in RMB business, with RMB deposits worth more than $161 billion (RMB 1 trillion), accounting for approximately 24 percent of foreign currency deposits among authorized institutions there (see Figure 2). At year-end 2014, the value of outstanding RMB-denominated debt instruments and bonds lodged with the Central Moneymarkets Unit of the Hong Kong Monetary Authority reached $65.4 billion (RMB 407 billion)—52 percent of the total value of outstanding debt issues—representing a 6 percent increase year-on-year.

Hong Kong also serves as a platform for enterprises and financial institutions all over the world to conduct RMB trade settlement, payments, financing, and investments. In the first half of 2015, total RMB trade settlement conducted through banks in Hong Kong reached $513.4 billion (RMB 3.2 trillion) (see Figure 3).
Stock Exchange Listings

Hong Kong’s active international securities market has consolidated its position as the second-largest initial public offering (IPO) market in the world—in 2014, nearly $30 billion (Hong Kong dollar (HKD) 232.5 billion) was raised, a 38 percent increase from the previous year. In line with China’s “going global” strategy, which encourages Chinese firms to both invest abroad and expand overseas operations, mainland firms are increasingly participating in Hong Kong’s equity market: among the $30 billion in IPO funds raised last year on the SEHK, Chinese firms contributed approximately 86 percent. As of December 31, 2014, 876 mainland enterprises were listed on the SEHK—50 percent of the total number of listed companies—accounting for 60 percent of the total market capitalization (see Figure 4). Mainland enterprises benefit from raising capital in a freely convertible currency and taking advantage of the Hong Kong market’s greater liquidity and more effective and better regulated risk management investment instruments.
Figure 4: Market Capitalization of Mainland Firms Listed in Hong Kong

Note: "Mainland firms" refers to the following: (1) H-share companies, which are incorporated on the Mainland and controlled by either mainland government entities or individuals; (2) red chip companies, which are incorporated outside of the Mainland and controlled by mainland government entities; and (3) mainland private enterprises, which are incorporated outside of the Mainland and controlled by mainland individuals. Hong Kong Exchanges and Clearing, “Market Statistics 2014,” January 8, 2015, 14.


Shanghai-Hong Kong Stock Connect

Another pillar of China’s currency internationalization efforts is the Shanghai-Hong Kong Stock Connect, a mutual market access service between the Shanghai and Hong Kong stock exchanges launched in November 2014. The link enables institutional or retail foreign investors for the first time to trade A-shares—shares in mainland China-based companies traded on Chinese exchanges—which were previously only available to certain investors licensed under China’s Qualified Foreign Institutional Investor (QFII) and RMB QFII programs. For Hong Kong, the Stock Connect provides additional liquidity and supports the region’s offshore RMB business and its role as a financial gateway to China.

The northbound link—referring to funds flowing north from Hong Kong to China—allows investors outside the Mainland to trade selected equities on the Shanghai Stock Exchange (SSE), routed through Hong Kong brokers; the southbound link—referring to funds flowing south from China to Hong Kong—allows investors in mainland China to trade selected equities on the SEHK, through members of the SSB (see Table 1).
Table 1: Framework of the Shanghai-Hong Kong Stock Connect

