

**CHINA'S ROLE IN THE WORLD: IS CHINA A  
RESPONSIBLE STAKEHOLDER?**

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**HEARING**

BEFORE THE

**U.S.-CHINA ECONOMIC AND SECURITY REVIEW  
COMMISSION**

**ONE HUNDRED NINTH CONGRESS  
SECOND SESSION**

—————  
AUGUST 3-4, 2006  
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Printed for use of the  
United States-China Economic and Security Review Commission  
Available via the World Wide Web: [www.uscc.gov](http://www.uscc.gov)



UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

WASHINGTON : September 2006

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# **CHINA'S ROLE IN THE WORLD: IS CHINA A RESPONSIBLE STAKEHOLDER?**

**THURSDAY, AUGUST 3, 2006**

**U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION**

The Commission met in Room 385 Russell Senate Office Building, Washington, D.C. at 8:37 a.m., Chairman Larry M. Wortzel and Vice Chair Carolyn Bartholomew, Commissioners Daniel A. Blumenthal and Michael R. Wessel (Hearing Cochairs), presiding.

## **OPENING STATEMENT OF VICE CHAIRMAN CAROLYN BARTHOLOMEW, HEARING COCHAIR**

COMMISSION VICE CHAIR BARTHOLOMEW: Good morning, everyone. I'm Carolyn Bartholomew, the Vice Chairman of the Commission. Welcome to our panelists and our guests. Today we are focusing on China's role in the world. It is admittedly a big topic to fit into a day and a half of hearing.

Rather than an exhaustive review, we hope to bring to the forefront a number of common questions and themes that are raised by Chinese government strategy and actions around the world.

China is playing a greater and greater role on the world stage. As it does so, the scrutiny of its actions and its intentions is, not surprisingly, also growing.

There is much to question. The Chinese government likes to characterize itself as engaging in a "peaceful rise." Yet, its active engagement with and assistance to countries which others in the international community have condemned as human rights abusers or threats to international peace raise serious questions about its intentions.

And the world's understanding of China's intentions globally, like most of its governmental affairs, suffers from its lack of transparency.

Today's experts will try to break through some of the lack of transparency, testifying on China's economic diplomacy, its energy diplomacy, and its engagement with pariah states. We will consider the nature of the relationships China is establishing with countries around the world and the impact of those relationships on U.S. interests.

In Africa, for example, China seems focused on resource-rich states buying up oil, natural gas and other minerals from the Sudan, Chad, Nigeria, Angola, Algeria, Gabon and Equatorial Guinea.

In 2005, Chinese official sources reported total investment of \$175 million in African countries, primarily on oil exploration and infrastructure projects. When China signs an oil contract, development aid often follows in the form of medical supplies, infrastructure investment, debt relief and lowered trade barriers.

International organizations have reported more than a few cases where China has ignored standards of international law, humanitarian concerns, and human rights when these conflict with China's resource acquisition needs.

How are Chinese investment practices affecting U.S. initiatives to increase the effectiveness of foreign assistance to promote transparency and accountability and to end human rights abuses?

As part of our mandate to advise Congress whether China is likely to be a reliable diplomatic partner, we will explore these issues as part of the broader theme of how trade and energy security are linked in China's diplomatic strategy in countries around the world.

Despite the press of world events, the U.S. must remain focused on nuclear proliferation in Iran and North Korea. Success in addressing those threats requires Chinese cooperation. This Commission attaches such importance to China's actions regarding those countries that we will devote a separate hearing in September to this topic.

As today's panelists address China's relationships to countries of concern including North Korea and Iran, I look forward to hearing their views on China's alignment with other regimes and governments including those in Sudan, Venezuela, and Burma. How do we reconcile those relationships with China's supposed interest in being a dependable partner for the United States?

Thank you again to our witnesses, to our guests. I look forward to the statements that we'll be hearing today and at this time I'll turn the microphone over to Commissioner and Hearing Cochair Dan Blumenthal for his opening remarks.

[The statement follows:]

### **Prepared Statement of Vice Chair Carolyn Bartholomew Hearing Cochair**

Welcome to our panelists and guests. Today, we are focusing on China's role in the world. It is admittedly a big topic to fit into a day and a half of hearings. Rather than an exhaustive review, we hope to bring to the forefront a number of common questions and themes that are raised by Chinese government strategy and actions around the world.

China is playing a greater and greater role on the world stage. As it does so, the scrutiny of its actions and its intentions is, not surprisingly, also growing. There is much to question.

The Chinese government likes to characterize itself as engaging in a "peaceful rise." Yet, its active engagement with and assistance to countries which others in the international community have condemned as human rights abusers or threats to international peace raise serious questions about its intentions. And the world's understanding of China's intentions globally, like most of its governmental

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In Africa, for example, China seems focused on resource-rich states, buying up oil, natural gas, and other minerals, from the Sudan, Chad, Nigeria, Angola, Algeria, Gabon and Equatorial Guinea. In 2005, Chinese official sources reported total investment of \$175 million in African countries, primarily on oil exploration and infrastructure projects. When China signs an oil contract, development aid often follows in the form of medical supplies, infrastructure investment, debt relief and lowered trade barriers. International organizations have reported more than a few cases where China has ignored standards of international law, humanitarian concerns, and human rights when these conflict with China's resource acquisition needs. How are Chinese investment practices affecting U.S. initiatives to increase the effectiveness of foreign assistance, to promote transparency and accountability, and to end human rights abuses?

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Thank you, again, Mr. Chairman and our witnesses. I look forward to their statements. At this time, I will turn over the microphone to Commissioner and Hearing Co-Chair Dan Blumenthal for his opening remarks.

## **OPENING STATEMENT OF DANIEL BLUMENTHAL, HEARING COCHAIR**

**HEARING COCHAIR BLUMENTHAL:** Thank you, Commissioner Bartholomew, and thank you to all of you in attendance today.

Last year former Deputy Secretary of State Robert Zoellick laid out a sophisticated framework for U.S.-China policy. He urged China to become a, quote, "responsible stakeholder in the international community." China, he said, "has a responsibility to strengthen the international system that has enabled its success."

For the United States and the world, he said, the essential question is how will China use its influence? At the hearing today and tomorrow, we're going to ask this question: how is China using its influence?

Though Zoellick identified concerns about China's domestic behavior, today our topic will be China's international behavior. The Deputy Secretary pointed to concerns about China seeking to "lock-up" energy supplies. He urged China to play a constructive role in ending the genocide in the Sudan. He spoke of regional anxiety about China's military modernization and threats to Taiwan, concerns that China is not merely engaging with the Southeast Asian nations but positioning for a



role of predominant power.

As a member of the Permanent Five of the Security Council, China has used the threat of a veto to block U.S.-supported measures intended to end the genocide in the Sudan, punish North Korea for a host of violations of its international commitments, and persuade Iran to abandon its quest for nuclear weapons.

During the past decades, China has greatly expanded its involvement in regional organizations in the Shanghai Cooperation Organization. China was a founding member of the SCO, established in 2001 as a mechanism for economic and security cooperation among Russia, Central Asia and China.

Since that time, the SCO has not only called for the removal of U.S. troops in Central Asia in support of operations in Afghanistan, but has also turned down the United States' request for observer status while that status has been granted to Iran, Pakistan, India and Mongolia.

Within Southeast Asia, China has embarked on an ambitious agenda to secure trade and diplomatic agreements at a time when U.S. trade in the area is declining.

While the United States certainly supports free trade, China's activities raise concerns that it is using commercial diplomacy to increase its influence at the expense of the United States. Secretary Zoellick laid out a sophisticated China policy, but it will only work if the world's responsible stakeholders hold China accountable to that vision and if there are some penalties for acting irresponsibly.

We believe Congress may have a role in helping with such monitoring as does this Commission. I look forward to today's testimony and we will now turn to today's first panel.

This morning we are pleased to have Senator Inhofe joining us. He is the chairman of the Environment and Public Works Committee and the third ranking member of the Senate Armed Services Committee, which recently held hearings on the Pentagon's report about China's military modernization.

We'd like to express our appreciation to Senator Inhofe for his support for our Commission's work. The support was most clearly demonstrated when he offered the amendment to the 2006 Defense Authorization bill calling on the president to establish a plan to implement the Commission's recommendations in its 2004 report.

A modified version of that amendment was accepted by unanimous consent and became law when the president signed the bill. The senator was also one of the earliest to recognize the problems of the CFIUS process and to offer legislation to address that problem.

Thank you very much, Senator Inhofe, for being here today and for sharing your thoughts and concerns. We look forward to your comments.  
[The statement follows:]

## **Prepared Statement of Daniel Blumenthal, Hearing Cochair**

Thank you, Commissioner Bartholomew, and thank you to all in attendance today. Last year former Deputy Secretary of State Robert Zoellick laid out a sophisticated framework for U.S. China policy. He urged China to become a “Responsible Stakeholder in the International Community.” China, the Secretary said, “has a responsibility to strengthen the international system that has enabled its success.” “

For the United States and the world, the essential question is – how will China use its influence?” That is the topic of our hearing today – how is China using its growing influence?

Though Zoellick identified concerns about China’s domestic behavior today we will touch upon China’s international behavior. The Deputy Secretary pointed to concerns about a China seeking to “lock-up” energy supplies, he urged China to play a constructive role in ending the genocide in the Sudan, he spoke of regional anxiety about China’s military modernization and threats to Taiwan, concerns that China is not merely engaging with ASEAN but seeking to gain a position of pre-dominant power.

As a member of the P5 of the Security Council, China has used the threat of a veto to block U.S.-supported measures intended to end the genocide in the Sudan, punish North Korea for a host of violations of its international commitments, and to persuade Iran to abandon its quest for nuclear weapons.

During the past decades, China has greatly expanded its involvement in regional organizations such as the Shanghai Cooperation Organization (SCO) and the Association for Southeast Asian Nations (ASEAN). China was a founding member of the SCO when it was established in 2001 as a mechanism for economic and security cooperation with Russia and four Central Asian republics.

Since that time, the SCO not only has called for the removal of U.S. troops in Central Asia supporting operations in Afghanistan, but has also turned down the United States’ request for observer status while that status has been granted to Iran, Pakistan, India and Mongolia.

Within Southeast Asia, China has embarked on an ambitious agenda to secure trade and diplomatic agreements—at a time when U.S. trade in the area is declining. For example, China’s and ASEAN’s plan to establish a free trade agreement has produced a schedule of tariff reductions among these nations. When it is fully established, this free trade area will encompass approximately 1.9 billion people and will support \$3.0 trillion in combined trade.

China also is using trade, especially in Asia, to isolate Taiwan economically in the region. China also is doing all it can by means of its efforts to expand its influence through Asia to minimize Taiwan’s interactions with regional organizations.

While the United States certainly supports free trade, China’s activities raise concerns that it is using commercial diplomacy to increase its influence while reducing that of the United States.

Secretary Zoellick laid out a sophisticated China policy. But will only work if the world’s responsible stakeholders hold China accountable to that vision and if there are penalties for acting irresponsible. Perhaps the Congress has a role in helping with such monitoring. I look forward to today’s testimony.

Thank you, and now we’ll proceed to our first panel.

## **PANEL I: CONGRESSIONAL PERSPECTIVES**

### **STATEMENT OF JAMES M. INHOFE A U.S. SENATOR FROM THE STATE OF OKLAHOMA**

SENATOR INHOFE: Thank you and thank the whole Commission for what you've done. I think you've been doing the Lord's work, but I just wish that more people were aware of what you're doing and some of the results and some of your findings. I know it's been a difficult job for you.

Let me just share a few thoughts that I have on my checklist. Last year I gave four speeches on the Senate floor. Each one was quite lengthy. In fact, I was giving a talk yesterday, and I said if anyone has insomnia, just pull up my Web site and read my China speeches, but I did talk in some detail, much more detail obviously than we'll be able to get into today.

But in the speeches on China's growing global influence and the impact it has on our national security, these issues covered such a broad spectrum from the alarming rate of increase in the military modernization to the lack of economic accountability. I testified before this Commission, I guess a year or so ago, and it was a very concerning picture then, and while the media has turned its attention to other issues--and that's not quite fair to say, because I don't think the media ever has really focused on this issue-- the threat continues to grow.

China is sustaining a ten percent economic growth. For some years now, their oil consumption and their needs have continued to rise exponentially, doubling and doubling again. China's military spending has gone up in double digits. Let me just share a personal experience.

I have a reason to be in Africa quite often. It started out as kind of a ministry thing, and now I'm helping with the developing of the African Brigades. Everywhere I go where there are really big oil reserves, whether it's the Sea of Guinea, or Nigeria, or Benin, everything that is new and shiny is built by the Chinese. I have to say what they are doing it smart. They're smarter than we are because they go in there, and I don't care where it is, where you go, you'll see that they are building things. Now, we watch this take place over a period of time and it's really disconcerting.

Let me just run over a few things. The human rights problems. China does continue to repress certain religious groups including Christians. They have brutally cracked down on any organized groups that they view as a threat to the party rule.

In proliferation, China is a proven violator of nonproliferation treaties--we know that--that keep such countries from access to delivery systems, system technologies. In 2003, a CIA report to Congress that firms--I'm quoting now--"firms in China provide dual use missile-related

items, raw material and/or assistance to countries of proliferation concern such as Iran and North Korea."

Look at the countries we are having problems with today. It's Iran and North Korea. In Iran, China has continued to support Iran. Remember the \$72 billion deal and now 13 percent of the total oil that is used by China comes from Iran. Just two days ago, China signed a \$2.7 billion oil refinery upgrade with Iran. So I see these things as things that are really serious problems.

I mentioned Africa because the saying in Africa is "the United States tells us what we need and China gives us what we want." And that's true because if it's a conference center in Benin or it's a stadium in the Congo, nonetheless, it's there.

In South America, we see Venezuela, the anti-American President Hugo Chavez enjoys a \$3 billion trade strategy with China including provisions for oil and gas.

Our SouthCom Commander, General Craddock, has been concerned about what's happening now in South America. He says China is increasing its influence in South America, filling a vacuum left by the United States. In his March 9, 2005, House testimony, General Craddock called China's progressing interest in the region "an emerging dynamic that could not be ignored."

Industrial base. Some of the experts believe that China is attempting to undermine the United States industrial base and likewise the defense industrial base. I have a direct quote from the book *Unrestricted Warfare*, and I think it's one that I would recommend the reading of this book. It was written by two of the PLA colonels. And it says, and I'll quote just a couple of sentences out of it. It said:

"Military threats." This compares the problems, how they can change it around from a military threat to an industrial threat or an economic threat--"military threats are already no longer the major factors affecting national security. Traditional factors are increasingly becoming more intertwined with grabbing resources, contending for markets, controlling capital, trade sanctions, and other economic factors. The destruction with they do in the areas attacked"--that's us--"are absolutely not secondary to pure military wars."

Unless our relationship with China is backed up with strong action, they will never take us seriously. We'll certainly see more violations of proliferation treaties. They'll continue to manipulate regional and global trade through currency undervaluation and other unhealthy practices. They will develop oil resources and energy alliances with countries that threaten international stability.

They'll continue to escalate the situation over Taiwan, raising the stakes in a game neither country can win. In today's world, we see how the unpaid bills of the past come back to haunt us in full.

I'm not saying that it's all bad. Hopefully some good changes are

taking place. In North Korea right now, China has recently made steps that appear to be in the right direction. In some other areas, some good steps are taken. You mentioned, Commissioner, in your introduction of me, that we had the problem with CFIUS. We're making some changes in CFIUS, but when you stop and think that we had a system in place that was supposed to allow us to look at different trade opportunities, different mergers, business activities that are going on, and evaluate what does that do to our national security, we weren't doing it.

The best evidence: they have had 15,000 applications. Only one was denied and that was by George I, so clearly it wasn't working, and it was run by people who really just were concentrating on one thing and that's doing business with China. Business is good, totally ignoring the threats that could be out there.

If there are questions and want to know what is in this legislation that has changed, I'd be glad to respond to your questions, but nonetheless, I think that's something that is improving.

The U.S.-China Economic and Security Commission that was created to give Congress a clear picture about what's going on, you've done your job, but we haven't done our job. Let me just ad lib a couple of observations that I've made.

I've been in the Senate since 1994. I came to the House eight years before that, and I served all that time, most of that time on the House and the Senate Armed Services Committee. During the '90s when I saw the tearing down of our military during the Clinton administration, during that same period of time that we went down in terms of our modernization program, the veto on such things as the THAD missile--that's the Theater High Altitude Area Defense System--the troop strength, going down to about 60 percent of what it was before, this euphoric attitude that the Cold War is over, we no longer need a military. At that same time, China had increased its military procurement by 1,000 percent.

I remember so well in the first month of the Clinton administration, the first thing they did is go into the energy labs and take away the security, do away with background checks, do away with color-coded IDs. And as a result, the Chinese were able to get virtually everything we had. So I've been watching this take place over a period of time.

It's very discouraging to me, and here we are after going through the '90s of the demise of our military, and all of a sudden 9/11 happens, and then we're in war, and we're trying to prosecute a war, at the same time rebuild a military.

So China does have an effect on all these things that we do. I know we all know that there is a relationship between China and some of the countries that I mentioned earlier in my statement. So with that, I would say this: you've done your job; you're continuing to do your job. We haven't done our job; the media hasn't done its job, in listening to the recommendations, the findings that this Commission has come up with.

So I'm very proud of you, but I'm not very proud of us.  
[The statement follows:]

**Prepared Statement of James M. Inhofe  
A U.S. Senator from the State of Oklahoma**

- Thank you. I want to say how much I appreciate and support this Commission. Your hard work has given us the information we need to get an accurate picture of the very puzzling issue of China's growth. I have long followed your work, and continue to utilize your expertise.
- Last year I gave four floor speeches on China's growing global influence and the impact this has on our national security. These issues covered a broad spectrum, from alarming military modernization to the lack of economic accountability. I testified before this Commission--it was a very concerning picture then, and while the media has turned its attention to other issues, the threat continues to grow.
- China is sustaining a 10% economic growth for some years now. Their oil consumption (and need) continues to rise exponentially, doubling and doubling again. China's military spending growth has been in the double-digits for almost two decades, and that isn't including large portions that we know they are hiding.
- Yet the threat here is not the simple fact that China is growing, but it is doing so by using some unhealthy practices that threaten the world community and will undercut any long-term progress they hope make.
- Allow me to emphasize some areas that I view with particular concern:
  - **Human Rights:** China continues to repress certain religious groups, including Christians. They have brutally cracked down on any organized groups that they view as a threat to Party rule.
  - **Proliferation:** China is a proven violator of non-proliferation treaties that keep such countries from access to delivery system technology. In 2003 the CIA reported to Congress, that "firms in China provided dual-use missile-related items, raw materials, and/or assistance to ... countries of proliferation concern such as Iran ...and North Korea." Look at the countries we are having problems with today: Iran is developing nuclear capabilities, and North Korea continues to develop its long-range missile program. We know China uses proliferation as a tool to gain influence.
  - **Iran:** China has continued to support Iran:
    - China gets 13% of its energy resources from Iran. Naturally, China has dragged its feet to allow the U.N. Security Council to holding Iran economically accountable for its nuclear program.
    - Two days ago, China has signed a 2.7 billion dollar oil refinery upgrade deal with Iran.
  - **Africa:** We know that China is developing Africa as a source of resources, export markets, and diplomatic support.
    - Gulf of Guinea, oil reserves
    - Benin: conference center
    - Congo: stadium

- “US gives us what we need, China gives us what we want”
  - **South America:**
    - In Venezuela, anti-American President Hugo Chavez enjoys a \$3 billion trade strategy with China, including provisions for oil and gas.
    - Army General Bantz Craddock, who heads the United States Southern Command, stated that China is increasing its influence in South America, filling a vacuum left by the U.S. In his March 9, 2005 House testimony, General Craddock called China's progressing interest in the region "an emerging dynamic that could not be ignored.”
  - **Industrial Base:** Some experts believe that China is attempting to undermine the U.S. industrial base and likewise, the defense industrial base. I have a direct quote from the book *Unrestricted Warfare*, written by two PLA (People's Liberation Army) senior Colonels:
    - “Military threats are already no longer the major factors affecting national security... traditional factors are increasingly becoming more intertwined with grabbing resources, contending for markets, controlling capital, trade sanctions and other economic factors...the destruction which they do in the areas attacked are absolutely not secondary to pure military wars.”
- Unless our relationship with China is backed up with strong action they will never take us seriously. We will certainly see more violations of proliferation treaties. They will continue to manipulate regional and global trade through currency undervaluation and other unhealthy practices. They will develop unreliable oil sources and energy alliances with countries that threaten international stability. They will continue to escalate the situation over Taiwan, raising the stakes in a game neither country can win. In today's world we see how the unpaid bills of the past come back to haunt us in full; ignoring these problems is unacceptable.
- I am not saying that we are doomed to a confrontation with China. I believe that if we properly address these problems, like pruning a tree, we will encourage China to become a responsible stakeholder and enable a healthy relationship between our countries. But we must act.
- I haven't come today to just deliver bad news:
- **North Korea:** China has recently made steps in the right direction by
  - Publicly condemning the recent missile tests by signing the UN Security Council resolution
  - Freezing North Korean bank accounts in Macao last week
- Another area where some good steps have been made is in addressing the shortcomings of the **CFIUS** review process. Last year we discussed how the process is “broken”. I believe that I can come before you today and say that we have made headway.
- As you know, the Committee on Foreign Investment in the US (CFIUS) is the panel that reviews foreign transactions and buyouts of US companies. This raised great concern because, quite simply, they weren't doing their job.
  - Out of over 1500 transactions reviewed, only one merger was stopped. This reflected a porous system which allowed companies to participate and withdraw when it suited their best interests.

- I pushed hard to change this, introducing a stand alone bill to make some of the necessary changes, and it was since taken up by Banking Committee. The bill that they voted out was approved in the Senate by Unanimous Consent on July 26. Allow me to go over some of the changes:
  - The Secretary of Defense is named Vice Chairman of CFIUS
  - Defines national security and the factors CFIUS and the President need to take into consideration before rendering a decision in the process.
  - Notification related to transactions affecting national security are now mandatory
  - Investigations of transactions shall be completed even if the filing is withdrawn by the applicant
  - Submission of a yearly, cumulative report of all acquisitions to oversight committees
- These are just a few of the changes that I believe will go a long way in ensuring the security of our dual use technology and economic base. It's not perfect, but it's a start.
- We must deal with China now, because right now we have leverage. We are a major supplier of technology to China, and the key leader on the world scene. This is the time we have to affect change if we ever will.
- The US-China Economic and Security Review Commission was created to give us in Congress a clear picture about what is going on—and you have done your job well. Now we in Congress must do ours. Thank you.

### **Panel I: Discussion, Questions and Answers**

HEARING COCHAIR BLUMENTHAL: Thank you very much, Senator. Do you have any time for questions?

SENATOR INHOFE: Sure.

COMMISSION VICE CHAIR BARTHOLOMEW: Senator Inhofe, thank you very much for your leadership and also I'd like to acknowledge the humanitarian work that you've been doing to help people in Africa which is extraordinary and very important.

SENATOR INHOFE: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: It's Africa that I want to ask you about. The Bush administration has tried a new way with foreign aid with the Millennium Challenge Corporation, which is supposed to be increasing transparency and accountability, good governance, all of these issues, to make foreign aid more effective.

As you have watched the way that the Chinese government is providing foreign assistance in Africa, are they providing it with any strings attached? Is it going to cause problems for us as we try to implement more transparent, more accountable and more good government activities in these countries?

SENATOR INHOFE: Yes, it's been my observation that strings are always attached. I could go country by country on things that we're trying to do, in East Africa, in Tanzania, Rwanda, Burundi, Uganda, and then West Africa too, Benin and Ghana and Cote d'Ivoire--I see what we're trying to do, and yes we're the good guys there. The program I think is



working. Some of the countries are participating; some are not.

But the difference is this. I mentioned the things that are built, the coliseums, the bridges and all these water systems and everything, they're out there-- and while I have never seen a document that says that there are strings attached, I do know that when they took their action up in the Sudan and refused to go along with us, all of a sudden they began importing oil from Sudan. That isn't just a coincidence.

So I would have to say that while I have never seen documents where strings are attached, I would bet my life they are.

COMMISSION VICE CHAIR BARTHOLOMEW: Different kinds of strings, of course, than the conditions that we put on our foreign assistance?

SENATOR INHOFE: Yes, those are to fill voids that China has. Let's keep in mind, the United States and China are the number one and number two countries in terms of our reliance upon foreign countries for oil or for our ability to fight a war, you could say. So while they go in, I said they're doing it smarter than we are, I don't approve of the way they're doing it, but they're getting results, and we're not getting results.

So I would say this: any kind of aid that goes in there, humanitarian aid or anything else, I hesitate to say humanitarian aid--they're not doing much in areas like northern Uganda where we have the problem of Joseph Kony for 30 years has been murdering kids and disfiguring them, and up in Sudan, we know what's happening in Darfur. They're not any help there. So their heart is not there. But when they do something, I have no doubt in my mind that the strings are attached.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you.

HEARING COCHAIR BLUMENTHAL: Senator, in my opening remarks, I referred to Deputy Secretary Zoellick's China policy, as he articulated it, of becoming a responsible stakeholder in the international system, and I said that it probably won't work unless you can't hold them accountable and actually have some penalties for not being a responsible stakeholder.

What your thoughts are in that regard? What do we do? We know about the violations and we know about the bad behavior, but what do you think the U.S. government and the U.S. Congress can do to start to hold China more accountable for some of its bad behavior?

SENATOR INHOFE: Yes, Commissioner, I mentioned that in my opening statement that they are not accountable. On the proliferation problems that we're having, it's there. I go back to Reagan, he said "trust but verify." We're trusting, but we're not verifying, and I think they understand that.

I think we have to have accountability tied to everything that we do so that it is a measurable accountability, and we know that it's happening, and this has not been the case as I mentioned in my opening statement. Hopefully, we will.

HEARING COCHAIR BLUMENTHAL: Commissioner D'Amato had a question.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman, and thank you, Senator Inhofe, for your continued support for the Commission's work and your good work on the China issue, CFIUS and other issues.

I wanted to mention that the subject of this hearing has to do with China as a stakeholder and the growing competition between the United States and China in the energy area. Assuming that the supply of energy is going to be finite and this competition is going to grow, do you think it is productive for the United States to try to engage China in the development of cooperative mechanisms to mitigate some of this competition and try and bring China into cooperative solutions on alternative energy supplies and sharing in the event of supply disruptions to try and keep supply and price under control through the IEA and these sorts of things?

This has been proposed by the Commission, but the administration has not really taken us up on it in terms of the summit process. But it still seems to me to be a growing problem where we might be able to be the country that proposes some kind of institutional mechanisms to build a cooperative framework here.

SENATOR INHOFE: Yes, I think we should. I chair the Environment and Public Works Committee, as the Commissioner said, so I have probably more to do with energy than even the Energy Committee does. And it is a crisis here, and I'm one who believes that oil, to start with, we've got to have that. The technology is not here that we can just throw that out the window like some of the left environmentalists might think.

We need nuclear energy. We need fossil fuels. We need clean coal technology. We need renewables and China does, too. I think it would be worthwhile for two reasons--to have some kind of a forum where we are trying to mitigate, jointly do these things. Since we have the same problem, let's try to solve it together.

Number one, there's an outside chance it might work, but if it doesn't, then it's become visible and people will see that we have made that effort and it's not working. So if you have a verifiable way to set that up so we can address our mutual problems because our problems are the same in terms of energy reliance. I've read your recommendations--they're excellent recommendations, and I think that we should--in fact, I'll make a point to try to encourage the administration to follow those recommendations.

COMMISSIONER D'AMATO: Thank you very much, Senator.

SENATOR INHOFE: Yes, sir.

HEARING COCHAIR BLUMENTHAL: Thank you. Chairman Wortzel.

CHAIRMAN WORTZEL: Thank you very much, Senator, for your

testimony here and for your support for the Commission.

Senator McCain in an interview recently made it clear that it was a Chinese cruise missile provided to Iran that Hezbollah used to attack that Israeli ship recently. These Chinese exports are more and more sophisticated, and more and more able to evade advanced electronic countermeasure systems. I wonder if you have any specific recommendations on how we can toughen our export control laws, especially with respect to Europe where companies are providing advanced military technologies to China.

SENATOR INHOFE: Yes, that was critical back in the early '90s of the Clinton administration. One occasion comes to mind when it took a waiver for President Clinton to sign. You had to sign a waiver in order to allow us to sell to China a guidance system for their missiles. And it ends up that was the Loral Corporation that made them. Bernard Schwartz was chairman of the Loral Corporation who is also the number one contributor to the Democratic Party.

All that can't just be a coincidence, but that along with what has happened in our energy labs, we have lost a lot of technology. And it's something that is not, hopefully, that is not taking place today. But it did, and I'm not sure what they have, but I do know this. Back in 1998 when John Jumper was a two-star general, he did a very courageous thing. He stood up and was willing to say publicly--that was toward the end of the Clinton administration--that we have a real serious problem with our modernization program, that the best strike vehicles we have are F-15 and F-16.

The Russians were making SU, at that time actually using SU-27s, and they had SU-30s on the drawing board but not made yet. China, in one purchase at that time, and it was not classified, purchased 240 of those SU-27s, better than what we have. I'm not sure what we have that they don't have right now, but certainly we've seen the light, and we're going forward with our Raptor and the Joint Strike Fighter and we're going to try to get back up where we should be. What I'm saying is that we've known about the nuclear capability, the delivery systems. We've known about this technology that China has had for a long time.

But in conventional warfare, they now are in a position where we never dreamed in the early '90s that they would be.

HEARING COCHAIR BLUMENTHAL: Thank you.

SENATOR INHOFE: We have an Armed Services hearing with Secretary Rumsfeld and General Pace that I'm supposed to be at in just a second here so I'll probably have to go.

CHAIRMAN WORTZEL: I'm glad he's coming.

SENATOR INHOFE: Right. But I do, again, before you came, Mr. Chairman, I was very complimentary in the work that you've done, the work product, and thank you so much for your service.

HEARING COCHAIR BLUMENTHAL: Thank you very much,

Senator.

[Whereupon, a short break was taken.]

## **PANEL II: ADMINISTRATION PERSPECTIVES**

HEARING COCHAIR BLUMENTHAL: We're going to get started. Chairman Wortzel would like to make a remark.

CHAIRMAN WORTZEL: I want to welcome Deputy Assistant Secretary Christensen to the hearing and to the government. I want to thank him for his service to the United States and in the administration. I'm very pleased to see that he's joined the government. I've known him in the academic community and in the policy community, and I think he'll make a great contribution to our nation.

Tom, the floor is yours.

### **STATEMENT OF DR. THOMAS CHRISTENSEN DEPUTY ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS, WASHINGTON, D.C.**

DR. CHRISTENSEN: Thank you very much. I'd like to thank Chairman Wortzel, Cochairs Bartholomew and Commissioner Blumenthal, and the other Commissioners for inviting me here today. I've addressed this Commission before with Dan Blumenthal at my side, but I've never done so as a government official and never while Chairman Wortzel was running the Commission.

Larry has been a generous colleague and a friend throughout my professional career, and he's also been a fine example of the importance of public service for me. So it's a particular honor to address the Commission under his leadership today as I start my role in the U.S. government, which I began on July 17.

I submitted a longer version of my comments today in written form, so I'll speak more briefly this morning about some of the main points in that longer testimony. I wanted to start by saying that we're all aware that last September, Deputy Secretary Robert Zoellick made a very important speech in New York to the National Committee on U.S.-China Relations.

In that speech, he noted that China was already fully integrated into the international economy and was already a member of the most important international institutions.

He challenged China in that speech to move past simple integration in the international system and to adopt a leadership role, a proactive leadership role, to help create a more stable and constructive international system. He used the term "responsible stakeholder" to describe that role that he envisioned for China's future.

I want to emphasize I think it has been a mistake about the speech--

that often occurs--that Deputy Secretary Zoellick was talking about a vision for China's future. He wasn't describing China today as the responsible stakeholder that he hoped China would become.

His speech instead lays out a vision for the future and challenges China to adopt over time the international and domestic policies necessary to fulfill that vision, that hopeful vision for China's future.

His speech also lays out a U.S. strategy, a strategy designed to create the conditions under which China is more likely to accept these important roles in the international system and to become that responsible stakeholder.

So today what I'd like to address is how well we're doing in encouraging China to become that responsible stakeholder that Deputy Secretary Zoellick envisioned for the future.

In a nutshell, I'll argue that we're doing well, and that there's reason for optimism looking forward. The picture is, of course, mixed, and we're doing much better in some areas than others and we continue to work hard to make progress on these issues.

One main reason for optimism about the future is that the Bush administration has adopted a very sound strategy toward China and, toward this issue, engaging China on areas of common interest to expand cooperation, while maintaining the array of U.S. capabilities in the region necessary in case China chooses a path other than the one we envision for China's future.

We engage China, as you know, in all the major international organizations and regional organizations including the United Nations, the World Trade Organization, the ASEAN Regional Forum and APEC.

We also engage China on an array of bilateral exchanges, on economics, energy, and transnational issues including infectious diseases, migration and the environment.

We use these dialogues to encourage China to adopt a responsible position on these key issues, these key international issues, but we also, and this is important, we also urge China to respect human rights and religious freedom and to open up its domestic political system to greater freedom, democracy and the rule of law for its own people.

When we do this, we emphasize that the most successful and stable countries in the world are liberal democracies that protect human rights, and in the process we attempt to put to rest the argument that one often hears in China that U.S. promotion of democracy and human rights is a thinly veiled attempt to weaken the Chinese nation and to prevent China's rise on to the international stage as a great power.

We are clearly not trying to contain China's growth and there's no better example of that than Deputy Secretary Zoellick's speech which not only claimed explicitly that we were not trying to contain China's growth and influence but actually invited China to play a more influential role in the international system, albeit an influential role that fits China's

interests, the U.S. interests and the global interests in stability and prosperity.

So how are we doing? Overall, I would argue that the trend lines are good, but that there's much more progress in some areas than others, and I'll list some of the areas where I think we've made progress and I'll list some of the areas where I think there are outstanding problems and there is much less progress.

The most positive example I can think of is cooperation with China on the North Korean nuclearization issue.

China helped found and has hosted the Six Party Talks. It helped broker the September 2005 Joint Statement committing North Korea to denuclearization, and it helped broker and voted for U.N. Security Council Resolution No. 1695, an important resolution which condemns North Korea explicitly for its missile tests, and calls on U.N. members to be vigilant and to prevent certain transactions that might assist North Korea's missile and weapons of mass destruction programs.

As a China specialist for many years, I can say several years ago, it would be hard to imagine China playing such a proactive role in multilateral security institutions and condemning North Korea, and pushing such concrete measures on U.N. members to constrain North Korea's capabilities.

So I think that this is real progress. Obviously, the North Korea issue is a very difficult issue and we're not satisfied with the progress on the North Korean side, but China has been a constructive actor on this issue and we continue to urge China to play an even more proactive role in urging North Korea to return to the Six-Party talks and to denuclearize.

On Iran, China has in the last year supported the P5 Plus One package of incentives and disincentives that call for Iran to stop nuclear weapons related activity including the enrichment of uranium.

China last week supported U.N. Security Council Resolution 1696 which calls on Iran to respond positively to that P5 Plus One package by August 31, and we'll continue to work with China as that date approaches to prepare appropriate measures if Iran is not forthcoming by that deadline.

On Sudan, obviously we've been very disappointed with China's support for the regime in Khartoum because of the massive violations of human rights in Darfur. There's been some progress on this area, however, even in this area, with the Chinese agreeing to deploy peacekeeping forces to the south of Sudan and offering at least conditional support to date for the idea of rehatting the African Union troops to become U.N. peacekeeping forces in Darfur.

We'll continue to work on this issue and we'll continue to urge China to use its influence in Khartoum to elicit better behavior from that regime, and we remain extremely concerned about the humanitarian crisis in that country.

In Burma, we're also not satisfied with China's approach and we continue to engage China in dialogue trying to get China to use its influence in that country to push for positive change.

On functional issues, we've also made progress, and I'll describe some of those issues, and on other issues we've had less progress. We have cooperated in the global war on terror. Despite remaining problems on IPR and currency issues, we've had some successes on the economic front as well. The Joint Commission on Commerce and Trade in April reached some important agreements related to operating systems and software being put on Chinese computers before they're sold, thus reducing the incentives for software pirates to pirate software and to sell that software on the black market.

The trade deficit is very large with China, but since China became a member of the World Trade Organization, its markets have opened and U.S. exporters have benefited from that opening. Exports from the United States in the five years since China has joined the WTO have doubled.

Obviously, there are still some problems there and we can address some of those problems perhaps in the Q&A.

We cooperated with China at APEC on issues like the spread of avian flu so there are various issues of cooperation on transnational issues as well, but there are real problem areas, and we don't want to gloss over those problem areas, and we engage China in a very frank and candid way when we have such problems.

One of the outstanding problems is the issue of human rights and religious freedom and political reform in China more generally. We believe that China's record on these scores is very poor and we continue to push for a results-based dialogue on human rights and religious freedom, not just a dialogue for its own sake.

We encourage Chinese political liberalization more generally and will continue to do so in all of these channels as we move forward. On military affairs, we're also not satisfied. We're realistic. We understand that as China's economy grows and as China modernizes as an economy and a society that it will try to build more modern military forces. We understand that, but we're concerned about the pace and the lack of transparency in Chinese military modernization and we're particularly concerned about the fast-paced build-up across from Taiwan, particularly since the second half of the 1990s.

There has been some recent progress on this front. Secretary Rumsfeld had a successful trip to China last fall, and General Guo Boxiong, the highest ranking military officer in China, recently visited the United States in July and that trip was also considered successful by both sides.

In addition, President Hu and President Bush have agreed to have exchanges between STRATCOM, the U.S. Strategic Command, and the Chinese Second Artillery. This is important because one of the things we

need to understand moving forward are changes in Chinese doctrine.

In conclusion, I'll just say that I think the results of these processes are mixed, but the trend lines are good given where we started from. The thing that makes me optimistic, although cautiously optimistic, is that we have a successful strategy in place, and I'm honored to be included in the administration to help further that strategy looking forward and I'm hopeful that we can be successful in pushing the strategy and making progress in the years to come.

Thank you very much, and I look forward to your questions.  
[The statement follows:]

**Prepared Statement of Dr. Thomas Christensen  
Deputy Assistant Secretary of State for East Asian and Pacific Affairs,  
Washington, D.C.**

Chairman Wortzel, Hearing Co-chairs Bartholomew and Blumenthal, Commissioners, thank you for inviting me to join you to discuss this extremely important topic, an issue that has important implications for our future. China's rising influence on the global stage is presenting all countries, as well as key global institutions, with new challenges. What role will China, as an emerging power, play in global economic and security organizations? Will China use its rising influence in ways that are compatible with U.S. interests, or will it seek to advance interests that undermine the global system, and the peace and prosperity it has provided for so many around the world? Will China's increased wealth and worldliness lead to a more open, transparent, and stable society at home? In short, will China emerge as a responsible global stakeholder or not? This is a question of vital concern to U.S. diplomacy in the 21<sup>st</sup> century and the answer to it will say much about what type of world we will see in the coming decades.

Almost a year ago, former Deputy Secretary Zoellick gave a speech in New York that made an important contribution to the debate over where China was headed and what U.S. policy should be in response. In that speech, he spoke of the vision and hope of China as a responsible stakeholder in the global system, a system in which China is already highly integrated and from which China was already enjoying substantial benefits. It is important to note, however, that former Deputy Secretary Zoellick did not say China currently is the responsible global stakeholder that he envisions. Rather, he emphasized that U.S. policy should focus on urging China to become such a responsible global stakeholder. This is in fact the crux of U.S. policy toward China today, a policy that combines active engagement to maximize areas of common interest and cooperation, along with a recognition that we need to maintain strong U.S. regional capabilities in case China does not eventually move down a path consistent with our interests. As our relationship with China continues to expand, we seek to encourage China to join us in actions that will strengthen and support the global system that has provided peace, security and prosperity to America, China, and the rest of the world. As President Bush said when he welcomed Chinese President Hu to Washington in April, the U.S. welcomes the emergence of a China that is peaceful and prosperous, and that actively participates in and contributes to international institutions. As former Deputy Secretary Zoellick argued so clearly, we do not seek to contain China, but rather to help channel China's growing influence in a positive direction.

On the diplomatic front, we are working closely with China, engaging on an extremely broad range of issues in which we believe China and the U.S. have common interests. This includes many issues in which there are readily identifiable common objectives and we work cooperatively with China to create the means to achieve those objectives. It also includes issues on which we do not see eye-to-eye. On these issues we also engage, and we do so in a frank and candid manner that ensures that U.S. views are made clear. Our engagement with China takes place in many different forums, both bilateral and multilateral, and at many different levels. But it always has the same objective: seek to identify and maximize the areas



in which we have common interests, build upon those interests to mutual benefit, and, in those areas in which we differ, encourage China to understand our concerns and change its behavior in ways that will advance not only our interests, but also its own.

Let me provide some examples. The U.S. works actively with China in most major international organizations, from the United Nations to the World Trade Organization, to regional organizations such as the ASEAN Regional Forum (ARF) and Asia-Pacific Economic Cooperation (APEC). Bilaterally, we engage China on economic issues through such annual meetings as our Joint Commission on Commerce and Trade (JCCT) and Joint Economic Commission (JEC). We meet with China regularly to discuss non-proliferation issues, counterterrorism cooperation, law enforcement cooperation, global issues from environment to health, and science and technology cooperation. The Senior Dialogue, started by former Deputy Secretary Zoellick, along with our long-standing economic policy dialogue with China's National Development and Reform Commission (NDRC), provide further opportunities for discussions at a broader, more strategic level. And, in addition to all of these regularly-scheduled meetings, each year we have an extremely robust schedule of exchanges between key policymakers. Most recently, for example, President Bush met with President Hu in Washington in April and in St. Petersburg in July. Chinese Vice Premier Wu Yi visited here in April; China's senior defense official and senior law enforcement officials visited here in July. In fact, it seems that hardly a month goes by in the year that we do not have a cabinet-level visit, either here or in China. Congressional exchanges are also numerous and frequent.

The U.S. uses each and every one of these opportunities to encourage China to work with us, in advance of common interests, to build and strengthen the global system, advance global peace, security and prosperity. We also use them to urge China to move more quickly toward strengthening respect for human rights and religious freedom, as well as introduce democracy to its system. We make clear to China that doing so is in China's own interests. A nation that is free and democratic, that respects and protects basic human rights, including the freedom to worship, is a nation that is more stable domestically and more respected internationally. As China engages the other great powers, its leaders and people will learn that wealthy and stable countries are liberal democracies. In engaging China and expanding our cooperation on areas of mutual interest, we are in effect encouraging China to act as a responsible global stakeholder. In short, the concept of China as a responsible global stakeholder is not only our objective, but a framework for a process that involves building an important and mutually beneficial relationship between our two countries.

So, how are we doing in this process? What are the prospects for China playing a more positive role in the global system? On both counts, I believe the answer is good, but much remains to be seen. On the prospects for the future, I am optimistic, for a number of reasons. First, China has bet its future on globalization and its ability to succeed in the global system. The Chinese people have reaped tremendous economic benefits over the past two decades from China's opening and engagement with the global economy. China can succeed only if the global system from which it derives benefit does as well. This gives China an enormous stake in the success of the global system. Second, I believe China has realized, and will continue to find, that the more it becomes a major part of the global system, the more its interests align with those of other major stakeholders, including the U.S. I believe we are seeing indications of this on many fronts. As Secretary of State Rice noted recently in response to precisely the kind of question that was raised by the Commission for today's session, our work on North Korea at the UN is strong evidence of "the U.S.-China relationship working to solve problems in international politics." Let me touch upon this and some other examples:

North Korea. China played a significant role in hosting the Six-Party Talks and helped broker the September 2005 Statement of Principles in which Pyongyang agreed to give up its nuclear weapons program. In the past few weeks we have seen China take unprecedented actions to express concerns to North Korea over its provocative missile launches, including working with the U.S. and others to pass the very strongly worded UN Security Council Resolution 1695, condemning North Korea for its provocative behavior and calling on member nations to take concrete actions to curb international assistance to North

Korea's nuclear and missile programs. We will work further with China to find ways to urge North Korea to make the strategic choice to abandon completely, irreversibly, and verifiably its nuclear weapons program; adopt more responsible behavior; and implement the Joint Statement.

Iran. China has stated that it shares our assessment that Iran must not obtain a nuclear weapons capability. Over the past year, we have worked closely with China to find a diplomatic solution to the issue. China has publicly endorsed the package of incentives and disincentives presented by the five permanent members of the Security Council and Germany (P5+1) to Iran. On July 31, the United Nations Security Council adopted, with China's support, Resolution 1696, which requires Tehran to suspend fully its uranium enrichment-related and reprocessing activities by August 31. If Iran refuses to comply with UNSCR 1696, we will work closely with China on next steps, building on the July 12 agreement among P5+1 Ministers.