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<th>Asset Classes</th>
<th>Northbound</th>
<th>Southbound</th>
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<tr>
<td>Investors</td>
<td>Selected SSE A-shares</td>
<td>Selected SEHK stocks</td>
</tr>
<tr>
<td>Brokers</td>
<td>SEHK members who fulfill eligibility requirements</td>
<td>SSE members who fulfill eligibility requirements</td>
</tr>
<tr>
<td>Currency</td>
<td>Traded and settled in offshore RMB</td>
<td>Traded in HKD and settled in RMB</td>
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<tr>
<td>Trading Venue</td>
<td>SSE</td>
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<td>Clearing House</td>
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<td>Hong Kong Securities Clearing Co.</td>
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RMB internationalization is still in the early stages, largely due to the deliberate and incremental pace of China’s regulators in their efforts to control potential risks. For this reason, trading is subject to a maximum cross-border investment quota (i.e., aggregate quota), together with a daily quota. The northbound aggregate quota is set at $49 billion (RMB 300 billion)—less than 1 percent of the total A-share market—and the southbound aggregate quota is set at $41 billion (RMB 250 billion). The daily quota limits the maximum net buy value of any cross-border trades under the program each day: the northbound daily quota is set at $2.1 billion (RMB 13 billion), and the southbound daily quota is set at $1.7 billion (RMB 10.5 billion). The program’s initial northbound aggregate quota of $49 billion is equivalent to 9 percent of all offshore RMB assets ($548 billion as of 2014) (see Figure 5). Before the launch of the Stock Connect, quotas for the QFII and RMB QFII programs—the only available channels for international investment in China’s A-shares—were $67 billion and $48 billion respectively in 2014, according to China’s State Administration of Foreign Exchange.
Given the previous limits on access, the initial response from international investors was strong: northbound trading on the link’s first day attained 100 percent usage of the daily quota (see Figure 6). While subsequent months of operation saw less active northbound daily trading, Chinese investors for the first time used the entire southbound daily quota in April 2015, reaching a record high in turnover for the link at $4.8 billion (RMB 29.9 billion) and making the Hong Kong exchange the highest market capitalization exchange in the world. Some analysts credit the allowance by Chinese regulators for mutual funds to buy Hong Kong shares under the program the preceding week for the surge, a change that made it easier to get around southbound barriers like high capital thresholds.
Celent, a division of management consulting firm Oliver Wyman, is a research and consulting firm focused on information technology in the financial services industry. A June 2015 report from research and consulting firm Celent identified a number of restrictive features of the stock link that may create operational complexity and introduce risk. These include a complex settlement cycle, no day trading and limited support for short selling, a requirement to settle in RMB, asset fungibility issues, and onerous shareholder risk and reporting requirements. Despite these risks, however, the report predicts that forthcoming improvements to the program will enable greater participation by institutional investors and initiate inclusion of A-shares in global equity benchmark indices within the next few years. If Chinese regulators remain committed and active in opening the country’s capital account, quotas are expected to be expanded to meet investor demand. The Celent report estimates these factors will drive international holdings of A-shares to $428 billion by 2017, setting the stage for other similar joint initiatives such as a stock link between Shenzhen and Hong Kong. While a Shenzhen-Hong Kong stock link was initially slated to launch by year-end 2015, the project was reportedly put on hold in June due to technical difficulties. During the Commission’s July trip to Hong Kong, Andrew Wong, Permanent Secretary of Hong Kong’s Financial Services and the Treasury Bureau, said the technical issues had been sorted out, and China’s State Council would determine the best time to launch the program. In spite of the fluctuation in the mainland stock markets since late June, according to the Financial Services and the Treasury Bureau, “the Hong Kong securities markets have been trading and operating in an orderly and smooth manner.”

Because the level of trading through the Stock Connect is low, Hong Kong is not expected to suffer contagion from the downturn in the Mainland’s equity markets through that channel, according to Mr. Wong. But markets in the two economies tend to move
in tandem. Since the Hang Seng index—the main indicator of overall market performance in Hong Kong—hit a seven-year high in April, it has fallen 25.5 percent as of September 1, following Shanghai’s plummeting index, which has fallen more than 38 percent as of September 1 since it peaked this year in mid-June amid massive Chinese government intervention.\(^{140}\) Given the strong presence of Chinese companies listed on the SEHK—mainland firms account for 60 percent of market capitalization there—it is not surprising that falling valuations in Shanghai would affect the prices of their shares in Hong Kong.\(^{141}\) Overall, according to Mr. Wong, volatility in the mainland markets is partly related to the prevalence of margin financing (i.e., borrowing money to invest) among China’s retail investor-dominated traders.\(^{9}\)

During the Commission’s July trip to Hong Kong, U.S. Consulate officials indicated Hong Kong’s strict rules on transparency and strong regulatory capabilities highlight the maturity of its financial markets and enhance the ability of the SEHK to withstand sharp fluctuations in the mainland markets.\(^{142}\) Hong Kong has also introduced a host of measures to control risks. When the Stock Connect was established in late 2014, Hong Kong and Chinese regulators signed a memorandum of understanding to enforce information disclosure and sharing.\(^{143}\) In July 2015, Hong Kong Exchanges & Clearing Limited, the holding company of the SEHK, announced the introduction of volatility curbs that will use an auction at the end of the trading day to reduce volatility when calculating closing prices—a measure used by all major stock exchanges—when it goes into effect in mid-2016.\(^{144}\)