Afghanistan. China has stated publicly that it supports Afghan reconstruction and President Karzai's efforts at national reconciliation. Since 2002, China has committed \$230 million to Afghanistan, including a new \$80 million pledge at the February 2006 London Conference. China volunteered for a seat on the Joint Coordination and Monitoring Board, designed to improve civilian reconstruction assistance in Afghanistan. China also has donated non-lethal equipment to the Afghan National Police. President Karzai met with President Hu and other Chinese leaders during his June 18-22 visit and initialed eleven agreements ranging from cooperation in fighting transnational crime to efforts to boost bilateral trade.

Iraq. China backed UN Resolution 1637, which extended the mandate of the coalition military presence in Iraq, and voiced support for December's National Assembly elections. China congratulated Iraq on the formation of its new government and welcomed Iraq's leaders to visit Beijing in the future. China pledged \$25 million in assistance to Iraq at the 2003 Madrid Conference, although it has not disbursed the funds to date. And it has begun negotiations with Iraq on debt relief, which could mean forgiveness of 80% of the approximate \$5.6 billion that Iraq owes China.

Burma. Although China contends that engagement rather than isolation and sanctions will make it less likely that Burma's political situation will destabilize, China joined a UN Security Council consensus in December 2005 to discuss Burma in informal Council consultations. China knows Burma's policies have led to a steady deterioration in the country's political, economic, and social situation, posing risks -- narcotics trafficking and others -- to the entire region. We are continuing our discussions with China on Burma.

Lebanon. China has expressed deep concern over the on-going situation in Lebanon and it has called for a cease-fire. We worked closely with China in the UN Security Council to pass a Presidential Statement on Israel's firing on a UNIFIL post, which caused the deaths of four UNIFIL observers, one of them Chinese. We have been in close contact with the Chinese in explaining our position that a ceasefire must be sustainable and lasting.

Sudan. On May 16, China backed a unanimous UN Security Council resolution supporting -- in principle -- the transfer of peacekeeping operations in Darfur from the African Union to the UN. As Chair of the UNSC in April, China, despite its reflexive hostility to sanctions, refrained from blocking a UNSCR 1672 resolution imposing sanctions on four individuals accused of involvement in atrocities. This marked the first time that targeted sanctions, including a travel ban and asset freeze, have been employed since the UNSC authorized such measures in March 2005. China has contributed personnel to peacekeeping operations in southern Sudan and has said that it would consider assisting a UN mission in Darfur.

Global Health. We've come a long way in this area. For example, China hosted a donors' conference in January 2006, where nearly \$2 billion was committed by donors to combat avian influenza. We are seeing increased transparency, quicker notifications and sharing of information with the World Health Organization, the U.S. CDC and other experts at combating global disease.

Energy security. I know this is an area of particular interest to the Commission. Our interests would suggest that China and the United States, as the world's two largest consumers of energy, should work together to improve supply security, expand the supply of non-oil and gas energy sources, lower demand, and increase efficiency of usage. We are making progress. China has been active in the Asia Pacific Partnership on Clean Development, an initiative to improve energy security and efficiency. It is working to host an Energy Ministerial in October, which would bring together the six largest energy consuming nations in the region (U.S., China, Japan, South Korea, Australia, and India) to discuss joint cooperation and solutions to our energy concerns. In September, China is hosting the second annual Energy Policy Dialogue with the Department of Energy, a bilateral forum for discussing mutual energy concerns and policy interests. More broadly, one of the major topics of discussion when we get together with the Chinese for broad, strategic conversations has been China's energy policy. Both former Deputy Secretary of State Zoellick and Undersecretary of State Shiner have discussed China's energy policies in depth with their Chinese counterparts. We are encouraging China to realize that the best way for it to pursue its energy security is to help strengthen global markets not to seek preferential equity deals with irresponsible and, ultimately, unstable regimes. China is improving its coordination with the International Energy Agency (IEA) and working to put in place a Strategic Petroleum Reserve to both reduce international concern for China's energy demands and improve its own energy security. We hope that in the long run, China can feel secure in its energy needs.

Of course, there are many areas in which the U.S. and China have very different views, and we never miss any opportunity to let China know of our concerns:

Human Rights and Religious Freedom. China's record on human rights and religious freedom remains extremely poor. We monitor this issue very carefully and work hard to present a balanced view each year in our annual human rights report. We continue to urge China at every opportunity to respect the basic human rights of its people, rights that are not only in some cases provided in China's own constitution, but are also internationally recognized standards. We make clear to China that it should have no fear of organized religion – the most successful and advanced countries in the world recognize and respect the freedom of their people to worship in each individual's own way, and China should not be an exception if it wants to be a success. China needs to introduce democracy, good governance, and the rule of law, and expand the role of civil society -- all critical to ensure any country's stability and sustained growth in the information age. These are in China's own interests and we hope China will come to that realization. We seek to convince patriotic Chinese that such reforms will make the Chinese nation stronger, not weaker and to counter the cynical argument that U.S. support for freedom and democracy in China is a veiled attempt to destabilize China and prevent China's rise as a great power.

Trade/Economic Imbalances. China's economic growth has been rapid and both our countries have benefited from China's membership in a rules-based trading system. U.S. exports to China have risen more than 20% a year since China joined the WTO in 2001. Nevertheless, as then USTR Portman observed in February, the "U.S.-China trade relationship lacks equity, durability, and balance in the opportunities it provides. This disparity is due in part to China's failure to honor certain commitments." We work hard in our bilateral exchanges to urge China to address the causes of the imbalances, including China's huge global trade surplus and its need to move more quickly to introduce greater exchange rate flexibility.

I believe China appreciates the problems created by its production overcapacity and trade surpluses, and is trying to find ways to address them, primarily by stimulating domestic demand. However, we continue to make clear to China that the major economic imbalances between China and the rest of the world erode political support for strong relations with China and encourage the forces of protectionism. We also have encouraged China to do more to advance the Doha Development Agenda, which would greatly enhance the economic prospects for many countries. The process has reached a major impasse, and

we believe that China should play a more active role, commensurate with its economic size and performance.

Non-Proliferation. We have a mixed record with China in addressing what should be our common interest in stemming the proliferation of weapons, especially those related to missile technology and weapons of mass destruction. I believe China's awareness and understanding of the importance of this issue at the strategic level is growing, but it needs to do more to rein in the proliferation activities of its own companies. The United States will continue to make clear that such activity by Chinese entities threatens China's security, just as it threatens global security, and we expect China to do more to adhere to international nonproliferation principles. China's experience in working in the UN Security Council on the issues of North Korean and Iranian missile and nuclear programs is doing much to raise China's awareness of the importance of working with us on these issues.

China's Military. China continues to modernize its military, including making major increases in defense spending and acquisition and development of increasingly sophisticated systems. To some extent, this is a natural consequence of China's growing economic means and the comparatively outdated nature of its armed forces. Nevertheless, the lack of transparency on the pace, scope, and direction of China's military modernization will continue to be of concern to us and to China's neighbors. We also note the rapidly growing capabilities arrayed against Taiwan that risk disrupting the status quo. We respond to those increases in accordance with our obligations under the Taiwan Relations Act. We note Beijing's refusal to renounce the use of force against Taiwan. Beijing needs to reduce those threats and to increase cross-Straits dialogue, including direct talks with Taiwan's duly elected leaders. In keeping with Presidents Bush and Hu's commitment to enhance bilateral military ties, we continue to press China to be more forthcoming about its military budget, doctrine and strategy in order to build confidence and improve the U.S.-China military relationship.

#### Some Final Observations

Let me stop there, but add a couple of observations.

First, China's global emergence is a natural consequence of its economic growth and development, and need not be seen as a threat to the United States. It does present challenges as well as opportunities. Through a strategy of preserving U.S. regional and global strength and engaging China constructively, we are working hard to ensure that China recognizes its own interest in supporting and strengthening the international system. I think China increasingly recognizes this interest and we are making progress in many areas of mutual concern.

Second, we must build on the foundations of cooperation while continuing to talk about those areas where we do not agree. We have already seen that the areas of mutual interest have grown over the past 27 years. I would argue that they will continue to grow.

With that, I would be pleased to take your questions.

## **Panel II: Discussion, Questions and Answers**

HEARING COCHAIR BLUMENTHAL: Thank you very much, Secretary Christensen, and I'd like to second Commissioner Wortzel's remarks. I've followed your work for a long time, and I think the American government very much benefits from you leaving the "Ivory Tower" and joining the government and I think the country is better off for it.

I know that you have written a lot about Taiwan, Japan and China,

and I'm wondering in terms of trend lines what you see on that particular issue? It seems from an outside perspective that China feels quite confident that Taiwan is neutralized. In the Chinese perspective, I suppose that would mean that reunification is going to happen on China's terms. And Japan seems to be more concerned about the fact that Taiwan's isolation is increasing, and perhaps the perception is that U.S. support for Taiwan has diminished. Things like non-support for the Free Trade Agreement have, I guess, added to this perception.

I'm wondering what your interpretation or the administration's interpretation is of the trend lines regarding that very important triangular relationship is?

DR. CHRISTENSEN: It's difficult for me to ascribe views to the Chinese and the Japanese about the cross-Strait relations, but it does seem to me that U.S. policy on cross-Strait relations has been successful in the past few years in creating greater stability in cross-Strait relations than we've seen even two or three years earlier.

As you know, the Chinese support a stable status quo, and to the degree that China is confident about the future, it's hard to say whether that's the result of Chinese internal discussions about the future of unification or rather, it's recognition that cross-Strait relations are stable and that the United States is playing a constructive role.

Unification is a different thing than preventing conflict in the cross-Strait relationship, and I can't say how confident Chinese officials are that unification is going to come any time soon. The question is will there be events that could lead to military conflict across the Taiwan Straits in the near term, and at present, my impression is that people in China who are well-versed on these issues are a bit more confident that stability can be maintained in the near term than perhaps they were a couple of years earlier.

On Japan, again, I don't want to ascribe views to the Japanese government on cross-Strait relations, but I would say on this one score that it has been a concern of the U.S. government that Chinese-Japanese relations have not been very stable and strong, and we've been urging China and Japan to have more dialogue and to improve their bilateral relationship because we don't see it in U.S. national security interests, in U.S. national interests more generally, for Chinese-Japanese relations to be in the place that they've been for the last couple of years.

HEARING COCHAIR BLUMENTHAL: Would it be fair to say, again without ascribing views, but just as having exchanges with Taiwanese officials, that their sense of isolation is increasing?

DR. CHRISTENSEN: Taiwan's officials, is their sense of isolation increasing? I think the Taiwan leadership has long been concerned with Beijing's efforts to isolate Taiwan in the international community, both in organizations for which statehood is a prerequisite and in other organizations. I think that concern is persistent and certainly exists

today.

The United States has been a supporter of Taiwan's participation in international organizations that don't require statehood as a prerequisite, and the United States encourages actors in APEC, for example, to treat Taiwan as a full member and also encourages Taiwan's participation in international organizations like the World Health Organization as an observer so that Taiwan can enjoy the benefits of information, timely information, about important health risks that Taiwan faces.

HEARING COCHAIR BLUMENTHAL: My time is running out, but what is the position now on the Free Trade Agreement? The USTR has made a statement that it's not going to go forward with it. Is that the administration's position right now?

DR. CHRISTENSEN: That's not my understanding of the U.S. Trade Representative Office's position. My understanding is that their statement is that the time is not presently right to move forward with a free trade agreement because certain pieces aren't in place on the Taiwan side, and that they want to work through the TFA arrangement to encourage Taiwan to adopt certain policies that will create the conditions necessary for FTA discussions to move forward in the future.

I don't think any determination has been made by any part of the U.S. government that says that a free trade agreement with Taiwan is just something we're not going to pursue.

We do have some more immediate concerns related to pharmaceuticals to the government procurement agreement and the WTO to cross-Strait relations as well because one of those preconditions, as Ambassador Bhatia laid out in his speech in Taiwan, one of those foundational conditions that could improve the environment for an eventual FTA would be for Taiwan to have more robust economic connections with the mainland and to integrate itself more deeply in the regional economy. Without those connections to China, it's very difficult for Taiwan to do so.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Secretary Christensen. Chairman Wortzel.

CHAIRMAN WORTZEL: Some of the reflections that I've seen in Chinese newspapers and journals talk about the way that the United States, despite all this engagement, is really hedging as it builds up its own military and reinforces its own international position more or less as a new form a containment strategy against China. How do you respond to that and how does that get into the equation when we begin to deal diplomatically with the Chinese?

DR. CHRISTENSEN: It's an excellent question. Thank you for it. I would separate two concepts that you laid out in your question, and that is a hedging strategy versus a containment strategy.

It's very clear that the United States is not involved in a containment strategy toward China in the way that we had a containment

strategy toward the Soviet Union. If you look at the strategy toward the Soviet Union, it wasn't just designed to create an array of alliances and friendships and relationships around the Soviet Union to prevent potential Soviet aggression.

It was also a strategy to keep the Soviet Union weak, to weaken the Soviet Union internally, to limit the economic opportunities that the Soviet Union had on the international stage through institutions like CoCom.

If you look at the U.S.-China relationship, it's very different from what we had with the Soviet Union. There's obviously no effort to contain, and I often ask my Chinese colleagues when I meet them, when this issue comes up, what country has done more to assist in Chinese economic growth and prosperity since 1978 than the United States?

It's very clear that the United States has seen Chinese economic growth in the reform period as a positive outcome for the United States. Obviously, that Chinese economic growth also carries concerns on the economic side of the equation in terms of the openness of their markets to our products, intellectual property rights protection, et cetera, but in general we see Chinese economic growth as a positive phenomenon. So there is obviously no containment strategy going on.

The term "hedging" is a term that was used in some academic writings in the United States, but it was also used in some testimony by Defense Department officials when they addressed U.S. strategy towards the region, and it's a term that may be an apt phrase to capture U.S. preparedness in the region for a range of contingencies that might occur in the future.

Again, I think it's a very different idea than containment and the idea is that we are trying to work with China to encourage China to have positive developments at home and positive developments in its foreign policy, but we view with some concern some trends in the Chinese military modernization, as I discussed earlier, and we create new capabilities for the United States.

We bolster our relationships in the region in case China chooses a road that's different than the one that we hope China will adopt in the future. But even when we mention those attempts to build capabilities in the region, I think it's important to note that the build-up, the strengthening of U.S. presence in various places in the Pacific are not designed only to deal with China or some future Chinese scenario.

The Pacific deployments that the United States has are part of a broad network of military capabilities around the world, and they're in place for a range of potential scenarios including the global war on terror and the projection and power to other regions, some of which flow through the Asia Pacific.

So perhaps that answer was too long to your question, but again the key thing I think is to separate hedging, which is in a sense a natural and

prudent strategy, from the strategy that's sometimes ascribed to the United States by critics of the United States, that we're containing China's growth and we're trying to prevent China's rise as a great power on the international stage.

Thank you very much.

HEARING COCHAIR BLUMENTHAL: Commissioner Reinsch.

COMMISSIONER REINSCH: Welcome, Mr. Christensen. I didn't realize we had such a celebrity with us. This is more cameras than we've ever had here, I think, so I'm very impressed. Welcome to the government.

Let me ask a question about the responsible stakeholder idea first, and then I have a more specific one. I'm a big fan of that concept. It's actually something that we pursued in the last administration. We didn't have a nifty slogan and nobody gave a big speech, and we didn't have as much success as this Administration appears to be having. But it's an important concept, and I'm glad to see you articulate it and explain it the way you did, and I'm glad to see that it remains the government's policy.

I'm struck, though, by the examples that you cited. The concept, I think, involved some realization that responsible stakeholder means that you want them to take on a role in the system that involves system maintenance and support and not simply action in their own interests. In essence, there will be occasions when they have to take one for the team, if you will, as opposed to simply pursuing their own bilateral interests.

It seems to me that the examples of progress that you cited are largely areas where their interests coincide with ours, which is welcome and good news, but I'm wondering, particularly if you look at the areas that you cited as areas of disappointment, that perhaps we're not making as much progress on the responsible stakeholder concept as you might suggest. It seems to me that when we went into areas--trade and economics being one--perhaps nonproliferation being another--where it's not so clear that their interests coincide with ours, the level of cooperation has been much less. So I'm wondering if perhaps the picture is quite as bright as you paint it.

DR. CHRISTENSEN: Thank you for your question, sir. I did not want to portray the situation as currently purely rosy. I think that it's a mixed picture. I tried to emphasize that in my comments. Perhaps I wasn't clear enough, and I think that there are a range of issues, some on which we've made some real progress and others on which we have not made sufficient progress.

You asked a very important philosophical question, which is a question about China's own interests and whether China is pursuing its own interests or pursuing the global interests of the international community, and I think it's an interesting way to put it.

When I listened to Deputy Secretary Zoellick's speech in New York--I had the pleasure of being in the room--one of the themes that I



noticed right away about the speech is that he was trying to say consistently that we are urging China to adopt positions that are in China's own interest and the issue is to make China understand that its integration in the international system creates interests in that international system that should make China want for its own sake to support international peace and stability and prosperity around the globe in ways that are not necessarily myopic but are farsighted and constructive.

So on the issues you raise on nonproliferation, we're working with the Chinese to try to get them to improve their behavior on this. They have adopted some domestic laws and measures that approximate international standards on nonproliferation, but we're not satisfied with their enforcement of those regulations. But I think in our dialogues with the Chinese, we're urging them to understand, and we believe they are increasing their understanding, that proliferation out of China has consequences that don't just hurt the United States, that don't just hurt Japan, that don't just hurt Western Europe, but that hurt China itself, that instability in the Middle East from which China imports its energy resources in an increasingly large volume is not a positive thing for China.

As China becomes more integrated in that international economy and becomes more influential in various regions of the globe, they have real interest in creating conditions for stability in those areas.

One of the examples that I raise where we're disappointed is an issue like Sudan where China clearly supports the government in Khartoum in part, in large part, because it believes that Sudan is a source of energy resources moving forward.

One of the efforts that we're making with China is to convince China that this is not the best way for them to pursue their energy security for their own interests, because unstable regimes with repressive behavior toward their own population are ultimately unstable regimes, and you don't want to invest and put all your eggs in the basket of an unstable area, and China should participate with the United States in trying to create more transparent, accountable and ultimately stable governments in the areas where it gets its resources, both oil and otherwise.

COMMISSIONER REINSCH: Let me interrupt because time is short. That's a very helpful answer and I appreciate it. Let me be clear. I think that you're on the right track in what you're trying to do. I think there are a number of circumstances where it's going to turn out to be harder for them to make that transition in their own thinking than we would like, but it's certainly the right approach, and your explanation of the Sudan case is a good one because it's a case where their short-term interests might be perceived in very different terms than what you're trying to convince them is their long-term interest.

And, keep it up, but I think it's going to be difficult. Let me ask

you one very short question, if I may, and that is on the nonproliferation side, to what extent do you think, or maybe the answer is both, but maybe give me some weights--

HEARING COCHAIR BLUMENTHAL: Commissioner Reinsch, we'll have time to come back. We got a whole list of questions here. So we'll have time for follow-up.

COMMISSIONER REINSCH: I'll be back.

DR. CHRISTENSEN: Thank you for your question, sir.

HEARING COCHAIR BLUMENTHAL: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you and I appreciate your entering public service and appreciate your being here and your testimony this morning.

I'd like to follow up in part on your last responses as it relates to energy. We've seen, as you well know, the proposed transaction with CNOOC last year, and we've seen in recent weeks the chairman of that company giving a number of interviews indicating that the real problem was a question of public relations, not a question of intent or design.

Clearly, when many members of Congress raised questions about the transaction, they were looking at the overall approach of China to resource acquisition, not just energy, but looking at metals and many other materials and resources they need to fuel their economy as their growth increases.

You mentioned Sudan just a moment ago. China's resource acquisition strategy is raising questions all around the globe as it seeks to engage in resource acquisition in ways different than the U.S. and other market players do. They want to own the resources outright at the well head. They seem to be willing to engage in various transactions to ensure those supplies, which runs counter to its stated goal of becoming much more of a free-market player if you will, which was imbedded in the WTO accession strategy.

That appears to me to be much more of a competitive challenge to the United States. Many of these resources are finite or they're resource additions or occurring at somewhat slower place than demand is increasing worldwide for not only energy, of course, but metals, et cetera.

How should we view that? I don't think this is a PR problem. I think this is a problem of a very different strategic approach to providing the wherewithal for their economic growth.

DR. CHRISTENSEN: Thank you very much for the question. We do engage China on these issues, as you know, through the dialogues that I outlined. Department of Energy has a dialogue with them. The State Department with their National Development and Reform Commission has a dialogue that touches on energy issues.

In these dialogues and in our broader discussions on policy issues, we tried to urge China to understand the nature of international energy markets, that energy is ultimately a commodity that no single player is

going to be able to control, and that for China to have true energy security, the best way for China to pursue that energy security would be to cooperate with major consumers like the United States, Japan and others to create stable marketplaces and to do research into energy efficiency, et cetera, not to seek equity shares for resources in unstable areas of the world or with unseemly regimes that violate human rights and create international tensions.

My impression is that there's a debate in China about how China should proceed on this issue and I think that U.S. engagement on that issue, trying to again urge China to understand where its own interests lie and where they don't lie, and urge China to understand that it's not going to get energy security by having far-flung equity shares in various parts of the world that are unstable, far from China's shores, and that the best way for China to get energy security is to cooperate with actors like the United States and others in creating more stable markets and urging stability in those regions.

Part of stability in those regions is encouraging the transparency and accountability of the governments. I'll give you one example of where it seems on the surface where U.S. interests and Chinese interests seem to overlap, but the lack of coordination creates problems for U.S., in other actors' foreign policies toward a specific region of the world, and that is in the case of Africa and Angola where the IMF was considering a loan to the Angolan government, but with conditions to try to increase transparency and accountability for that government.

Because of China's drive for energy equity shares, in large part, China gave an unconditional loan of \$2 billion to the Angolan government and there's nothing wrong with Chinese aid to Africa. That's something that we encourage, but it would be better if we could coordinate that aid so that we could produce more stability in the long-term in Africa so that China could enjoy a flow of resources from that area and everyone else can.

Even if China is the sole recipient of those resources out of a country like Angola or Sudan, since oil and energy is a global commodity, that benefits the entire marketplace. So it's not a question of should they own any oil resources anywhere, but it's a question of keeping the eye on the prize, which is to keep the global marketplace for energy resources stable and open and to cooperate with the international consumers in that process, and we're encouraging them to do so.