**Mutual Recognition of Funds**

In a move to further deepen financial cooperation and promote the joint development of the Hong Kong and mainland capital markets, the China Securities Regulatory Commission and Hong Kong Securities and Futures Commission jointly announced the introduction of a long-awaited “Mutual Recognition of Funds” initiative, giving international asset managers a channel to access mainland China’s growing and previously untapped retail investor market—the number of new individual investor accounts on the SSE grew thirty-fold year-on-year in June 2015—boosted by a growing middle class and a huge pool of domestic savings.\(^{145}\) Implemented on July 1, 2015, the Mutual Recognition of Funds initiative enables mainland China and Hong Kong funds to be distributed in each other’s markets through a streamlined vetting process, enabling non-mainland Chinese retail investors and fund managers to enter the Chinese retail fund market through Hong Kong.\(^{146}\) The move is expected to increase the diversity of asset management activities in Hong Kong’s asset management industry, which previously relegated fund management services largely to sales and marketing, by incentivizing fund managers to base their funds in the city.\(^{147}\)

The initiative is intended to further expand cross-border RMB flows and facilitate China’s efforts to open up its capital markets and internationalize the RMB by providing an avenue to convert

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\(^{9}\) For more details on fluctuations in the mainland stock markets, see Chapter 1, Section 1, “Year in Review: Economics and Trade,” of this Report.
domestic savings in mainland China into cross-border investments.\textsuperscript{148}

**Implications for the United States**

The United States has a long history of positive bilateral relations with Hong Kong and is committed to the region's stability, prosperity, and continued success as an international trade and financial center. The United States and Hong Kong share many values, including respect for rule of law and for civil liberties. To bolster Hong Kong's stability and prosperity, the U.S. government encourages Beijing and Hong Kong to continue to work together to further Hong Kong's democratic development in accordance with the Basic Law and the aspirations of the people of Hong Kong.\textsuperscript{149}

Hong Kong's high degree of autonomy and economic freedom make it a valuable and preferable destination for U.S. investors and an important U.S. trading partner. Approximately 1,300 U.S. businesses operate in Hong Kong, drawn in part by the region's openness, transparency, free market, and strong rule of law.\textsuperscript{150} After mainland China, the United States is Hong Kong's second-largest trading partner. The United States maintains its largest trade surplus with Hong Kong and its tenth-largest goods export market.\textsuperscript{151} Moreover, Hong Kong and the United States continue to cooperate economically in a number of bilateral and multilateral fora, including the World Trade Organization, the Asia-Pacific Economic Cooperation, and the Financial Action Task Force. The two also maintain a strong law enforcement partnership in areas including customs, intellectual property rights protection, financial fraud, counterterrorism, and immigration.

In line with the Commission's recommendation in its 2014 Annual Report to Congress, the Hong Kong Policy Act report was updated in 2015 after an eight-year hiatus pursuant to H.R. 5013, the State, Foreign Operations, and Related Programs Appropriations Bill, 2015, which mandated the Secretary of State report to Congress on key developments in Hong Kong.\textsuperscript{152} According to the report, Hong Kong has maintained a sufficiently high degree of autonomy under the “one country, two systems” model to justify continued special economic treatment by the United States for bilateral agreements and programs.\textsuperscript{153} But recent trends have sparked U.S. concern over growing constrictions of Hong Kong's press and media freedoms, including increasing reports of political pressure to self-censor, violent assaults against members of the press, firing of journalists critical of the central government, and cyberattacks against prodemocracy media.\textsuperscript{154}

As the economies of Hong Kong and mainland China become even more integrated through liberalization efforts like the Shanghai-Hong Kong Stock Connect, U.S. investors will look to Hong Kong’s regulators to uphold rule of law and international financial standards and best practices to minimize risks to the global financial system to the highest degree possible.

**Conclusions**

- In June 2015, Hong Kong's Legislative Council voted down electoral reform legislation based on a framework designed by Chi-
na's central government. This framework would have limited the candidates eligible for chief executive nomination to those acceptable to Beijing. As a result, election of the chief executive in 2017 will employ the same method as the 2012 chief executive election, whereby a 1,200 member committee elects the leader.

- Members of the general public, legislators, students, and other vested parties lack consensus on how to pursue electoral reform in Hong Kong's future chief executive and Legislative Council elections.