Again, we don't see this as something that's against China's interests. We see this as trying to help China realize where its own interests lie and to increase cooperation along those lines.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSIONER WESSEL: I'll look forward to opportunity to follow up later.

HEARING COCHAIR BLUMENTHAL: Commissioner Mulloy.

COMMISSIONER MULLOY: Dr. Christensen, thank you very much for being here. On page seven of your prepared testimony, you talk about Mr. Portman, who was formerly the head of the USTR and now runs the Office of Management and Budget, quoting him, saying: "The U.S.-China trade relationship lacks equity, durability and balance."

Then you further note the exchange rate issue among those issues that are out there that are causing the lack of equity, durability and balance.

On page seven you go on to say that this erodes political support for strong relations with China. I always say to my Chinese friends if you don't deal with the economic relationship, it will in time poison the political relationship. We did some hearings on this Commission out in Dearborn, Michigan earlier this month in July, and we looked at our industrial base and that got us into looking at the defense industrial base.

That hearing indicated there is serious erosion both of our industrial base and our defense industrial base going on. Machining industries, tool and die industries, and other things are gravitating out of the country to China and producing stuff and then shipping it back here. I think the exchange rate problem is part of that, but I think it's a larger issue.

Senator Inhofe in his testimony specifically cited his concern--he's a leading Republican senator--about the erosion of our defense industrial base in his testimony before this Commission earlier today. I expect that we'll probably look and address that in our upcoming report.

Is there any concern in the State Department about the economic relationship and the imbalance being not just a political problem but a national security problem because of the impact it is having on the industrial base of this country?

DR. CHRISTENSEN: I appreciate your question. I'll have to get back to you on the State Department's position on the defense industrial base issue in particular. I don't want to comment without a knowledge base on that issue. But I can address the broader issue of trade and the exchange rate problem and the concerns that we have about the trade relationship being in balance, if you would prefer, sir.

COMMISSIONER MULLOY: Do you accept the premise which I laid out that this could be happening and is something that you in your leadership position in the Department of State will seek to have the department to look into this as a real issue?

DR. CHRISTENSEN: I'm certain it will be an issue of concern to us. It sounds like an issue where Commerce and the U.S. Trade Representative's Office would likely take the lead.

COMMISSIONER MULLOY: I would expect DoD to be very--

DR. CHRISTENSEN: DoD would be involved in it as well, as you suggest, sir. So I think the State Department would obviously be concerned about such a phenomenon. Whether the State Department would be in the lead on it is an issue that I would be surprised if the State

Department were in the lead on it. We would be concerned about it. We would work with those other agencies to further our interest, and your broader intellectual question, yes, any situation which creates trade imbalances should affect the entire spectrum of the economy, and the defense industrial base being part of the economy could be affected as well, and that would be of concern.

I gather, sir, that you're saying is separate from the concern about technology transfers and our control systems for technology transfers. This is a broader problem.

COMMISSIONER MULLOY: Yes. This is not just an export control issue. This is investment incentives by the Chinese. R&D is moving. Technology is moving. Capacity is moving. And these have enormous implications for the United States.

DR. CHRISTENSEN: In general, the position that we have is that this type of economic interaction with China, with the investment in China and production in China, is a positive thing. In general, our position is that the type of integration that China has had into the international economy with the United States and also with its regional partners is a positive outcome.

So, in general, our position is clear, that this is a positive outcome, but there are problems in the trade relationship. As I stated in the testimony, there are imbalances that need to be addressed, and we address them on a regular basis, both in terms of the currency issue where we strongly urge greater flexibility in the currency and on specific trade issues.

Intellectual property rights is a major issue where we don't feel that U.S. patent holders' intellectual property is sufficiently protected in the Chinese marketplace. This is a very important issue for the U.S. economy as it progresses and changes over time and becomes much more focused on these types of industries where intellectual property is so important.

So we are engaged with the Chinese on these issues and again I'll have to get back to you on the defense industrial base question in particular, and I apologize for not having a ready response for you.

COMMISSIONER MULLOY: Thank you.

HEARING COCHAIR BLUMENTHAL: We'll just submit that as a question for the record.

DR. CHRISTENSEN: Thank you very much.

HEARING COCHAIR BLUMENTHAL: Commissioner Houston and then Commissioner Donnelly, and Chairwoman Bartholomew at the end.

COMMISSIONER HOUSTON: Dr. Christensen, thank you so much for being here this morning. I have a question that I think might encapsulate a lot of what my fellow Commissioners have asked you already this morning.

Our policy toward China is reasonably a carrot and a stick, but it seems like the carrot is really big and the stick is really small. And the

carrot has to do with economy and the stick is more sort of a military/political/human rights instrument.

Some of the things that China is doing in the world today are of concern. Its increasing relationship with Hugo Chavez in Venezuela, with Mozambique, with the Sudan, Zimbabwe are very concerning.

Also its involvement with Cuba in financing and giving equipment to Cuba's drilling of oil, which is arguably between Florida and Cuba, and we could be siphoning out from our end except that they're siphoning out from their end.

Also with UNIFIL, a great number of the UNIFIL peacekeepers on the Lebanese border are Chinese, and there has been some discussion that there the UNIFIL soldiers, particularly the Chinese, are not just ignoring what Hezbollah is doing, but showing tacit approval for their tunneling and bringing weapons in and all those kinds of things.

As Chairman Wortzel mentioned, there is the China Silkworm missiles that are now being dropped on the heads of our allies in Israel.

So when you look at all these concerns individually, they're upsetting. When you look at them in the aggregate, they are certainly troubling. So my question for you is one of the future, either short-term or long. If these problems continue to bubble up or worsen, and, for example, we find out that China is even more involved in supplying terror weapons either directly or not directly to Hezbollah and groups like that, do you see any kind of a sea change for the administration, either in policy or approach to China?

DR. CHRISTENSEN: Thank you very much for the question. I'd start the answer with the last part of your question and say I don't think a sea change is necessary on these issues, and that the United States government is very vigilant, the Bush administration is very vigilant, on Chinese proliferation of military technologies to Iran and obviously is quite concerned with those transfers, in part because Iran is a supporter of Hezbollah and Hezbollah has committed aggression against the sovereign state of Israel, our friend and ally.

So there's no question that these issues are already very much on the radar screen of the U.S. government, and we engage the Chinese on these issues on a regular basis. As you know, we point out to the Chinese government when their corporations are transferring technologies or weapons-related materials to Iran and other actors of concern in the international system, and we sometimes level sanctions against those companies when they do so.

It's helpful in that process when we can refer to Chinese law, when Chinese laws are in place that say these companies shouldn't be doing that. So on that sense, that's why I referred earlier to the fact that China has adopted certain regulations about its own companies that if enforced, and we'll push them to enforce them, could produce positive results.

On UNIFIL, I haven't seen these reports that China's UNIFIL

soldiers/officers have been involved in these activities. If true, obviously, that would be of great concern to the United States, but in general we applaud China's participation in those types of international peacekeeping operations, and we urge China to participate more in such activities, whether it be in the Middle East or in eastern Africa, et cetera, or western Africa. We applaud China's participation in those types of activities.

You mentioned Venezuela and China's strategy towards Latin America and we watch these developments very carefully. One of the initiatives that we have with China--I wouldn't call it an initiative but a standing policy--is to try to better understand some of these diplomatic initiatives on the Chinese part towards Latin America, towards Central Asia, towards Africa.

And one of the ways we've done that is we have sent high level U.S. officials, Assistant Secretaries of State for those regional bureaus, to China to discuss what their strategies are in Latin America, in Central Asia and in Africa, and Assistant Secretary of State Shannon discussed issues related to China's policies towards Latin America in the last year in Beijing. Assistant Secretary Frazier engaged the Chinese on their strategies towards Africa in the past year in Beijing, and most recently in July Assistant Secretary of State Boucher who handles South and Central Asia was in Beijing discussing their strategy towards that region.

So we do watch these activities carefully. In general, though, I would say, again on a philosophical note, we don't view China's inroads, diplomatic and economic inroads, in these regions as a bad thing. We don't assume that this is generally a bad set of events when China improves its diplomatic equities or its economic place in these regions.

There are aspects of it that concern us more than others, but the general approach is to understand what China is doing in these regions and to instead of treating it as a zero sum game, whether it be Southeast Asia, whether it be Latin America, or whether it be Central Asia, don't treat it as a zero sum game, but treat it as a potential positive outcome for both the United States and China, and improve U.S. equities in those areas and improve U.S. diplomacy towards Latin America, towards Southeast Asia, towards Africa, and to the degree that it's a competition, that's fine, but it's not a zero sum competition, and we see that the United States can strengthen its own position in Southeast Asia in a confident and constructive way and protect our equities there without being envious about Chinese progress in those areas.

I'm not sure if I touched on all of the issues that you raised in your excellent question, and I'd be happy to clarify later if you have any follow-ons.

COMMISSIONER HOUSTON: Thank you very much.

HEARING COCHAIR BLUMENTHAL: Commissioner Donnelly and then if you'll indulge us, Chairman Bartholomew.

COMMISSIONER DONNELLY: Thank you, Mr. Chairman. I'd like to return to the macro question of the stakeholder idea that Commissioner Reinsch raised, and I think he accurately said that this has been--whatever term one uses to describe it--certainly the hopes of American administrations over the past two decades.

But the danger is that it becomes a process rather than an actual thing, and I think what perhaps we're trying to do in this set of hearings is set out some benchmarks or some measures as to what a responsible stakeholder looks like, and then are we gaining on it rather than just sort of going along where positives and negatives are listed, but not judged and weighed in the balance.

I would say that there is some question in the long term as to whether our American interests and Chinese interests can be aligned in this regard. Do we expect China to become a stakeholder in the process of democratic transformation of the Middle East? Our policy is not simply to stabilize the energy resources there but to profoundly change the political order.

So what I hope you would do is set out say for the next two or three years, and then kind of in the mid-term, and then in this kind of open-ended or longer-term sense sort of put a little meat on the bones of what and when some of this stakeholder activity might generate something by which we could judge whether China is becoming a stakeholder and what it would look like if China were fully integrated into the liberal international order that we are trying to preserve.

DR. CHRISTENSEN: Thank you very much. It's an excellent question and it is what I'm trying to get at today. It's a complex problem, I realize, and it's difficult to give a very brief response, but I'll do my best to try to reiterate some of the themes that I stated before, and that is that this is a long-term process. We do see it as a long-term process as you suggest and there are various benchmarks that can be used to judge progress in that process.

I think in the United Nations and in the Six Party talks, in particular, you've seen real progress. Again, as a China specialist, looking back, trying to imagine where I would be seven, eight years ago thinking about the future of Chinese foreign policy, the idea that China would take a leading role in multilateral security organizations or grouping, like the Six Party talks, on an issue as important as North Korean nuclearization would seem at that time to be fanciful.

It's important, again, to understand the role of U.S. policy in this. The United States was very much a part of urging China to adopt that role. It didn't happen in a vacuum. The United States urged China to take a leadership role in this issue. China did take a leadership role by hosting the talks and by helping create the talks, and China has taken a leadership role in brokering the Joint Statement of last year, a Joint Statement that has North Korea agreeing to denuclearize.



Now, obviously, they haven't abided by that agreement, but it's very important to have that as a publicly stated benchmark for North Korean behavior. China helped us create that.

And then if you look at Resolution 1695 in the U.N. where you have China not just abstaining and stepping aside, and not just foregoing a veto, but actually supporting a resolution that condemns its long-term ally, North Korea, and asks the international community to take concrete measures to limit their interactions with North Korea so as to prevent North Korea from developing missile and WMD capabilities.

I think this is extraordinary progress. Again, are we satisfied? Is that the end of the process? No. But I think this is extraordinary progress, and I think we should recognize that progress where it occurs.

Now, you raise a broader question, sir, when you raise the idea of the international liberal order and whether China will participate in it, and this is one of the reasons that we always engage the Chinese not just on their international behavior but on their domestic reforms because ultimately to have a stable transparent China that is reassuring to its neighbors and to other global actors around the world, China will need to go through political liberalization as well.

And if China were to go through that political liberalization, it would seem to me that China would be more likely to be on board with the types of projects in the Middle East and elsewhere that are so important to this administration and to the future of world stability, which is a more accountable, open set of governments in these areas from which many of the terrorist threats that we face have arisen, and a more open and transparent system in China would be, all things being equal, a system that would be more likely to support those efforts in those parts of the world.

So it is a comprehensive package. Deputy Secretary Zoellick's speech did not just talk about international behavior in the near term but in the long term, and also talked about the need for domestic reform in China.

And the Chinese elites, academics, et cetera, talk about a peaceful rise. They talk about reassuring their neighbors as China's power increases. There's very little that could be done that would be more effective in that process than to have political reform in China, to have stability in China, to have openness and transparency in that system. So that Chinese patriots should realize that the best way for China to be strong and respected on the international stage is for China go through that liberalization process that we are urging around the world in China and elsewhere.

So I hope that addresses some of your questions. There are benchmarks out there for international behavior in the near term. We have hopes about Chinese domestic development and we engage them on those issues, and we see the issues as related as we look forward, but it is

a long-term process. There will be setbacks. There will be steps forward and we'll just keep working hard on the issue and we hope to make progress.

Thank you very much.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you, and I join my colleagues in welcoming you, Secretary Christensen, and thanking you for your service.

DR. CHRISTENSEN: Thank you, ma'am.

COMMISSION VICE CHAIR BARTHOLOMEW: I think you'll start seeing some of the challenges, of course, that the issues don't start the day that you start on the job, and that you're going to have to speak up in terms of what has happened before you as well as things move forward.

I also want to note particularly that we're seeing the results that proliferation has real world consequences. I hope that we seriously raise with the Chinese this chain that has been going on with the Hezbollah use of missile technology that came via Iran, that came via China and that it's real, and I think that we need to be raising that.

A number of issues that you raised. I want to specifically mention, though, definitional questions, which is that stability, common interest, and success, and, in fact, success, we've raised concern with your predecessor. Some of us have been concerned both in terms of success, in terms of how it was defined even in the Clinton administration, that too often success in our relationship with China is defined as talk, and we don't see much in the way of action. So I want to note that.

But otherwise, I really want to question our concept of common interests. Why do we believe that the Chinese government is interested in promoting transparency, accountability, and open governments elsewhere when it itself is not transparent, open or accountable? It's just very difficult for me to see them taking on an initiative to promote openness in places around the world when it's not something that they're very interested in doing themselves.

DR. CHRISTENSEN: It's an excellent question. I appreciate the question. I hope I didn't give the impression that I think that talk is the standard bearer or the benchmark of success in the relationship, and I agree with your concern on that score, that we shouldn't fall into the trap of thinking that dialogue itself is the ultimate goal. And I think the strongest example I can give in the current policy realm is that on human rights, we reject the notion that simply having a dialogue on human rights is the end game, and we've insisted with the Chinese that if we're going to have a formal dialogue on human rights, as they have requested, that it be results-based, that we want to see concrete progress on these issues, rather than just talking about broad principles. So I don't think it's just about talk.

You raised the issue about openness in the Chinese nation, and the

answer is complicated because China does have an incentive in having openness and transparency to some degree in these areas where they invest, et cetera, simply for their own economic interests. They want to know whether the deals that they make are going to go through, whether they're going to be honored in the future, and it may not be a commitment to the liberal order that Commissioner Donnelly raised earlier, but it may be as simple as self-interest, as they have economic interests around the world, to have accountability of the local governments to the deals that they make with the Chinese.

The Chinese economy, although its political system hasn't opened up, the Chinese economy has opened up very significantly in the reform period as you know. We know a lot more about the Chinese economy, and as China tries to increase economic wealth for its own people and the Chinese government tries to create economic wealth for the Chinese nation, in part, to stabilize their own political situation, they have to make tough choices on these scores.

They have to open up various sectors of their economy to make them more competitive on the international stage. They need to attract investors who demand a degree of accountability and consistency in Chinese behavior before they're willing to invest money.

So by integrating into the international economy, the Chinese government is encouraged and in some cases even compelled to start down this path of more openness and accountability at home, at least in the economics sphere and a request for those types of measures internationally to help their own economy grow.

On the issue of political reform and political openness, obviously the question is much more complicated. But I would say that as we engage the Chinese, as the great powers of the world, the vast majority of whom are liberal democracies, engage the Chinese, both in international, economic and security relations, but also in intellectual discussions about the future, it is our hope that right-minded Chinese, who are patriotic, who want China to do well and be strong, which is a widespread belief in China, will understand that the best road to Chinese power and strength in the international environment is through a process of political liberalization.

There is this argument in China, as you know, that says that when we push this on China, it's designed to keep China weak, but it's not a very intellectually strong argument, and it is an argument that can be knocked down.

So I'm hopeful that the very strong streak of Chinese national pride and patriotism that runs through Chinese society and in segments of the Chinese Communist Party, important segments of the Chinese Communist Party, will lead to a dialogue and discussion in China over time that this is the only way to go increase our economic wealth, to increase our international prestige and to put China in the international place that

people hope for China.

So I don't see these things as necessarily opposite and, yes, there are some myopic thinkers who believe they should deal with only regimes that are closed and do it in a secret way, but that's not going to win the day. Good ideas win out over bad ones, and that idea is not going to win the day over the long term if we handle these issues right and if the Chinese, the patriotic Chinese, are able to asset their interests within the Chinese system.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Secretary Christensen. Thank you for your time and your graciousness in answering our questions, and we wish you the best of luck.

DR. CHRISTENSEN: Thanks again for inviting me. It was a real pleasure.

HEARING COCHAIR BLUMENTHAL: We'll take a two-minute break and then we're going to start.

[Whereupon, a short break was taken.]

### **PANEL III: THE IMPACT OF CHINA'S DIPLOMATIC STRATEGIES ON U.S. INTERESTS**

HEARING COCHAIR BLUMENTHAL: Our third panel today we will look at the impact of China's diplomatic strategies on our interests around the world.

Our panelists will present testimony about three key areas of our interests, and increasingly of China's interests, around the globe. Our first speaker is Dr. Ernest Wilson, who will speak about China's activities in Africa. He joins us from the University of Maryland where he teaches in the Department of Government and Politics and the Department of African-American Studies.

He has published widely on foreign policy issues related to Africa, development and technology, and has served in various capacities as an advisor to the United States government.

Our second witness is Dr. John Calabrese who will offer testimony regarding China's diplomatic activities in the Middle East. He teaches U.S. foreign policy at American University and serves as editor of The Middle East Journal and has written widely about China's policies and relations with the Middle East.

Our third panelist, Dr. Cynthia Watson, will discuss China's diplomacy in Latin America. She teaches at the National Defense University and spent the year 2003-2004 researching Chinese activities in Latin America and has testified before this Commission in this past. We look forward to her updates.

So, without further ado, I'd like to pass along the microphone to Dr. Wilson. Thank you.

**STATEMENT OF DR. ERNEST J. WILSON, III  
PROFESSOR OF GOVERNMENT AND POLITICS, SENIOR  
SCHOLAR, CENTER FOR INTERNATIONAL DEVELOPMENT AND  
CONFLICT MANAGEMENT, UNIVERSITY OF MARYLAND,  
COLLEGE PARK, MD**

DR. WILSON: Thank you very much, Mr. Chairman. I'm delighted to be here with you and your fellow Commissioners to talk about such an important topic in today's global political economy. As you pointed out, I have been privileged to work in government, in think tanks, traveled to Africa and to China once or twice a year, and have written extensively on both parts of the world.

Mr. Chairman, you asked me to address four questions, which I will do directly, but I wanted to just suggest one way that I have found helpful to phrase these issues in thinking about the relationship between China and Africa, and I would put it in these terms, is the current relationship between the People's Republic of China and Africa, are they engaging in economic and strategic and political activities such that they are moving toward global norms? In other words, are they converging with what the West and Japan are doing?

Are they taking activities which are diverging from what the international community thinks is important, or are they taking behaviors which, in fact, maintain what they are doing at the present time? And so I'm going to try to answer that question at the end of my testimony and suggest that for the most part we do not see divergence between the United States and the People's Republic of China in their policies toward Africa.

We see some evidence of convergence, but there are still areas of friction and concern that your Commission and the Congress should pay attention to. So that's sort of my bottom line.

Let me turn then to the questions that you pose to me directly, and the first is to what extent does China use tools of statecraft, whether military, diplomatic, business and so forth, to open doors in Africa for resources and energy trade and do these new relationships compete with existing U.S. ties to the continent and do they complicate it?

It is of course a truism that all countries use all the tools of statecraft at their disposal to advance their multiple interests and certainly China is no different. What I'd like to do is just take a brief second and walk through some of those areas of activities.

Foreign aid. China concentrates its foreign aid, for the most part, in infrastructure activities, again in contradiction to what the French or the British and certainly the Americans do with their foreign assistance. They concentrate on construction such as highways, railroads and power supplies and to a certain extent, they are also moving into health care and

training for health care workers.

In some ways, this is a compliment to what other countries do who do not concentrate on infrastructure. The biggest concern, I think, for all of us in foreign assistance, and I'll return to this, is to what extent they are providing this foreign assistance and turning a blind eye toward issues of transparency, democracy, and so forth?

One downside, another downside of Chinese involvement in Africa, is they tend to import many of their workers. They do not rely a lot on local people and in conversations I've had with African leaders, this is a source of some concern.

Diplomacy. There was a report recently out of the Carnegie Endowment for International Peace that talked about the rise of China's soft power in Asia, and we certainly see that in Africa as well. China's top two leaders have made multiple high visibility trips to Africa over the past six months to try to drum up support for China, and in these activities, the following line is the one that they take: they say we are a third-world country just like you Africans are third-world countries, and so we know your experience and so you should pay attention to us and implicitly give us slightly better deals than you might give to formal colonial powers.

They also say that we are a very successful developing country and so therefore to the degree China has been successful, you need to follow our example. So those are the diplomatic claims that are made by China as they move ahead.

In terms of their business activity, it's far below what we see in the West in part because, as you know, China has been a state-owned communist society and communist economy. So the kind of business activity that we see in other countries has not yet reached the levels that we see in the Western countries, but we would probably see that happen.

The Africans have responded, I think, positively to this. I've been in touch recently with senior people in Nigeria and South Africa, talking about China's involvement. The rhetoric they like. They like the rhetoric of non-involvement with what they see as interference in their internal affairs. They like the idea that China is investing in infrastructure, and they are also deeply concerned about other matters.

Number one: will the Chinese invest not only in oil issues, but in non-oil activities? There's a major concern in southern Africa because the Chinese have an overvalued exchange rate and given their export machine, they have essentially wiped out the textile industry in southern Africa, which is a great concern to them.

Some of them, the more democratically oriented ones, are also concerned about China's lack of transparency and democracy in their own country and are concerned that other countries might, like Angola, Sudan, et cetera, might fall prey to those kinds of ideas or at least have it buttressed even more.

I'm going to skip over what steps the U.S. should take to strengthen its ties to Africa except to say economic activities, opening up their markets, listening more to what the Africans have to say on this issue and others, but I do want to say what impact Sino-African relations are having on Africa and by implication U.S. foreign policy issue.

One is the petroleum issue. That's an issue that I think is extremely important. I see that you're talking about this tomorrow, so I will not go a lot into that except to say in the African case it cuts two ways. On the one hand, for oil-exporting countries, the fact that China is in the market bidding up the price of oil and trying to invest in oil fields is a good thing for African countries--

Angola, Nigeria, Cameroon, other countries, Gabon, that export.

For those countries that import oil, however, there's a downside because the price is higher and it cuts back on their ability to import other non-petroleum goods. We can get into a discussion if you wish of the impact of whether that's crowding out U.S. investment in the continent, and I can return to that.

Let me conclude by saying so what? I think the so what question for the U.S. Congress should be based on whether or not, ladies and gentlemen, you decide that there is convergence, divergence or the maintenance of a mixed status quo in China's dealing with Africa and other parts of the developing world?

As I suggested at the beginning, my conclusion is that the Chinese are at a point in their history where they are still trying to figure out exactly how to handle Africa. They're relatively new to the game. This I think provides the United States with potential leverage to go in and say we expect you as a great power, as a rising power, to behave according to the norms of the international community, both the explicit ones--WTO, et cetera--but also the implicit norms, and that includes pressing transparency and democracy.

One way in which that could be done, I suggest to you, commissioners, is to support not only what the administration is doing but also to look at nongovernmental organizations, think tanks, universities, community groups, in the United States and in Africa, and try to get them to dialogue with their counterparts in the People's Republic of China, to begin to move a conversation more toward what we would see as a liberal and open world political economy including China's being more open domestically to having these kinds of dialogues among nongovernmental organizations.

Thank you very much, Mr. Chairman.  
[The statement follows:]

**Prepared Statement of Dr. Ernest J. Wilson, III**  
**Professor of Government and Politics, Senior Scholar, Center for**  
**International Development and Conflict Management, University of**  
**Maryland, College Park, MD**

Mr. Chairman:

I am delighted to have the opportunity to testify today before this important Commission, on such an important topics as China's growing global role.

There are few issues more vital to U.S. national interests than understanding and responding appropriately to the changing global role of the People's Republic of China.

The PRC's changing role touches on all elements of American interests – economic, diplomatic, strategic, technological and military. These interests range from intellectual property rights protection to bilateral tensions over the straits of Taiwan. China's rapidly evolving relationship with Africa, the topic of this testimony, is important in its own right, and also reveals important dynamics and trends in China's global role more broadly

My perspective on China's relationship with Africa is shaped by many years visiting and working in Africa as well as China. I have published and advised governments on the political economy of the world petroleum market, especially in Africa, and more recently, I have studied and published on the other great market of our modern era, the information and communications sector. My most recent book examines the expansion of IT industries in China, Ghana, Brazil and other countries, and I usually get to China and to Africa several times a year. I have been privileged to be deeply involved in these and other subjects as a scholar, a senior government official at the White House, and as an international advisor. I have also testified on China-Africa relations before the House Sub-Committee on Africa, Global Human Rights and International Operations.

**The Four Questions**

The Committee asked me specifically to address four questions concerning China's relations with Africa:

1. To what extent does China use tools of statecraft (military power, diplomacy, business activity, and aid) in Africa to open the door for resources and energy trade? How does this compete with existing U.S. relationships or complicate the establishment of new relationships?
2. How does China seek to be portrayed through its diplomatic relations. Can its portrayal be reconciled with its actual actions?
3. What steps should the U.S. take to strengthen relationships in Africa?
4. How have Sino-Africa relations affected U.S. diplomatic, economic, and security interests in Africa?

**Framing the Issue of China's Behavior in Africa**

Before I answer these four questions directly, let me suggest one way of framing the discussion that may be helpful for the policy recommendations you must ultimately make, and pass on to Congress. It seems to me that the recommendations should be shaped largely by whether you decide that Chinese behavior in Africa – and in other regions – conforms to international norms or it doesn't. Put another way, are current Chinese actions in Africa *converging* with accepted international norms? Are they *diverging* away from those norms? Or over time, are we witnessing China maintain a static *status quo* that lies somewhere between convergence and divergence? The policy implications of each are quite different.

The key element here is '*over time*'. The best policy recommendations will be based on observable trends in Chinese behavior, and not just on snap shots taken at a single point in time. Of course, describing one country's relationships with 50-odd other nations is hard enough; tracking them over time is much more



difficult, but I respectfully suggest it is worth the effort. At the end of this testimony I will hazard a guess about whether we are seeing divergence, continuity or convergence in Chinese-global behaviors?  
Let me now turn to your four questions.

**To what extent does China use tools of statecraft (military power, diplomacy, business activity, and aid) in Africa to open the door for resources and energy trade? How does this compete with existing U.S. relationships or complicate the establishment of new relationships?**

It is a truism that countries use all the tools of statecraft at their disposal to advance their multiple interests, including their interest in obtaining natural resources and energy, and opening markets. All countries act as if it is important to create and maintain good relationships with other countries that produce and export raw materials like oil and gas. All governments tend to pay more attention to resource-rich countries than to resource-poor ones.

China is no exception. China is on a new glide path, and new strategic direction, in experimenting with a variety of ways to use the tools of statecraft to open the doors to get privileged access to energy and resources in Africa and elsewhere. By so doing, China certainly complicates the existing U.S. relationships with Africa (and, for that matter, with China as well) I will describe some of those strategies.

**Foreign Aid:**

Chinese foreign assistance is concentrated in several sectors, especially infrastructure construction, such as highways, railways and power supplies. They also typically support large and visible construction projects such as public buildings like stadiums. They also have been active for many years in the health sector, sending physicians to Africa, and training Africans in medical care in China. It should be noted that the Chinese operate in sectors where other donors are less active. This means some of their work in Africa is complementary to that done by the U.S., for example. It is also worth noting that there has been little effort to train Africans and build local capacity. In contrast to the British or Scandinavians, for example, the Chinese approach is to import workers from home to build their large projects, with little effort to partner with local groups or hiring many people in country. This is a consistent complaint of the Africans, and some have started to pressure the Chinese on this.

An important part of foreign assistance these days is debt forgiveness. The Chinese have forgiven about one billion dollars of bilateral debt. They are also training more than 100,000 Africans in Chinese universities and military institutes.

We may be starting to see some innovation in Chinese foreign assistance. In Nigeria for example, they seem to be increasing the sectoral spread of their projects, into agriculture, health, water and also training.

**Diplomacy:**

These days foreign aid and traditional diplomacy are closely linked in PRC activities in Africa. The Chinese have dramatically stepped up their diplomacy and their exercise of 'soft power. A recent report on China's soft power by the Carnegie Endowment for International Peace points out that China is sending far more diplomats into the Asia region than any other power - many more than the U.S., for example. This general trend is also manifested in Africa. China's top two leaders have made multiple high visibility trips to Africa, as have had a host of other senior Chinese officials.

At every stop the Africans are reminded that China too is a Third World country which suffered from foreign occupation, and that it respects the sovereignty of its brethren developing nations to take their own decisions free from outside pressures. (SEE below) The PRC also maintains a China - Africa forum which brings together senior officials from both regions on a regular basis.

**Business Activity:**

As a long-time communist country the PRC did not send many trade missions abroad; but as more businesses are privatized one is starting to see more. In Nigeria, for example, a trade mission recently explored possible investment and sales opportunities in that country. We should expect however that as

Chinese companies strive to become more globally competitive they will engage in more aggressive sales and marketing in Africa and other countries, within but also beyond the natural resources sectors. According to the CEO of a large and well-respected American oil services company who recently returned from China, Chinese companies are striving to become “world class corporations befitting a great country”. He believes they are more and more playing by international commercial rules.

**Military Power:** So far, this has probably been the least significant factor relative to other instruments of state craft. It is the case that Chinese arms show up across the continent from Liberia to Somalia. These seem to be mostly small arms sales to middle men arms dealers who in turn sell to Africans, both governments and rebels (lots in Liberia, for example). The available evidence suggests these are not major (especially relative to the U.S. which supplies about 50% of the world’s weapons) and hence the direct leverage of the Peoples Liberation Army or the civilian ministries is probably modest in African conflicts. Nor can China compete effectively in its military training and educational programs with the ex-colonial powers, given the latter’s continuing ties via their military academies like Sandhurst in the UK and St. Cyr in France.

**How Does China seek to be portrayed through its diplomatic relations. Can its portrayal be reconciled with its actual actions?**

In contrast to the other big powers China has long portrayed itself as a developing country facing the same challenges of poor infrastructure, inadequate education and urban-rural splits that mark all other developing nations. As such, China claims a deep and abiding understanding of its fellow Less Developing Countries (LDCs) not shared by other western countries or Japan. China also claims it too was the victim of colonialism (Japanese), a claim that plays very well in Africa.

A second related claim the PRC makes is that it is not just a developing country, but is a remarkably successful developing country that has made great strides in economic growth and social well-being. Therefore the country offers itself as a model to other developing nations seeking their own path to growth and stability

Thus, the Chinese try to distinguish themselves from other donors because of their sensitivities and understandings, and hence they claim to be more fraternal and less interventionist or pushy than other donors. A keystone of its foreign assistance and diplomatic strategy is to refuse to get much involved with the internal political, institutional and policy arrangements of its partners. So far it has refused to employ explicit conditionalities as a requirement for receiving assistance, in stark contrast to western donors.

Does it live up to these self-portraits? Yes and no. It is a developing countries, as anyone who has traveled outside Beijing or Shanghai can attest to. Equally clearly, China is not your garden-variety LDC, but belongs in that small group of ‘Newly Industrializing Countries (NICs) that straddle two worlds. Does it meet its rhetoric of non-intervention diplomatic and foreign aid strategy.

**What steps should the U.S. take to strengthen relationships in Africa?**

The U.S. could take a number of steps to strengthen its ties to Africa to help achieve long term and sustainable economic growth, and improved standards of living. These steps would also enhance America’s standing in Africa relative to other big powers who also seek to win friends and influence people on the continent. Some of these are direct, others more indirect. Some are institutional, others more policy-driven.

- In light of current situation with the Doha round of trade negotiations under the framework of the WTO, the U.S. should exercise even more leadership – and demonstrate flexibility to -- improve access of African products to American markets, especially agriculture.
- Through instruments like ExIm and OPIC, find ways to encourage greater U.S. investment in the non-extractive industries of Africa – i.e. in services, manufacturing and agriculture.
- One of America’s greatest successes in Africa was helping Africans create the current generation of leaders, intellectuals and skilled professionals through our support for higher

education. USAID, but also non-profits like the Rockefeller Foundation helped build and maintain great universities in Africa, and provided funds for educating Africans in U.S. colleges and universities. This should be repeated today.

- Support African initiatives like NEPAD, and listen more carefully to Africans themselves, including on their views of China's role in their continent.
- Much greater levels of support for conflict reduction and training.

### **How have Sino-Africa relations affected U.S. diplomatic, economic, and security interests in Africa?**

Evolving Sino-African relations have affected U.S. interests in Africa in several ways, some are more direct, others indirect.

For professional Africa hands, whether in government or the private sector, handling Africa has now become more complicated. Instead of just tracking the commercial and diplomatic comings and going of the Brits, the French, the Belgians and the Japanese, they now need to assign resources and staff to track the comings and goings of the Chinese as well. New people and new systems are being put in place to do so. In conversations with senior officials in the State Department in Washington, China's African adventures are now on the front burner.

Also, Chinese geo-strategic and geo-economic maneuvers in Africa seem to be leading the PRC to be much more conservative and narrow in their voting behavior at the United Nations, sometimes opposing American interests. For example, they have deliberately blocked moves to tighten the screws on the Khartoum government by imposing mandatory sanctions.

On the bi-lateral diplomatic front American embassies in Africa now try to counter Chinese efforts to create an explicit alternative to the 'Washington consensus' on foreign assistance and the rules of diplomacy. "If the Chinese won't interfere with internal politics and policies in Africa, why should other big nations? If China has been successful with a non-democratic development model far from the current requirements of the west for transparency and participation, why should other nations harangue the Africans to conform to western ideals of democracy and development?" These are arguments American diplomats are confronting.

The economic impacts of China –African relations are more indirect, but potentially much more serious than the diplomatic impacts, and they should raise serious concerns for the Congress and the administration. First, the combination of China's efficient export engine, combined with an exchange rate held deliberately low – some say artificially and unfairly low – has sent a tsunami of destruction across the African manufacturing landscape, especially in the textiles industry. Textiles are typically the first rung in the development of manufacturing for all countries. But the Chinese export engine has flooded the region with cheap products, eviscerating industries in countries like Lesotho, Botswana and even South Africa. To the degree this tsunami wrecks Africa's economic development prospects, it poses challenges to all concerned, including America. The South Africans recently concluded negotiations with the Chinese to try to reduce the negative impact of their textile exports on Africa's largest economy, which is now generating unemployment and dislocation among workers. In one conversation with a senior South African official, there was clearly a sense that the country was trying to take steps to mitigate the textile tsunami. They are also insisting that when Chinese invest, African workers must be hired. At the same time, the official said, the African continent is so 'hungry for investments' in the economy that they don't always have the luxury of pressing too hard on the investment terms.

### **The Tough Issue of Petroleum Politics.**

This is probably the thorniest issue of all in China-Africa-American relation. The short version of the story is that the impact on Africa of expanded Chinese involvement with the oil industry is a double edge sword. On the one hand, Chinese purchases have substantially boosted government revenues of oil exporters like Angola, Gabon or Nigeria. On the other, it hurts far more countries than it helps because PRC petro-purchases have on their own bounced up global oil prices and hence reduced the non-oil import component

of what the majority of African countries can afford to buy. (This in turn is partly offset because China's purchases have also pushed upward the price of other non-oil raw materials like copper and timber.)

As a guiding principal one needs to keep in mind that since oil is a fungible commodity - whether China or the U.S. imports supplies from Angola or Kuwait makes very little difference in the price we pay. The oil market is the oil market, everywhere. In preparation for this hearing I contacted some of my old colleagues who are world-class experts in the oil patch, and they urged caution when reaching conclusions about the intersections of petroleum and politics. They claimed that it doesn't make too much difference if China or country X's oil companies chooses to buy or 'own' a particular field in Africa or Latin America and pump the oil; *or* whether they choose to buy equivalent amounts on the open market. Even if China is moving aggressively into Africa to buy reserves, the fact remains that relative to the traditional oil majors, Chinese companies hold a tiny proportion of total world petroleum assets. Nor are their current raw material investments in general likely to 'crowd out' other investments, whether those of the U.S. or other western countries.

So What?

What's the U.S. interest here? To the degree that most African economies are further damaged by higher oil prices and African industry is undercut, then the U.S. and other nations need to be concerned about the higher risk of economic stagnation, further political instability, humanitarian crises and providing fertile ground for the growth of terrorist groups.

But taken together, however, the political and strategic impacts of China on Africa have been fairly modest. One would be hard pressed to find many instances where a significant U.S. foreign policy purpose in Africa has been turned aside or compromised either by direct or indirect challenges by the PRC, or where African authorities have changed their views because of the 'soft power' or commercial pressures of the Chinese.

A Few Additional Questions.

I trust I have answered the four basic questions you posed to me in your invitation. Were I asked to think of a couple more questions the Commission could consider, I would respectfully nominate the following ones to you and your staff that deserve more detailed reporting and analysis than one can give in this kind of testimony.

- o *Current Situation Africa-Wide.* Description and assessment of the current extent of China's engagement with Africa as a whole, including diplomatic representation, commercial ties, military arrangements, high level visits, and so forth.

- o *Review of the Experiences of Selected Countries.* More detailed analyses of PRC actions in selected African countries where they are most active. This might include Angola, Nigeria, South Africa, Sudan and Zimbabwe. Especially, what have been the impacts on our bilateral relations with those countries? Based on analytic assessments of these two topics, do we find divergence, status quo or convergence?

- o *The View from Beijing.* What do we believe are China's interests and motives in its Africa engagements? What are the key institutions and who are the key players in Beijing, and how do they define their interests? (foreign affairs, state owned enterprises, trade and economy ministry, their 'Africa Bureau', and so forth)

- o *African perspectives.* What are the prevailing views of China's new initiatives in Africa's leading capitals? Lagos? Pretoria? Nairobi?

- o *Comparative Perspectives.* How different are China's behaviors and policies from those of other powerful states? Compare and contrast China's economic, diplomatic, strategic and other relations with those of leading EU countries like France or the UK, as well as Japan or Korea. How far outside the current multilateral perspective (e.g. World Bank) is China's behavior?

o *Options for Action.* Depending of whether we find divergence, convergence or the status quo, what is the full range of options available to the Congress and the executive branch?

#### CONCLUSION.

At the start of this testimony I suggested one could frame China's changing role in Africa in terms of *divergence, continuity* or *convergence*. If the behavior of Chinese firms and government agencies in Africa is *veering sharply away* from global norms, then we will see divergence and the U.S. Congress and the executive branch should be appropriately concerned, and take appropriate policy actions. If Chinese firms and agencies *maintain* their current mixed patterns of commitments -- some close to global norms, others outside of them -- then we should continue to monitor and to engage as appropriate to encourage greater compliance. If the PRC demonstrates that over time it is shifting its commercial, foreign aid and diplomatic actions in Africa closer to those of other big powers, then that pattern should be noted and indeed welcomed.

Based on my own analysis it appears that Chinese behavior in Africa maintains *a mixed pattern, and that it is more likely to move more toward convergence than divergence.*

Three elements suggest this conclusion. The most recent policy basket of diplomacy, foreign assistance, business interest and direct investment observed in Nigeria suggest a wider range of behaviors than one has seen in the recent past. This could be evidence of policy innovation. At the other extreme, there is little evidence of recent actions that lie far outside international norms. Finally, there are several historical trends that suggest future movement toward convergence rather than divergence or strict status quo, and that the country is still feeling its way in international resource politics. For example, the PRC has little experience with 'oil diplomacy'. It only recently became a net importer of petroleum, only about a decade ago. Also, the PRC has little experience with 'modern' foreign assistance, nor does it have much experience with high stakes, high level African diplomacy. It is new to the game.

One could conclude that the Chinese themselves are trying to figure out their optimal balance of convergence, divergence or status quo. If that is true, it is worthwhile for Congress to provide carrots and a few sticks to urge the PRC leadership toward convergence. This could be achieved through a variety of means, many of them using non-governmental channels. One could imagine a series of regular engagements among Chinese, American and African experts on Africa, to discuss the pros and cons of different kinds of activities in Africa. This could be organized by think tanks or universities, but appropriate government participants could be invited as well.

The non-governmental actors could point out the costs of relying on outmoded, old-style approaches to Africa.

At this point in China's period of experimentation in Africa, I suggest that the role of Congress should be to monitor the PRC's Chinese relationships with Africa for evidence of convergence, continuity or divergence; and to promote dialogue on these issues through non-governmental and governmental channels. There is no evidence that other more serious steps need to be taken now.

The ultimate goal of American foreign policy toward the PRC is clear - we want China to play by the same basic rules, and to meet the same international obligations, as any other powerful country. We are not asking the Chinese national leadership to withdraw from the world stage. We are not saying "do not trade with Africa, do not invest in Africa, do not import oil from nor export to Africa." We are not saying "do not provide foreign assistance nor maintain diplomatic ties with Africa." What we should be saying is that we expect China to play by the same formal rules of the game, such as those of the WTO or the ITU, whether for intellectual property rights or oil imports; and beyond that, we also expect that China will demonstrate a sense of global responsibility commensurate with an international power's weight and position. This involves respecting informal and implicit norms like responding appropriately to natural disasters, or to conflicts around the world, and engaging in international relations with respect for sovereignty but also attentive to and supportive of transparency, openness and the widest possible political

participation. Germany, France, Japan and the U.S. have very different approaches to Africa. This is a good thing, since it provides complementarity. China's approach to Africa will never be identical to the U.S. approach. It remains to be seen how much Beijing will pursue convergence, and at what pace, to make China conform more to current international norms for dealing with Africa.

Thank you, Mr. Chairman.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Dr. Wilson. Dr. Calabrese.

**STATEMENT OF DR. JOHN CALABRESE  
SCHOLAR-IN-RESIDENCE, THE MIDDLE EAST INSTITUTE,  
ASSISTANT PROFESSOR, AMERICAN UNIVERSITY,  
WASHINGTON, D.C.**

DR. CALABRESE: Thanks very much for inviting me. I've had the opportunity to speak with many of you or hear most of you speak at other audiences, and the only thing that concerns me is that you invited me. I hope this doesn't degrade the reputation of the Commission.

Unlike Professor Wilson, I'm not going to speak directly to the questions that you asked because I think those are covered, to the extent that I could cover them, in my written testimony. Instead, what I'd like to do is tick off some of the themes that I tried to develop, albeit briefly, in those written remarks.

The first thing that I want to emphasize is that it's difficult to generalize about how Sino-Middle Eastern relations are developing, what their content is, and what their implications for the United States are. A major reason for this is that China has cast a very wide net.

China's relations with the countries of the region are all inclusive. A positive aspect of this is that since 1992 China and Israel, from the United States perspective, have enjoyed a very fruitful, mutually beneficial relationship. However, there is a caveat: Israeli-Chinese military interaction has, in some instances, been a concern.

Of perhaps the greatest concern today is the content, direction, underlying motivations, and consequences of Sino-Iranian relations. This is a subject I hope we can explore in the Q&A period.

A second point that I'd like to emphasize is that the relationship that China has cultivated with the Middle East are multifaceted and they date back well over ten years. They are multifaceted in the sense that they are anchored in personal and institutional relationships in the diplomatic sphere, and encompass a great deal more than trade in crude oil. There is also a military dimension of Sino-Middle Eastern relations, aspects of which ought to concern us, do concern us. We should remain very vigilant about China's arms transfer and proliferation practices. In short, China is deeply engaged with the Middle East and the Middle East is deeply engaged with China across a wide range of activities. These

have become extensive and permanent feature of the international landscape.