- Press freedom in Hong Kong is increasingly under pressure due to recent instances of violence against journalists, increasing political and economic pressure to self-censor, and use of economic coercion to disrupt independent reporting. The absence of a freedom of information law in Hong Kong also contributes to a lack of transparency with regard to open access to and preservation of government records.

- Hong Kong's world-class economy, particularly its capital markets, is playing an increasingly pivotal role in mainland China's efforts to push through financial reforms, including development of its domestic financial market, improvement of the international competitiveness of its firms, and liberalization of its capital account.

- In an effort to internationalize the renminbi, among other objectives, Hong Kong and mainland China have jointly established a number of pilot programs, including the Shanghai-Hong Kong Stock Connect and the Mutual Recognition of Funds initiative, to boost international participation in China's markets. These developments are expected to enhance market transparency and foreign investor access on the Mainland and enhance cross-border fund flows.

- Deepening integration exposes Hong Kong to the risks inherent in China's volatile equity markets, presenting operational risks for some investors. Moreover, foreign investment into mainland markets through Hong Kong still faces structural and quantitative limitations.
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RECOMMENDATIONS

China and Central Asia

The Commission recommends:

• Congress request classified briefings from the U.S. Intelligence Community on the nature of U.S.-China cooperation on counterterrorism to ensure the U.S. government is not inadvertently supporting Chinese counterterror policies and tactics that undermine human rights.

• Congress direct the U.S. Government Accountability Office to prepare a report assessing the U.S. New Silk Road policy. This report should evaluate the New Silk Road’s strengths and weaknesses and its current status and future prospects for meeting U.S. policy objectives in Central Asia. This report should investigate how U.S. policy toward Central Asia intersects and interacts with U.S. policy toward China more broadly, and how the U.S. and Chinese Silk Road initiatives interact in Central Asia.

• Members of Congress and their staffs consider traveling to Central Asia, and, when doing so, engage with U.S. business community and nongovernmental organizations to discuss ways of improving human rights, rule of law, environmental protection, and business environment.

China and Southeast Asia

The Commission recommends:

• Congress direct the U.S. Government Accountability Office to prepare a report assessing the effectiveness of recent U.S. efforts to enhance the maritime security capabilities of allies and partners in Southeast Asia and identifying the remaining challenges and opportunities.

• Congress urge the Administration to enhance its support for regional information sharing institutions focused on maritime security in Southeast Asia.

• Congress direct the U.S. Government Accountability Office to expand its August 2015 report Southeast Asia: Trends in U.S. and Chinese Economic Engagement to evaluate whether Chinese government funded investment and assistance projects in Southeast Asia negatively affect U.S.-funded projects in Southeast Asia.
Taiwan

The Commission recommends:

- Congress urge the Administration 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 Administration to invite Taiwan to participate at least as an observer at U.S.-led bilateral and multilateral military and security exercises, including future Rim of the Pacific (RIMPAC) and Cyber Storm exercises.

- Congress encourage the Administration to increase its public support of Taiwan’s participation in international organizations, which would help Taiwan expand its status and legitimacy in the international community.

- Congress require the U.S. Department of State, the U.S. Department of Defense, and the U.S. Department of Commerce to jointly prepare a classified report on Taiwan’s role in the U.S. strategy in Asia. The report should include an overview of Taiwan’s current role in the strategy; U.S.-Taiwan defense cooperation and a description of all joint programs; and opportunities for Taiwan’s inclusion in U.S. Asia strategy.

Hong Kong

The Commission recommends:

- Members of Congress, when visiting mainland China, also visit Hong Kong, and that Congress encourage senior Administration officials, including the secretaries of State, Defense, and Commerce, to make visits to Hong Kong part of their travel.

- Congress sustain the language in the Department of State, Foreign Operations, and Related Programs Appropriations Act of 2016 reauthorizing the report requirement under the U.S.-Hong Kong Policy Act of 1992 supporting human rights and democracy in accordance with the Sino-British Joint Declaration.

- Congress urge the Department of State to increase its public diplomacy efforts in Hong Kong in support of press freedom, media independence, and academic freedom.

- Congress engage parliamentarians from the United Kingdom in an interparliamentary review of China’s adherence to the Basic Law since the handover of Hong Kong to China in 1997, with specific attention to rule of law, progress in achieving universal suffrage, and press freedom.