Third, there is a tendency for us to either assume or to portray China's relations with its Middle Eastern partners as being crafted and controlled by their respective political leaderships. We are tempted to adopt this view particularly when talking about energy cooperation, because of the dominant role in the energy sector in China that state enterprises play. Here, the conventional wisdom that all state enterprises are a static mode, all equally governed or guided, by the state. I am a skeptic about the notion that the Chinese political leadership can or does control how these relationships are developing

In pursuing business in the Middle East, is CNPC, for example, guided by commercial and market considerations or simply taking cues from the state

These latter questions are outside my area of expertise. I think one of the great things about this hearing and others, I hope, that you will hold is that there will be a cross-fertilization of expertise and disciplines because I don't think that it's very fruitful to have, on the one hand, people who are strategists talk about this set of evolving relationships without having some knowledge of the energy dynamics and vice versa.

A fourth point I wish to emphasize pertains to the question of whether in launching and consolidating these energy ties the initiative is coming from China or from its Middle Eastern partners? Clearly, the initiative cuts in both directions. However, it is impossible to generalize. We must examine this question on a country-specific basis. In the case of Sino-Iranian relations, for example, geopolitical considerations motivating Iran. With the nuclear issue center stage, those geopolitical considerations, those security concerns are the principal drivers for Iran to seek to engage China more deeply in the energy sector.

Geopolitical considerations are a distant second or third. Doing business, trying to capture and enlarge the Chinese sort of niche, the Chinese market, and the way in which the principal Saudi energy companies are vying with other producers to do business in China and in East Asia is the principal driver.

A fifth point I'd like to emphasize is that I think diversification is the name of the game for China as well as for each of China's Middle Eastern partners.

Now what do I mean by diversification? From the Chinese perspective, I think that they see it as imperative, not only in their dealings in terms of the energy sector, but in terms of their dealings outside the energy sector, to have numerous partners and to enlarge their business activities, both within energy, beyond energy, within the Persian Gulf, outside the Persian Gulf From the point of view of China's Middle Eastern partners, there's also an emphasis on diversification. I don't think

that any individual country, including Iran, is interested in an exclusive relationship with China. .

I guess time is running out--you can never get a professor to talk within a time limit anyway.

HEARING COCHAIR BLUMENTHAL: That's why we have this timer in front of us.

DR. CALABRESE: What I hope that we could do is go through, if we have some time, each of these bilateral relationships and talk a little bit about them: China-Saudi; China-Iran. China-Iraq is fascinating. China-Israel is fascinating, and there are interesting contradictions, in the way that China is posturing and conducting itself, both on the state level and on the sub-state level with respect to each of these countries and others.

UAE, for example, is a really important player when it comes to China, but not for the exact same reasons that Iran or for that matter Saudi Arabia is important to China. Why is this tiny mini-country on the edge of the Persian Gulf so important in the sort of business framework of those who are looking from Beijing to carving a larger and larger and larger economic presence in the Gulf and beyond? This, too, is a subject that merits further discussion.

[The statement follows:]

**Prepared Statement of Dr. John Calabrese  
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CHINA'S GLOBAL ECONOMIC REACH AND US PRIMACY**

China's diplomatic strategy and conduct in the Middle East are set in the broader context of the progressive development and global reach of the Chinese economy on the one hand, and US global preeminence on the other.

Beijing has long viewed economic progress as a necessary means of bolstering regime legitimacy and stability, as well as enhancing China's status and influence on the world stage. The economic modernization program has been designed with a distinctly outward focus, leading to China's deeper integration into the global economy. This is most visible in two respects: the rapid expansion of China's export capacity and the widening of its export market, and the equally rapidly rising appetite for foreign sources of raw materials with which to fuel the burgeoning industrial sector and to meet surging domestic consumption needs.

China's economic modernization efforts have helped bring about unprecedented high rates of growth, abundant foreign exchange reserves, and optimistic forecasts for growth in the near term. Nevertheless, there is grave concern in Beijing about the economy's exposure to the vicissitudes of the market. This concern is most acute with respect to China's growing dependence on foreign sources of vital industrial inputs and oil/gas supplies.

The paradoxical mix of self-confidence and anxiety ties in with the global geopolitical situation. From the Chinese perspective, American primacy is the dominant characteristic of the current international system. And Beijing is quite conflicted about it. In addition to having become a major stakeholder in the world economy, China, as the result of extensive economic ties with the United States, is also deeply invested in a



stable Sino-American relationship. Yet the Chinese have deep misgivings about the purposes and conduct of US foreign policy. To Beijing, the basic precepts of the Bush Doctrine such as preventive war and democracy promotion are anathema. The Chinese are also uneasy about the forward projection of American military power into West and Central Asia.

Given that the primary locus for both China's international energy activities and US foreign policy priorities is the Middle East, current circumstance has created incentives and opportunities for China to become ever more engaged with the region—diplomatically, economically, and (though to a far lesser extent) militarily as well. As a result, the Middle East has emerged as a region where US and Chinese interests and policies intersect.

## SEPARATING FACTS FROM FEARS

Sino-Middle Eastern relations are neither new nor can they be captured easily and accurately in a label. These relationships have developed in stages. In the 1950s, Chinese statecraft consisted chiefly of diplomatic efforts to woo Arab nationalist leaders by declaring solidarity with them and encouraging them to set aside their differences with each other in the interest of forging with Beijing a “united front” against Western domination. Though this message had some resonance, Sino-Middle Eastern relations did not advance in any concrete way. In the 1960s, Beijing's approach to the Middle East bore the imprint of the Chinese Cultural Revolution and the intensification of the Sino-Soviet rivalry. Accordingly, Beijing supported national liberation movements and other sub-state actors in the Middle East (as it did elsewhere in the developing world), ranging from the Algerian interim-government to various Palestinian factions and the Popular Front for the Liberation of Oman and the Arabian Gulf (PLFOAG). However, the level of priority and the amount of material assistance China provided to such groups in the Middle East were relatively low as compared to other regions.

There are four aspects worth noting about these early periods of Sino-Middle Eastern relations. First, in terms of what might be called a “Chinese cosmology” or worldview, the leadership in Beijing consistently regarded the Middle East as a focal point of great power rivalry whose control was a key determinant of the global distribution of power, and for this reason viewed developments in the Middle East as being linked, however tenuously, to China's national interests. Second, China had a policy toward the Middle East in spite of the fact that it had virtually no economic interests to promote and protect. Even in the energy sector—the centerpiece of Sino-Middle Eastern business relations today—China remained, until 1993, a net oil exporter that purchased modest quantities mainly from three of the smaller Gulf producers. Third, Chinese diplomacy was geared mainly toward advancing *political* objectives. Fourth, insofar as most of the Middle East was concerned, China was a distant, little understood second-tier player in regional and global affairs.

The tide began to turn in the late 1970s. The strategic decision by Deng Xiaoping to make economic modernization China's top domestic and foreign policy priority was a path-breaking development. This was coupled with the normalization of China's relations with the West and specifically with the United States. While staking out an “independent” foreign policy vis-à-vis the superpowers in the 1980s, Beijing abandoned all but the pretense of revolutionary communist ideology in conducting statecraft. In terms of the wider Middle East, China effectively became a status quo, rather than a revisionist power.

There are several noteworthy aspects of China's approach during this period (1970s and 1980s). First, there was a return to the primacy of state-to-state relations. Second, there was a willingness by Beijing to make common cause with regional governments and with the United States, as in supporting the Afghan *mujaheddin* mainly in order to weaken the Soviet Union. Here it is necessary to underscore that Afghanistan was an issue where there existed a broad region-wide consensus that China could join at a low level of risk and cost. Third was the opportunism China displayed in probing for business in the region, as in the weapons it sold to both Iran and Iraq during their 1980-1988 war. Fourth was the increasing salience of economic factors in China's Middle East statecraft. The weapons sales just mentioned gave China a firm though narrow foothold in the regional arms market, a flurry of labor service and engineering contracts

paved the way for much more lucrative turnkey projects, and the volume of Chinese oil imports from the Middle East began to rise in slow but steady increments. These burgeoning commercial activities eventually led Beijing to become more active on the diplomatic front.

Since 1993—the date marking China’s emergence as a net oil importer and the date often though misleadingly used to identify the *inception* of Sino-Middle Eastern relations—there has undoubtedly been a sea change in their scale and scope. Before turning to the questions posed by this Commission, which relate to how Chinese statecraft has been used to consolidate Sino-Middle Eastern ties and the possible implications for US interests and policies, it may be helpful to describe the actual *substance* of these relations.

China has cast a wide net in the Middle East. Its bilateral relationships with the countries of the region are multifaceted. Today, high-profile visits by senior leaders, cabinet ministers, mid-ranking and working-level ministry staff, and business delegations are the norm rather than the exception. Indeed, with the signing of long-term trade and economic cooperation agreements, many of these contacts have become institutionalized. Efforts are being made to bridge the Sino-Middle Eastern cultural divide, through tourism, educational and other exchanges. With every successfully negotiated contract and completed project has come greater familiarity with one another’s business practices and greater awareness of one another’s strengths and deficiencies.

Sino-Middle Eastern business is booming, both reflecting and reinforcing the aforementioned trends. Energy cooperation, which forms the core of the dynamic growth of Sino-Middle Eastern economic ties, has itself become a diverse field of business activity, with Chinese energy entities engaged in upstream and downstream development projects in the region and some of their Middle Eastern counterparts doing the same in China. The internationalization of operations by Chinese companies in *non-energy* sectors has also made its impact felt in the Middle East. Chinese firms are involved in mining, shipbuilding, dam and hydroelectric power plant construction, and to some degree in manufacturing as well.

It is important to mention that although Chinese commercial interests and activities span many economic sectors and encompass the entire Middle East, they are spread unevenly throughout the region. A number of factors have contributed to this differentiated landscape. Conflict and instability, for example, have constrained the development of energy relations in Iraq, as have domestic restrictions on foreign participation and ownership in the energy sector in Saudi Arabia. Geopolitical circumstances, such as US sanctions that bar American oil companies from doing business in Iran have created opportunities that Chinese enterprises (among others) have turned to their own advantage. Finally, it is worth noting that Chinese firms in the energy and non-energy sectors are fanning out throughout the region and simultaneously in all other regions, not simply as the result of strategic guidance by the state but in response to their own calculations of profit and risk and the corresponding incentives to diversify their business relationships and reduce their exposure.

That said, the Arabian/Persian Gulf is the commercial and geopolitical center of gravity of this relatively new and consequential dimension of Sino-American relations. Dependence on foreign sources of oil is an irreversible fact of life for China—a fundamental feature of its energy profile and of the global energy market for years to come. The Gulf is a natural magnet for China. Indeed, Gulf suppliers are already vitally important energy partners. Since 1996, the lion’s share of Chinese crude oil imports (about 60 percent) has come from the Middle East. Furthermore, this dependence has been highly concentrated *within* the region. As recently as 2002, for example, oil purchases from just three Gulf countries—Saudi Arabia (11.53 mn tons), Iran (10.73 mn tons), and Oman (8.31 mn tons)—accounted for 43.3 percent of China’s total oil imports. Facing the challenge of unavoidable

dependence on a region of chronic geopolitical and market uncertainty and spurred by the Iraq War (2003), Chinese enterprises redoubled their efforts to diversify their sources of supply both *away from* and *within* the Middle East. By mid-2005, Chinese energy firms had invested \$15 billion and had bid successfully for exploration rights or had purchased equity shares in overseas oil/gas fields in 44 countries.

Again it is important to emphasize that though the oil supply relationship is the central strand of the burgeoning commercial ties between China and Middle East, it is by no means the only one. Nor are these increasingly extensive business relations a one-way street, with the Chinese side always taking the initiative. And, while geopolitical considerations undoubtedly inform and in some instances are conceivably the primary drivers of commercial activity, simply doing business has been a strong enough incentive to spur Sino-Middle Eastern economic cooperation.

Finally, it must be said that not every aspect of Sino-Middle Eastern economic cooperation poses the same type or level of challenge to the United States. Nor does every bilateral relationship present the same potential problem for US policy-makers or American businesses. Record-high energy prices and prognostications of “peak oil,” the escalating diplomatic crisis over the Iranian nuclear program, and, as will be shown, aspects of China’s past and present involvement in the Middle East have, quite understandably, raised questions about Chinese intentions. However, we might be best served to avoid taking it as a given that Sino-Middle Eastern relations are designed by Beijing mainly in order to challenge American preeminence by subverting US interests and policies in the region, or that they are inexorably headed in that direction.

#### **CHINESE STATECRAFT—OPENING THE DOOR FOR ENERGY TRADE**

**1. The Military Tool:** China does not currently possess the ability to project military force directly into the Middle East. Nor is there evidence that China can develop such capacity any time soon or has made the strategic decision to pursue this objective in the longer term. There are at least two factors that might explain why China has not embarked on this path: (1) the prohibitive risks and costs of challenging the United States in an area where the latter’s military presence is extensive and deeply entrenched; and (2) the fact that China benefits from the role that US forces play in ensuring the safe passage of oil from the Middle East to the global market.

Meanwhile, Middle Eastern states’ appear uninterested, at best, in a Chinese military presence in the region. This is perhaps because they regard China as a poor substitute for or inadequate shield against American military power. Alternatively, it might be because they view China as they do Russia, mainly as a second-tier military partner (i.e., primarily as a source of weapons and technology), possibly *in extremis* as a hedge against a deterioration of relations with Washington, and most likely as leverage in dealings with Washington.

Since the mid-1980s, China has been an active participant in the Middle Eastern arms market. China’s purchases from Israel have caused some consternation in Washington. But most of the concern and controversy surrounding Sino-Middle Eastern arms transfers has stemmed from China’s role as a *weapons supplier*, not as a customer. Clearly, not *all* Chinese arms transfers to the Middle East pose a high risk for American forces, or threaten to alter the regional balance of power in a way that endangers US allies and interests. Of the wide assortment of weapons that Chinese companies have transferred to the region over the years, there are three main areas of special concern: (1) missiles and associated technology, (2) material related to the possible manufacture of chemical weapons, and (3) nuclear technology.

Beijing’s claim that Middle Eastern states have legitimate defense needs and that Chinese companies have a legitimate interest in competing in the regional arms market is a valid one, and is generally regarded as such by US officials. Since the early 1990s China’s non-proliferation posture has improved considerably. There has been notable progress in spelling out and gaining Beijing’s acceptance of norms and standards of conduct regarding the transfer of specific types of weapons and technology. Yet, of the three sensitive areas listed above, the proliferation of missiles and missile-related

technology—mainly to Iran—remains the most persistent and arguably the most dangerous aspect of Sino-Middle Eastern relations. The US State Department and Treasury Department have repeatedly cited and sanctioned Chinese companies for their proliferation activities. Three companies (or their respective subsidiaries) stand out as “serial violators” of Beijing’s non-proliferation pledges and commitments—the Norinco Group, the Great Wall Industrial Corporation, and the China Aerospace Science and Technology Corporation (CASC).

These troubling aspects of China’s involvement in the Middle East are of course far from transparent. This poses several problems for the United States. It makes any such transaction and the scope of activity hard to detect, and the direct responsibility of Chinese state authorities hard to pin down. It is exceedingly difficult to establish conclusively that proliferation by a given Chinese company is linked to access to energy. Yet, while an energy-for-arms link can neither be simply assumed nor easily proven, what gives cause for concern is that all three companies identified above as “serial proliferators,” besides having poor track records on proliferation are state-owned civilian defense enterprises enterprises (SOEs) at least nominally under the direct supervision of the State Council.

**2. The Diplomatic Tool:** As mentioned earlier, China’s Middle East diplomacy is an extensive network of personal and institutional relationships conducted through bilateral and multilateral channels. While this diplomacy encompasses regional and international issues, it is primarily focused on promoting and supporting Chinese economic interests in the region. And Beijing’s economic diplomacy in the Middle East, as previously mentioned, while concentrated in the energy sector nonetheless consists of a broad-based effort both to attract Arab investment to China and to pave the way for Chinese firms to expand their market presence in non-energy sectors throughout the region.

Whereas in the past Chinese business had tended to lead and Chinese diplomacy to follow, in recent years the two are more tightly synchronized. This is partly a reflection of the increased size and professionalism of the Chinese diplomatic apparatus. It also reflects the cumulative experience of the growing number of Chinese diplomats who have served in the region. And of course it reflects the assignment of a higher level of priority and the dedication of greater resources by the senior leadership in Beijing to the Middle East.

In terms of the actual conduct of Chinese diplomacy, this has translated into (1) efforts to boost the prospects for Chinese enterprises to lock in long-term access to energy resources and (2) efforts to extend political support to Middle Eastern partners at least partly in order to protect and expand Chinese energy interests.

In the Middle East as in other regions, China has shown a propensity for “paying a premium” to gain or enlarge access to resources. Here diplomacy has been used to support the entry into and expansion of the presence of Chinese energy companies in the Middle East regional market.

Beijing can perhaps be faulted both for lack of transparency in making these arrangements and for encouraging unfair business practices. But the success of Chinese energy companies in the Middle East cannot be explained as the natural consequence of state-led and state-supported predatory practices. Chinese energy entities have shown a greater patience in overcoming the political and bureaucratic obstacles to doing business in the Middle East, as well as greater flexibility and higher tolerance for risk than many of their foreign competitors. A case in point is Sinopec’s willingness to purchase oil from Iran on a buy-back basis, terms which many Western oil firms are reluctant to adopt. Chinese companies are clearly willing to ignore political and human rights considerations, as well as to exploit US sanctions barring American companies from doing business. Of course it remains to be seen whether their willingness to assume greater financial risk and exposure than are many of their Western or East Asian competitors will pay off or backfire.

Furthermore, it is not clear how much “extra push” is required by Beijing to help pry open the door for energy business in the Middle East. For years, energy experts, reporting on global market trends, have projected South and East Asia as the two fastest growing energy consuming markets. Gulf producers were quick to realize this and have sought to capitalize on it. For example, both Saudi Aramco and

Saudi Basic Industries Corporation (SABIC), the latter the Middle East's largest petrochemical company, quite apart from any obvious political guidance or geopolitical consideration, altered their business strategies, pouring investments into China mainly in order to cash in on East Asian demand for petroleum products.

**3. The Business Tool:** Diplomacy has helped pave the way for lucrative deals whereby Chinese energy enterprises have expanded their presence in the regional energy market in exchange for their commitment to invest in other sectors. Following President Hu Jintao's recent visit to Yemen, for example, Sinopec reached agreement to finance the modernization of a cement factory, finalize investment in electricity, minerals, and telecommunications sectors as well.

But if wielding the business tool has its upside, it has its downside, too. In the case of Iran, for example, with every visit and joint communiqué there are pledges by China to expand private sector investment in small and medium-sized non-energy industries in Iran. However, relatively little investment of this kind has been forthcoming, and Iranian authorities are plainly disappointed. Instead, relatively inexpensive Chinese consumer products have been saturating the Iranian market, in some sectors having the perverse effect of crowding out local producers.

Chinese business activity in the Middle East and the diplomacy supporting it is aimed not only at prying open the door to the region's energy supplies, but also at *offsetting the financial costs* associated with the growing volume and rising prices of crude oil imports from the region. China's share of the entire Gulf market is just \$25 billion, representing a mere 5 percent of the region's trade volume. In order to balance and reinforce the energy relationship, China has taken two corrective measures. The first is aimed at boosting the export of capital goods and consumer merchandise. Here the United Arab Emirates (UAE) figures prominently as a hub for Sino-Middle Eastern commerce. As of 2002, there were about 350 Chinese businesses with offices in the UAE and about 8,000 Chinese workers employed there. Though UAE is China's largest trading partner in the Gulf and Arab world, an estimated two-thirds of Chinese exports to the UAE are then shipped elsewhere in the region. The second corrective measure is the effort to negotiate a free trade agreement with the Gulf Cooperation Council (GCC).

**4. The Aid Tool:** With its dramatic economic growth over the past two decades, China has transitioned from aid recipient to international donor. Even in leaner years, China dispensed aid. Until recently, the largest beneficiaries of Chinese foreign aid had traditionally been countries such as Pakistan, Bangladesh, and North Korea. In the hunt for resources, Africa has emerged as a prime destination. China appears willing to provide generous sums of unconditional aid and soft loans to Africa partners such as in the cases of Angola, Sudan, Zimbabwe, and Zambia.

Insofar as the Middle East is concerned, China was arguably more generous in its aid disbursements when it had far less to contribute than it does today. With respect to gaining access to Middle Eastern energy resources, trade and investment rather than aid seem to be China's preferred tools. That said, China has provided humanitarian aid in response to the Bam earthquake in Iran and other similar tragedies in the region. However, it is likely that China would have disbursed aid for these purposes even were its energy interests in the region not as substantial as they have recently become.

#### **SINO-IRANIAN RELATIONS AND GLOBAL EFFORTS TO SECURE PEACE**

There are two main areas where China's relationship with Iran could conceivably undermine prospects for peace: (1) the stabilization of post-Saddam Iraq and (2) the settlement of the Arab/Palestinian-Israeli conflict.

There is no discernible connection between Sino-Iranian relations and efforts by Iran to consolidate its influence whether by peaceful or violent means, either to support Shi'a power or to undercut the United States.

With respect to the Arab/Palestinian-Israeli conflict, China has good relations with Israel, as it does with all of the Arab states and with Fatah. There are no apparent links between China and Hamas, Islamic Jihad, or Hezbollah. Beijing ritualistically endorses the Palestinian claim to national self-

determination, expresses support for a two-state solution, emphasizes the need for a comprehensive negotiated settlement, and balances its condemnation of Palestinian terrorism with calls for Israel to exercise restraint. China has aligned itself with the mainstream or moderate Arab position. Thus, Chinese and Iranian policies toward Israel and the Arab/Palestinian conflict actually diverge.

However, mainly as the result of its proliferation practices, China's own conduct has undercut the tenor and thrust of its own diplomacy. As the recent upsurge in violence in the Levant has revealed, the missile fired by Hezbollah that struck the Israeli warship *Sear* on July 14<sup>th</sup> was reportedly of a type built and provided by Iran that incorporated Chinese technology. If these reports prove correct, then although several steps removed from the actual military operations launched at Israel, China's proliferation practices are nonetheless partially responsible for exacerbating the conflict.

A key point to add here is that while Beijing has consistently sought to avoid being drawn into regional disputes and has thus preferred to play a cautious and limited diplomatic role, there are growing expectations and pressures in the Middle East for China to be more proactive. Beijing's Middle Eastern partners are therefore seeking to capitalize on China's deepening energy dependence on the region and rising global economic power not just on the business front, but on the international diplomatic front as well.

### **CHINA'S STRUGGLE TO RECONCILE COMPETING INTERESTS**

Arguably the clearest case where China has sought to reconcile competing interests is in the escalating diplomatic crisis over the Iranian nuclear program. Chinese officials at various levels have been actively engaged in nuclear diplomacy: working behind the scenes in the UN and IAEA to advance Chinese positions; joining with other major powers, as in the May 2006 meetings in Vienna to discuss how to achieve a breakthrough; and conferring by telephone, as in President Hu Jintao's conversations with German Chancellor Angela Merkel and President George W. Bush. Chinese diplomats have consulted closely with their Iranian counterparts as well. At critical intervals, Chinese and Iranian officials have shuttled between capitals. Foreign Minister Li Xiaoxing traveled to Iran in early November 2004 to discuss the nuclear issue. Just prior to the November 25, 2005 meeting of the IAEA Board of Governors, Iran's envoy, Hoseyn Musavian, was dispatched to China for discussions. Chinese Foreign Minister Li Zhaoxing conferred with Iranian Deputy Foreign Minister Abbas Araghchi in Beijing shortly after the Western incentives package was presented to Iran in May 2006.

Throughout this period, China's nuclear diplomacy has rested upon three broad principles: (1) no intervention in the domestic affairs of another country, (2) no nuclear proliferation, (3) and no disruption of energy supplies from the Middle East. Beijing has sought to balance its interests in the nuclear standoff by emphasizing both Iran's rights and obligations under the NPT. In their public remarks, Chinese officials have made explicit their opposition to Iran's acquiring nuclear weapons and have repeatedly called upon Tehran to honor its treaty commitments and to cooperate fully with the IAEA. At the same time, they have strongly endorsed Tehran's position that, as an NPT signatory, Iran is entitled to access to nuclear technology and to nuclear energy for peaceful purposes.

Chinese officials have been quick to praise instances of cooperation by Tehran, as in President Hu Jintao's remarks following his meeting with then-Foreign Minister Kamal Kharrazi in Beijing in August 2003. At the same time, however, Beijing has urged Iran to clarify the details of its program. China has consistently maintained that negotiation—through dialogue and consultations—is the best way to resolve the issue. Chinese Foreign Ministry spokesmen have frequently expressed support for European and Russian diplomatic initiatives, welcoming them as “constructive proposals.” As frequently, they have insisted that the Iranian nuclear issue be addressed within the framework of the International Atomic Energy Agency (IAEA), and by implication, *not* within the UN Security Council.

Yet, during the past six months, China has found itself caught in a cycle of escalating Iranian defiance and mounting Western pressure. The Chinese response to this development has been measured and cautious. When in January 2006 Tehran removed UN seals on enrichment equipment, triggering the EU-3's decision to suspend talks, Chinese officials urged restraint and pledged to promote the resumption of diplomatic negotiations. While having previously resisted the US-led effort to transfer

the Iranian nuclear dossier to the UN Security Council, in February 2006 Beijing cast its vote with the majority of the IAEA Board of Governors members in favor of referral. The next month, Beijing also fell into line with other UN Security Council members, agreeing to a statement of “serious concern” and a deadline for further action.

However, Beijing does appear to have drawn a red line—stopping short of endorsing economic sanctions or leaving open the door to the possible use of military force to gain Iran’s compliance. Beijing, which has seemed quite comfortable in having Russia play a proactive role in resolving the nuclear crisis, joined with Moscow in blocking the US-led attempt in May 2006 to introduce a Chapter VII resolution at the United Nations. This blocking maneuver, conducted in tandem with Russia, had the salutary effect of providing a breathing spell during which Western countries could explore an alternative approach. Indeed, China welcomed the incentives package subsequently presented to Iran by EU High Representative for the CFSP Javier Solana, though Chinese Ambassador to the United Nations Wang Guangya noted that the US should set no preconditions and later cautioned against setting arbitrary deadlines for Iran to give an official response.

Iran’s aim *vis-à-vis* China has been rather clear and straightforward from the beginning—to win Beijing’s support and thus divide the major powers. In contrast, China’s position stems from *several* considerations. Though protecting its burgeoning energy interests in Iran is arguably the most important, China’s other concerns should not be discounted. The first is China’s longstanding opposition to “power politics.” Following from this is Beijing’s aversion to levying sanctions and its steadfast refusal to endorse military force to resolve international disputes. The second is China’s sympathy and solidarity with Iran, a developing country, in the face of Western pressure. The third is the conviction—shared with Russia and Europe—that exerting too much pressure on Tehran is likely to backfire, resulting in either Iran’s withdrawal from the NPT or unilateral military action by the United States. The fourth is cultivating an image and reputation as a responsible member of the international community and keeping its relationship with the United States on an even keel. Related to this is the fact that China has come to accept global arms control and non-proliferation norms, having joined the NPT in 1992. Last but not least is Beijing’s desire to ensure that support for Iran does not compromise its relationships with Iran’s Arab neighbors, all of which live in the shadow of Iranian power and with which China has developed profitable relationships. Illustrative of this concern is China’s support for a nuclear-free Middle East, which was spelled out in the communiqué issued at the second Ministerial Meeting of the China-Arab Cooperation Forum in May 2006.

HEARING COCHAIR BLUMENTHAL: Thank you very much. Dr. Watson.

**STATEMENT OF CYNTHIA A. WATSON, PhD  
PROFESSOR OF STRATEGY, THE NATIONAL WAR COLLEGE,  
WASHINGTON, D.C.**

DR. WATSON: I'd like to thank the commissioners for this opportunity this morning and, like Dr. Calabrese, I'd like to speak to three points that go beyond what's in my testimony. And one of the points I state very clearly in the testimony, but let me lay it out for all of us right now, and that is I don't find Chinese behavior in Latin America today to be all that surprising. I find it to be the behavior of a state that sees itself as an emerging power.

I don't think it's dependent on the form of regime. I think it's not dependent on being Chinese. I think it's simply a state that wants to believe it has a global role or at least believes it's developing that role.

My second point relates to something that Dr. Wilson said, and I think that this is a commission that's looking at U.S.-Chinese relations, but let me say it because you don't specialize in Latin America, while the Chinese are seeing opportunities perhaps--that's debatable--but are seeing circumstances which may push them to support, may push them to thwart, depending on your perspective, democracy and transparency in Africa, arguably, that is not the case in Latin America, and that relates to the fact that U.S.-Latin American relations, which are based on the idea, at least on our side, that we are seeking to see the enhancement, development, the spread of both transparency, democracy, as well as free markets, is virtually a bankrupt idea in some parts of Latin America.

The frustration with what has happened in the last 15 years, as incidents of corruption, as incidents of governments that have not governed particularly well and have been caught by that, is something that populations across the region are well aware of. What we're seeing in Mexico today is a manifestation of that instead of a validation of an election that may have been a close election.

Beijing therefore isn't put in the same position where they have to push for democracy and transparency because it's not as welcome.

My third point relates to a couple of things that Dr. Calabrese said that I think are particularly interesting in light of the Latin American experience, and that is there is indeed also mutuality of the desire on the part of Latin Americans to both diversify their partnerships around the world, their business relationships their diplomatic relationships, and I would say in particular it is dangerous to overstate the role that Beijing has in pushing a relationship with Caracas under Hugo Chavez Frias. He very much wants to see the relationship I would argue even more probably than Beijing does, because that's all he has going for him.

He has absolutely no other project, no other national program, except anti-U.S. sentiment, and therefore Beijing becomes absolutely crucial to him. But that's easy to overstate. It's easy to think that that's Beijing's part because we don't entirely understand what Beijing is doing.

At the same time, I think across the region, there is a sense that this is one more partnership that they can get into, they don't want to be put in a dependent position. Again, Dr. Wilson said earlier that African states are aware--I'm paraphrasing you--but he said something to the effect that African states don't want to be put in a dependent position.

I guarantee Latin American states do not want to be put in a position where they transfer what is largely seen on their part--I am not saying this is my view--but it is largely seen on their part as a relationship over which they have no control with Washington. They don't want to go into a relationship they don't have any control over Beijing, and they know that, and to a great extent I think we are not giving them enough credit when we assume that they don't realize what they're getting into with Beijing, quote, "moving into the region."



So let me stop with that. I did not go over my seven minutes and let me welcome your questions.  
[The statement follows:]

**Prepared Statement of Cynthia A. Watson, PhD  
Professor of Strategy, The National War College, Washington, D.C.**

I appreciate the opportunity to offer my analysis before the Commissioners this morning on China's evolving role in Latin America. These are personal views, not those of the National War College or National Defense University. If it pleases the Commissioners, I ask to enter into the record a paper I presented on this topic at the Institute for National Strategic Studies' June 2006 symposium on China in the international community. The paper considered many of the same broad issues the Commission is pursuing but will allow me to focus my remarks directly on the questions the Commission asked in the letter of invitation to this hearing.

My research on the topic has provided me with several important overall assessments of China's interest in Latin America that need be stated up front. First, I do not believe China **currently** poses a significant strategic threat to the United States in Latin America. Most important to the Chinese is their relationship with the United States which they would not jeopardize through strengthening their ties to regional governments at the expense of ties to Washington. Second, I believe the Chinese are acting as any great power would act: I do not find their actions uniquely Chinese nor are they surprising. The Chinese leadership of any regime would assert that they have global interests to include Latin America. Third, I believe that the opening for China results from the poor state of U.S.-Latin American relations as much as anything Beijing itself has done. Please note that in this assessment I will try giving a view from the Latin American perspective about the issues, not merely from Washington.

Chinese actions in Latin America indicate that Beijing **seeks to portray itself** as a benevolent, welcome 'newcomer' to the Latin American scene. The People's Republic of China established relations with the overwhelming majority of states in the region between 1970 and 1985, with Cuba a notable, early exception to that timeline. The November 2004 Hu Jintao visit, which I have compared elsewhere to a 'rock star' tour of the region, is only one of a series of diplomatic visits highly touted as opportunities for the region to get to know Chinese leadership and visa-versa. Chinese leaders have visited the major capitals of South America and Mexico occasionally since 2000 but not as often as they have been in the capitals of Asia. These meetings, along with similar reciprocals in Beijing, do not seem out of the ordinary for a state which considers itself a growing power on the world diplomatic scene.

On the question of Taiwan, Beijing has been restrained in its behavior as it has taken limited steps to reverse the diplomatic relations existing between Paraguay and the five Central American nations and Taipei. Beijing has made it clear it would not tolerate states seeking either to have dual recognition or switch diplomatic recognition back to Taipei but I am not aware of cases of that occurring. States in the region have predominantly chosen to accept Beijing as the sole government of China, based on Latin America's strong tradition of common understanding of international legal norms. The Latin American states have also recognized Beijing because they see it in their national interests to do so.

Central American states and Paraguay retain their fifty year old recognition of Taiwan because Beijing has not yet offered them a better deal. While there are some trade reasons for Taiwan's ties with these states, especially Panama, these ties are not likely to appear compelling to these states' governments over the long term if Beijing offers significant assistance and trade incentives. Taiwan, in short, is in a deteriorating position in this region as is true elsewhere around the world.

The security implications of Beijing's growing diplomatic presence do not seem dire to Latin American states, because the United States appears **to them** not all that interested in the region. The message that Latin American states have received in the post-911 years is that the United States puts its resources against known or anticipated terrorist threats, a condition lacking for the most part in this region. Proclamations of

shared inter-American visions of democracy or free trade appear hollow to Latin Americans, even in light of the free trade agreement with Chile (signed in 2003) or NAFTA with Mexico over a decade ago. The concerns that Latin America has with Venezuela are far less than those of Washington, even though the Latins share the turf with Caracas. While enhanced military and economic connections between Caracas and Beijing are noted in Latin American capitals, few in the region find Chávez Frías the danger that Washington does, despite his growing confrontational style and consolidation of power around himself. Furthermore, the April 2002 coup attempt against him left Washington, and not the Venezuelan leader, seen as the spoiler in the region.

Washington has concerns about Castro enhancing ties with Beijing but the Chinese are guarded in their approach to an aging dictator with no clear succession line in place. One thing that causes Beijing great discomfort is uncertainty, and few places in the region offer more of that in the future than does Cuba. There are military-to-military ties between the PRC and Latin American states but this is more because of the weakness of their ties with Washington than because these states seek to open their military establishments to the Chinese. Latin American militaries have attended People's Liberation Army educational facilities at times in the past when they could not attend those in the United States. The Article 98 issues (restricting ties with states not accepting U.S. objections to the International Court jurisdiction over U.S. forces) remains a bitter pill for the region.

The greatest way to neutralize Beijing's involvement in this region would be to improve U.S. ties with the area. Increased serious emphasis on a free trade pact for the whole of the Americas would be a first step. Seriously discussing United Nations reform to allow a permanent Latin American seat, probably Brazil but possibly Chile, on the Security Council would make a tremendous difference to these bilateral ties. Simply lowering the rhetoric about illegal immigration across the Mexican border would signal a genuine U.S. commitment to the region that feels increasingly that it's been ignored, abused, and taken advantage of by the United States. Turning to Beijing for solace should not surprise us but could be turned around now, before something significantly more permanent and sustaining could develop. Beijing is likely going to continue and strengthen its role in the region so that in the longer run the Chinese may become more important, but they are currently a peripheral concern for the Latin Americans.

Thank you for your time and I welcome your questions and comments.

### **Panel III: Discussion, Questions and Answers**

HEARING COCHAIR BLUMENTHAL: I have a question for all of you really because there seems to be a common theme, if I can sort of paraphrase, which is that Beijing itself is probably propelled into these various regions first for searching for markets and for oil and for resources and then, as Dr. Watson said, sort of getting used to a role as an emerging great power.

I have before me an article by Ian Bremmer from Fortune magazine that says that China is increasing its risks, pointing specifically to a threat by the Niger Delta Movement, a threat against Chinese citizens. Other Chinese citizens have been attacked in other places.

You can almost tell a story in which the Chinese are propelled forward into these regions, some of them rather murky, rather dangerous, possibly before they've thought through a strategy of how to be a great power, of how to protect your interests. I wonder how much risk you see in terms of this going a very different way than some of the conventional

thinking in Washington is, which is that China keeps emerging; China keeps growing more powerful; China deliberately goes into these regions to dominate them? Do you see another type of future where China gets itself into situations it can't control? It gets hit by terrorists and all of a sudden you see a China that can go in a number of different directions in terms of being in these parts of the world?

DR. WILSON: I'm glad you waited to ask that question till later because that's a tough question, but it's really the most important one. I'm going to give you one of these on-the-one-hand/on-the-other academic answers.

HEARING COCHAIR BLUMENTHAL: Good. We like those.

DR. WILSON: Which is it depends.

COMMISSION VICE CHAIR BARTHOLOMEW: We won't let you out of the room until you give us--

COMMISSIONER DONNELLY: That way we can pick the answer that we want.

DR. WILSON: All right. That's why I phrase this thing in terms of three possible scenarios. Will the Chinese respond in ways that make them more like the Italians, the French, the British and the Americans? Or will they respond in ways which will make them more, try to become more autonomous, pull out of the world system, et cetera?

My hunch is that the former is going to be the case rather than the latter as the economy becomes more of a market economy, firms, Chinese state-owned, once state-owned firms start to behave like private sector firms now. Look at the high tech industry that I know reasonably well. So I think that the domestic pressures, both political and commercial, will lead China to behave more like a normal country than a pariah or a radical country, let's say.

And to that extent if China is running, if CNOOC in the Delta region is running into difficulties with the local radical movement, poor people's movement, et cetera, then that's exactly what's happening with the British companies and the French companies. And so my hunch is that we will see those companies respond in ways that are not atypical of what Total would do as a French company or what British Petroleum would do as well. So I think I tend to assume that the Chinese will behave more and more like other states in the system rather than as a pariah state, but my colleagues may differ on that.

HEARING COCHAIR BLUMENTHAL: That would make it more difficult for them to hold themselves out as a leader of the third world then; right?

DR. WILSON: Yes. I think they're going to play this one. You've raised an important point which that is something they refuse to give up on. They have refused to say we are richer than all other developing countries virtually, and they have also refused to play the transparency democracy card.

I think they're giving up in other areas. They're investing more in nontraditional areas beyond infrastructure, but my hunch is those two will be the thorn that will affect China-U.S. relationships in Africa and other parts of the world.

HEARING COCHAIR BLUMENTHAL: Dr. Calabrese, in 48 seconds.

DR. CALABRESE: I can do it. I'll only stay on the downside of things. I think that we already see evidence in China's relations with different Middle Eastern partners, varying degrees of frustration in its business relations. Part of the reason for this is that, at least, for example, in the case of Iran, the business climate is exceedingly difficult to operate in, subject to bureaucratic red tape and bottlenecks.

It's one thing to get MOUs signed; it's another to get the agreements finalized. It's one thing to get the agreements finalized; it's another to implement them. So I think that we see, for example, just in this one case, China-Iran, there's some frustration. I don't think we're going to see an end to that.

Second, there's a degree of friction building in some Sino-Middle Eastern relationships. One source of such friction is the saturations of local markets with relatively low cost or even mid-range priced products--consumer merchandise, that crowds out local manufacturers. I think we already see evidence of some friction of this kind.

I also think that China runs the risk of being subjected to extortion or extortionate demands or high expectations. If China has shown a willingness, for example, to finance or to provide aid or to support showcase infrastructure projects in one country, potential business partners might expect or demand similar treatment

Finally, I think that China is likely to face political and strategic dilemmas. As we see, the deeper China gets involved in the Middle East, the harder it is for Beijing to avoid making difficult choices. Indeed, China faces a difficult choice in the case of addressing the Iranian nuclear challenge, and faces difficult choices and every time there is violence in the Levant. Those aren't going to go away.

HEARING COCHAIR BLUMENTHAL: So it's kind of welcome to superpower hood.

DR. CALABRESE: Exactly.

HEARING COCHAIR BLUMENTHAL: Good luck.

DR. CALABRESE: Exactly.

HEARING COCHAIR BLUMENTHAL: Dr. Watson, hopefully someone else will follow up.

DR. WATSON: Good, because I have a case that answers you very clearly.

HEARING COCHAIR BLUMENTHAL: We have questions from Chairman Wortzel and Commissioner Donnelly.

CHAIRMAN WORTZEL: Dr. Calabrese, I'd like to ask you some

questions generally about China's military interactions in the Middle East. You mentioned Israel's provision of significant amounts of high technology and sometimes American military technology to China that's been documented in places like Defense News and Jane's. Is that still going on and what are Israel's interests in doing that? Does the Chinese military relationship with Iran really help moderate the actions of Central Asian Islamic groups or is that just another way of earn a little extra money for the PLA or defense industries?

And finally, in Saudi Arabia, those intermediate range ballistic missiles that have been there now for over two decades surely need upgrade and maintenance. Is China doing anything to upgrade that missile force?

DR. CALABRESE: The easiest of the three questions to answer is the one with respect to Iran. There is an obvious contraction in terms. You could argue that it's not only worrisome for the United States, but in fact it has negative feedback effects on China's own interests.

Not everything that China provides to Iran or for that matter to any other customer is inherently destabilizing or inherently alters the strategic balance in the region, but there are certain specific items, mainly dual use technologies, that can be used to feed the Iranian indigenous capacity to build its own missiles, which are very worrying.

China has made numerous promises. It's adhered to a number of different standards. It's made many pledges, but you know as well as I that on about 70 different occasions, several Chinese companies—which I would call “serial proliferators” doing business in Iran, and not just military business, but other kinds of business including energy business, continue proliferate dangerous technologies.

I have a couple of suggestions about how to ramp up the pressure. This is something we need to be of very vigilant and very realistic about. We must continually remind the Chinese that this proliferation activity feeds back feeds back in ways that certainly don't serve their own interests.

On the question of Israel, I have little new information to offer a good answer. One reason why I cannot supply a good answer is that some of these military-to-military contacts and the content of the transaction that may follow from the, even in the Chinese-Israeli case, are rather opaque, difficult to detect, difficult to pin down. Of course the Chinese are ritualistically deny anything and everything concerning the transfer of military technology until presented with irrefutable evidence.

The third question--I'm sorry--what was it?

CHAIRMAN WORTZEL: The upgrade of the intermediate range ballistic missile.

DR. CALABRESE: Yes. You know, one would think that by this time they would certainly need to be upgraded. I really don't see any evidence of this. But then again I'm only privy to what's available in the

public domain. I don't see any evidence that this is going on.

I would add, however, that I do not believe the Saudis perceive China to be a major contributor to their defense capability in any niche and, of course, the fact that the United States just released about \$6 billion of military assistance to Saudi Arabia would suggest that Saudi Arabia is more interested in remaining tightly connected to the United States and wouldn't want to expand the military relationship with China lest it create some turbulence in U.S.-Saudi relations.

CHAIRMAN WORTZEL: You mentioned specific policy suggestions. I don't want to take up any more of the Commission's time, but those are very important. If you have specific policy suggestions and you want to revise or include them in your written testimony, we can make sure they get in the record and that we can consider them when we draft our annual report.

DR. CALABRESE: Okay. Be happy to.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Donnelly and then Commissioner Wessel.

COMMISSIONER DONNELLY: I've been looking for more specific benchmarks to try to figure out whether China is moving toward becoming a responsible stakeholder or not. So I'd like everybody to take that on, and in the spirit of leading the witnesses, I have some suggestions.

For Dr. Wilson, both Nigerians have Africa on the cusp of fairly profound political changes. Those are places that China has a presence and an interest--what role can we expect them to play in both those countries, particularly Nigeria, where the Muslims obviously expect to sort of have the presidency?

Dr. Calabrese, same question. You've been through the Iran bit, and I don't know if Pakistan is within your brief, but it's part of the greater Middle East, so I toss that out.

Dr. Watson, maybe a more cross-cutting issue about China. Even if the sort of initiatives are coming from Latin America toward China, is China going to take a standoffish towards the populist movements, Evo Morales as well as Hugo Chavez? Will they encourage that or will they, as you say, be very cautious about trying to foment or encourage that kind of sentiment? So, again, and feel free to add things that I didn't mention.

DR. WATSON: Why don't I start because mine is pretty brief?

COMMISSIONER DONNELLY: Okay.

DR. WATSON: This is in my written testimony--I didn't say it because I knew you all had privilege of reading my prepared statement before the hearing--but I don't believe Beijing will do anything to jeopardize the relationship with Washington long term.

As it relates to those two regimes in particular, and potentially a regime in Mexico should the election results from the second of July somehow be overturned, which I don't think is very likely, I think that

they would continue to have relations with those states. They would continue in the Venezuelan case to seek better economic relations, but I do not think that Beijing would engage in anything that appeared to be spreading the ideologies or frankly the movement.

I don't even think you're talking about ideologies. You're talking about cults of personality, certainly in the Venezuelan case, potentially in the Bolivian case, and frankly even in Mexico City. You're talking about a city that's larger than a lot of countries in terms of population. The mayor of Mexico City wants to be president while he's been president of 18 million people for a number of years.

I think they watch very carefully how we respond. I think they're aware of the fact this commission, as an example, has looked at this issue before, but I think they're not going to cease relations with those regimes because we don't approve of the regimes.

COMMISSIONER DONNELLY: Any quick thoughts about a post-Fidel? Give us just a guess since we don't know what could be upon us.

DR. WATSON: I think while they clearly have relations with Cuba, again as I state in my testimony, the thing that Beijing doesn't like is instability, and I think one of the lessons from this week is we don't have any idea exactly how things are going to go when he finally does kick off.

HEARING COCHAIR BLUMENTHAL: Any others, a minute and 30 seconds.

DR. CALABRESE: Thirty seconds. On the issue of Pakistan, I'm not a Pakistan specialist, so I can just hazard a few semi-informed guesses. China and Pakistan have a long-standing strategic relationship—one that has been and is mutually beneficial. It seems to me that this is an area where to some extent U.S. and Chinese interests are convergent in the sense that stability in Pakistan is very, very important for both countries for similar, though not identical, reasons.

I also think that there's a subtext: the United States and China have competing agendas vis-à-vis Pakistan. I think part of the reason for this is that China has a certain degree of mistrust about what American motivations are in consolidating relations with India. Consequently, when the U.S. releases F-16s to Pakistan and when we sign the nuclear deal with India, it creates a kind of a pressure whereby Pakistani officials might expect the Chinese to provide more extensive support. Now, having said that, the interesting caveat is that China at the same time, it seems to me, enjoys a pretty productive relationship with India. In short, we're in a very strategic environment in that part of the world is very fluid, with all the players hedging, including China.

DR. WILSON: Let me suggest, commissioner, that the benchmark issue is important. I think it's important for your work and what Congress needs. I was thinking about this earlier today and what I would do is I tend to think visually is draw sort of columns and rows, and here's foreign assistance and here's capital investment and here's human rights and

here's diplomacy. Here's what they're doing now in terms of, say, for foreign assistance.

Are they sticking in one sector or are they spreading their foreign assistance? Are they relying on tied aid so we'll give you some foreign assistance, but you have to buy our goodies? Are they building in some additional conditionalities? We'll give you our foreign assistance, but you can't lock up all of your opposition, for example.

COMMISSIONER DONNELLY: Just some of them.

COMMISSION VICE CHAIR BARTHOLOMEW: I think we know the answer to that one.

DR. WILSON: We think we know, absolutely. But one could design a set of benchmarks that would do that for capital investment, that would do that for foreign assistance, that would do it for human rights, diplomatic initiatives. I think it would be a useful thing. It would be a useful thing to do.

I think on the Nigeria, South Africa question, it points to perhaps a broader issue, which is that the Chinese tend to be pretty conservative in the sense that they want to talk to the guys in power, and again I don't know what happens in Latin America or in the Middle East, but one doesn't have the sense that they have a very sophisticated understanding of those who are out of power and might be contending for power are.

In other words, when our president goes overseas, he meets with the opposition. It is not clear that President Hu when he goes overseas meets with the opposition, which suggests that they're going to get, as someone suggested earlier, a big surprise the first time their guys get blown up or their guys are subjected to a hostage taking.

Because they don't have what we in the other Western countries have, which is a better sense of who the opposition is in South Africa, who the opposition is in Nigeria, they tend not to do that. They just want to talk to the guys who control things today.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Wessel.

COMMISSIONER WESSEL: Thank you to all our panelists. Dr. Wilson, you may have helped clarify a question I was going to ask. I'm going to ask it anyway and ask two specific questions of the other witnesses because earlier in your opening testimony you indicated that for oil-producing countries in Africa, China's involvement is a good thing, and I was struck by thinking about Sudan. My opinion is that's not necessarily a good thing with the provision of arms, et cetera, but as you just said, they may have a myopic view that it's about dealing with the people in power.

Dr. Calabrese, you mentioned the UAE and with the U.S.-UAE free trade discussions that have been ongoing, you piqued my interest. I'd like some specific information since you said that you had some views on that.

Dr. Watson, you did not mention Brazil. I would be interested in



what the specific range of issues is there right now between China and Brazil? Each of the witnesses. Did you want to start?

DR. WILSON: I agree.

COMMISSIONER WESSEL: I understand. Dr. Calabrese, just about the UAE?

DR. CALABRESE: Sure. Yes, very interesting. UAE plays a pivotal role as an entrepot or a kind of node of trade, not only within the Gulf but within the wider Middle East, and therefore China's interactions with UAE largely revolve around the attempt to use UAE's role in the regional market to sort of capture and enlarge its niche in non-energy sectors.

Secondly, when you look at the liquidity levels, given what the price of oil is these days, GCC countries and UAE in particular are awash in money and looking for investment destinations. And China, even though it has huge foreign exchange reserves of its own of its own, is looking for massive amounts of investment, in the energy sector and in non-energy sectors. So there are great cross-investment opportunities.

Thirdly, the United States is engaged in this pursuing free trade agreements. Like the United States China is China is pursuing bilateral free trade agreements with individual countries and China is also pursuing subregional free trade agreements. The one that involves the UAE is the attempt to forge a China-GCC free trade agreement. In the past few weeks, there have been statements by leaders on both sides that they intend to accelerate the negotiations, nail down the final technical obstacles and perhaps conclude the FTA agreement by the end of this year. But, of course, the Europeans have been saying that an EU-GCC FTA is imminent for the past 15 years, so it's not clear what the exact time table is and what the difficulties are that need to be overcome.

COMMISSIONER WESSEL: And that goods trade, is it also a financial center for the Chinese in terms of the region? You said that UAE is a node of--

DR. CALABRESE: Yes, banking, trade fairs, re-export of Chinese merchandise. It's an important nodal point. But I don't think that that is because China is transforming UAE into playing that role. China is merely exploiting a preexisting role that UAE had played in the regional market.

COMMISSIONER WESSEL: Dr. Watson, Brazil?

DR. WATSON: Brazil is easily the most important state to China in Latin America. Brazil is important for several reasons. One is for bilateral trade. Brazil has a number of export products that they are keen to export, most especially something like soybeans that fit well with China. They also are non-genetically modified soybeans so they are something they can get from Brazil they can't get from us, and there's a couple slaps along the way that make everybody feel better.

Secondly, there's a space program that's been in place in Brazil

since the late '50s. It's no longer active, as far as we know, by unclassified sources, but there also historically was a fairly significant nuclear program active in Brazil back to the 1950s. But additionally, this goes to something that Dr. Wilson was talking about: they can play the third-world card. Brazil would desperately like to have a seat on the Security Council. Beijing can always say, well, we understand your pain. We're also third world. We just happen to have finally got what we deserve, but we will help you down the line.

Now, again, as I indicated, I don't think the Latin Americans are particularly stupid, and I think that they understand that they may be played. On the other hand, they're not hearing good words about diplomacy and recognizing them as a legitimate, to-be-respected part of the world from much of the rest of the world, so they're happy to hear it from whom they can. So I think Brazil is the major focus of China's interest.

COMMISSIONER WESSEL: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Chairwoman Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much and thank you to our panelists. I've had the pleasure of appearing with Dr. Wilson on the panel and talking, and had a very interesting discussion with a group of Dr. Calabrese's students, so I really enjoy having you here testifying in front of us.

Two issues. One is I was particularly interested in the production transfer job loss issue which, Dr. Wilson, as you know, is becoming quite a big issue in Africa, textile production for one thing and other small manufacturing, and, Dr. Calabrese, you mentioned it in terms of the Middle East, and I wondered if you could elaborate on that a little bit, Dr. Watson? Is it also an issue also in Latin America?

But the second and bigger issue, bigger question, is I'm intrigued with your idea that other factors will benefit China in its dealings with other countries when the message that the Chinese government has gotten from the West is that economics trumps all, and as long as the business deals keep coming, then all of the other issues get demoted into a secondary status.

So is there any evidence that the Chinese government believes that it's not going to be able to buy its way out of any problems? A solution, of course, even in Nigeria, would just be to provide a bunch of money to the people who are causing the problem and the problem might just go away.

So do we have any evidence that the Chinese think that they're going to need to do anything other than just throw some money around?

DR. WATSON: Could I offer an answer to that which goes back to what I would say have said to Mr. Blumenthal. I look at where China isn't involved in Latin America, and that's a very interesting case. They are

not involved in Colombia, by all indications, and while it's popularly held that the Colombian situation is solved, that's an arguable point.

But what's interesting about it is Chavez Frias has made clear that he does support the ELN and the FARC in Colombia in whatever form they still exist. In a worst case scenario, I think Beijing could then have acted upon that to both support him should they have wanted to, but also to get involved in a place where there's a lot of guerilla activity still ongoing.

By all indications, they've stayed away from that, and I think the reason for that is I think they realize that the evidence over 50 plus years now is that money doesn't just buy everything off in Colombia, that this is a deep-seated problem. It may in fact under the current regime be resolved, but I've heard that for 40 years now, and I haven't seen it happen yet.

So I think the fact they've not chosen to do that says that they realize that they can be susceptible to the same dangers that affect both the regime, but others such as NGOs and businesses that have tried to operate in that part of Colombia that is subjected to especially the FARC.

DR. WILSON: I think on the job loss issue, it's very serious. It's increasingly a serious one for the Africans and it probably has greater impact than any foreign assistance that's being given in that part of the world because, as you know very well, commissioner, textiles are the sort of the first rung on the ladder to get to economic development. And in Lesotho and Botswana, those industries have been virtually destroyed.

Now, the South Africans in conversations that I've had with them have said in their bilateral dealings with the Chinese they are now insisting that that issue be addressed. I don't have the details on that. I don't know what that is, but the South Africans are sufficiently concerned that in their bilateral dealings they're pressing the Chinese to address that issue.

However, the Chinese, as you know, have millions of people coming in from the countryside and I doubt seriously if they're going to attenuate their export machine just to save a little face in southern Africa, so I think this will be a source of continued friction in Africa as it is in Mexico and other parts of the world where the Chinese are essentially eliminating industries and markets.

On the question concerning if can they buy their way out, I think that they understand that they can't just buy their way out. I have been impressed that before President Hu became president, there were discussions in the think tanks, intellectual circles of Beijing, about China's peaceful rise, and so the Chinese have been pressing China's peaceful rise for three or four years now--a lot of talk, a lot of talk, no action. Then President Hu becomes president and the soft power outreach of the Chinese gets dramatically accelerated.

So Hu goes to Australia and New Zealand. Hu and the premier

travel to many countries in Africa, all over the world. So I think the Chinese have a long-term sense of balance between economic power and diplomatic soft power. I don't pretend to be a full expert on China, but it is striking to me that, yes, they are throwing their money around, but there does seem to be a long term awareness that they have to have soft power as well as Yuan money power.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Dr. Calabrese.

DR. CALABRESE: On the issue of jobs, I think it's really interesting. On the one hand, you see in the Iranian case and it may be true in other cases as well--the Iranian one is the one I'm most familiar with--that there is a lot of discussion and a lot of dismay inside the Iranian political leadership about the saturation of the Iranian market of low end, low tech, textile and other products.

So there is that concern and that is a source of friction. Now, whether that friction could fundamentally alter the course or the totality of the relationship I really, I think at this stage no, and maybe not ever or not so in the foreseeable future.

But there's another piece that I hadn't thought about until you asked your question. Not the piece about job loss, but the piece about job creation. The kinds of things that China is investing billions of dollars in the Middle East in is in essentially the energy sector which is capital intensive, not labor intensive.

But the great dilemma for most Middle Eastern, especially producer countries, when we're talking about the distortion, structural problems in their economies, is they need to create jobs, and what they are insisting upon, although the Chinese are not necessarily in a position or wanting to provide them with, is the kind of investment that will create jobs.

So the Middle Eastern customer, let's say, is looking for the kind of investment that the Chinese may not be willing or prepared to make, particularly when there may be other more attractive destinations for them to invest in non-energy sector elsewhere.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: One comment, which is you raise a very interesting issue, Dr. Calabrese, on job creation and what it means in the Middle East, and I want to tie it right back in to security back here in the United States in an indirect way, but part of the problem that we are facing in the Middle East is the population bulge particularly unemployed young men.

Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Reinsch and then Commissioner Mulloy.

COMMISSIONER REINSCH: Thank you. Mr. Wessel asked one of my questions so I'm down to one. Mr. Calabrese, in your comments, I

think, on the Iran proliferation situation, you mentioned the number of incidents that occurred.

Is it your impression that that kind of activity is at the instigation of or the blessing of the Chinese government or at the initiative of Chinese companies, simply doing what they think is in their interest to do economically with the government either engaging in benign neglect or simply being incapable of dealing with it?

DR. CALABRESE: I wish I knew the answer to that question.

COMMISSIONER REINSCH: So do we all.

DR. CALABRESE: I really don't know. I think that's one of the difficulties in trying to hold China's feet to the fire on these kinds of issues. If one looks at the three companies that have most frequently been identified as proliferators, they not only conduct, strictly speaking defense business, but they do all kinds of other business as well. Furthermore, because their activities across the board are opaque, not transparent, one can't really tell whether, for example, they're proliferating with the knowledge of the political leadership, and whether this is being done in exchange for other business opportunities. The reform and reorganization of defense industries, an otherwise positive development, has made tracking these activities and connecting them to the political leadership in Beijing hard to pin down. To the degree that they may be rogue actors, it's problematic from the U.S. point of view, and ultimately, as I said earlier, it's problematic from the Chinese point of view too, if their ultimate goal is stability in the region.

COMMISSIONER REINSCH: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, all three of you, for being here. You've been very helpful. Your testimony, which I read, is very helpful as well. My question here is to Dr. Watson. You're a professor of strategy at the National War College.

On your opening testimony, your prepared testimony, you say, quote, "I do not believe China"--and then you put in big bold--"currently," and then go on to say "poses a significant strategic threat to the United States in Latin America."

Then you go on to tell us, I believe I heard you say China will not do anything right now to jeopardize its relationship with the United States.

DR. WATSON: Right.

COMMISSIONER MULLOY: Why will China not do anything right now to jeopardize its relationship with the United States? What is it after in this relationship with the United States? That's what I want to get at.

DR. WATSON: It's after a couple things. It's after an environment that it can use to continue to grow economically, to keep the Communist Party in power, to keep China able to play a greater role around the world.

Additionally China benefits tremendously from the international scene that we set, things like their ability to import petroleum in sea lines of communication that are protected by U.S. shipping, as a consequence of our own need to protect those lines of communication.

But, additionally, there are trade relationships, there are ways such as this hearing that we're increasingly treating them as a great power, so that the net approach that they have to the relationship right now is that it is a positive.

If the Chinese saw a massive movement on our part to penalize them under WTO, understanding that there are legal restrictions that exist, but we all know that states--no, I won't say that--I believe that states pursue their national interests and they are going to behave as they find necessary.

I don't believe that the Chinese would want to see the United States impose any sort of restrictions on China's behavior that could adversely affect their goal of continuing to rise in power.

COMMISSIONER MULLOY: All right. Here's my view and I'll throw it out to you. I think the Chinese see a United States in which they're running a huge, huge trade surplus.

DR. WATSON: Right.

COMMISSIONER MULLOY: It will probably be 240 billion this year alone.

DR. WATSON: Right.

COMMISSIONER MULLOY: This is a tremendous transfer of wealth out of here to China. And the investment and the technology transfer is all proceeding apace. So obviously they don't want to jeopardize that.

DR. WATSON: Right.

COMMISSIONER MULLOY: Now.

DR. WATSON: Right.

COMMISSIONER MULLOY: Do you see it that way?

DR. WILSON: Yes, I think that's their driving concern. I think we recognize, at least as you say, I would argue that they have a pretty good long-term view of the world.

COMMISSIONER MULLOY: Yes, that's my view.

DR. WILSON: I think the one exception is Taiwan.

COMMISSIONER MULLOY: I agree.

DR. WILSON: I think Taiwan is really the wild card, and the scary thing about the world right now is one could imagine a set of missteps that neither side wants that would lead to a fairly serious confrontation between the United States and Taiwan and my hunch is that would then trump these other issues.

COMMISSIONER MULLOY: Yes. Let me just go back one last thing on this. Dr. Watson, you say the United States really needs to pursue this larger free trade agreement with South America.

DR. WATSON: Yes.

COMMISSIONER MULLOY: In your testimony on page three.

DR. WATSON: Yes.

COMMISSIONER MULLOY: I don't know whether you're watching what's happening in this country, but when we got \$800 billion current account deficit and growing, the appetite for free trade or so-called free trade in this country is diminishing.

DR. WATSON: I'm well aware of that, commissioner, yes.

COMMISSIONER MULLOY: Warren Buffett says it should because we're bankrupting ourselves. We're selling off pieces each year of our national wealth to finance a lifestyle that we're no longer earning. That's what Warren Buffett is telling us.

I think rightfully so, and I think it comes from a rather mercantilist policy being pursued by China and other Asian nations. I would favor trying to integrate Latin America more into our own economy and have it a two-way street. But I don't think it's going to happen because of this other problem that we have out there with Chinese-led mercantilist policies in Asia.

DR. WATSON: I don't think it's going to happen because of U.S. domestic politics that don't even take China into consideration. My point, my overarching point is if I'm going to weigh as a strategist where my investment is going to bring me a better return on what I put into it, I believe that we would be better off to try to improve our bilateral relationship with the region than spend efforts on trying to thwart Beijing's actions in the region because I think we have a much better chance of succeeding.

And in the final question that I was asked of the four questions, policy recommendations were asked for, and one of the things that I think the region is acutely sensitive to, led by the Brazilians who like to see it as yet another instance of us trying to keep them down--it sounds vaguely like Beijing's reaction to things--is they say you told us at the December 1994 Miami Summit we were going to have a free trade zone of the Americas by 31 December 2005. There is no free trade zone. There are no negotiations.

COMMISSIONER MULLOY: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you very much. Commissioner Houston and then Commissioner Donnelly with a follow up.

COMMISSIONER HOUSTON: Thanks again to all of you. You've answered some wonderful, specific questions for us today. I would like to go back to sort of a broader question that goes back to the title of the session of the impact of China's diplomatic strategies on the U.S.

When you look at diplomatic strategies in most free nations, it's about establishing foundational relationships and resolving differences in the world. In the U.S., we have the Department of State and we have

USTR. Of course, there's always some overlap there, but their missions and their strategies are somewhat divergent. They do different things.

When you look at China, would your assessment be that to Beijing diplomacy and economic strategy, economic rise is the same thing? Do you think that they separate out the two disciplines if you would or it's just one?

DR. WATSON: I think the two are tied together. I think most of the world tends to have a more integrated government approach to things than we do. We have the luxury of a democracy. As we often forget, democracies, at least ours, was meant to be a slow lugubrious process with checks and balances.

Most of the world thinks checks and balances is a bizarre concept frankly, and I don't see it at all surprising that Beijing would equate those two things as being hand-in-hand and necessary to accomplish their national goals. I think that that's completely in line with their basic approach.

HEARING COCHAIR BLUMENTHAL: Mr. Calabrese.

DR. CALABRESE: China's diplomacy in the Middle East has become progressively more professionalized, more institutionalized. As a result, there is a great mutual understanding of how the political and bureaucratic and business climates operate, and ultimately that helps to pave the way for business.

As far as I'm concerned, in the Middle East anyway, the basic thrust of China's diplomacy is commercial diplomacy, and the basic thrust of that is, although not exclusively, energy diplomacy, though one sees some signs of what we might call a wider, more multivariate kind of diplomacy dealing with, as you put it, "resolving differences," by and large that diplomacy is reactive and low profile. China's overall diplomatic posture remains to try to bend with the wind, and especially bend with the prevailing wind within the Middle East. This is designed primarily to cultivate business and safeguard business interests.

DR. WILSON: I think the interesting question over the medium term is whether or not that formerly sort of tight fit gets pulled apart a little bit, and will their Department of Commerce and their USTR and their State Department begin to be more internally differentiated as institutions because domestically their society is going to get more internally differentiated.

If you look at the other end of the economic spectrum, which is the high tech stuff, and frankly that scares the hell out of me a lot more than some of the oil things that are going on because of what the Chinese are doing and that we are not doing in terms of education and educating engineers and so forth, if you look at what a Chinese company called Legend did, they bought up IBM, and they call themselves Lenovo, and what they seem to be doing is they seem to be saying that we want to be a big global world-class IT company, and how do we do that?



I think they're going around the world looking at world-class IT companies and trying desperately to learn, and that as that happens, one would imagine that their research institutions, the Chinese Academy of Science, all these institutions that used to be run by the military, their commerce, that these are going to start to evolve institutionally, and that will probably be a good thing for the world in the sense it will make the Communist Party less powerful, a little bit, not a lot less powerful, but it will provide some contending voices.

So I think you put your finger on something very important, and I think what we have to do is we have to be smarter in our own diplomacy, and Secretary Rice has talked about certain kind of reforms that she wants to undertake in our own State Department. I think those need to be multiplied by five.

And our sort of attention to our own intellectual capital has to be dramatically increased, and that will help us in our competition I think with the Chinese more than many other things that we might do.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Donnelly.

COMMISSIONER DONNELLY: Sorry to go from the perhaps the macro-sublime to the micro-ridiculous, but just a quick question for Dr. Watson. You said that the Chinese had been very cautious about transferring arms to Venezuela and sort of taken a pass on that. Do you believe that the Russian arms sales will sort of make the Chinese think that maybe it's okay to take a more liberal view of that?

DR. WATSON: No.

COMMISSIONER DONNELLY: If the Russians get away with it?

DR. WATSON: No, because I think everyone around the world right now, and I think it's been showcased in the last month, is aware of the growing tension between Moscow and Washington, and I think that Beijing can simply sit back and say this one is not worth getting into.

I've used the term elsewhere, that they are calibrated and measured in their relationship with the region, and I think that that's appropriate. I really think that's what they're doing. There's a lot more they could have done, and they've chosen not to up until this point.

HEARING COCHAIR BLUMENTHAL: I have one follow-up question, and that is you get a sense in each of your regions of increased activism, increased presence, increased activism, increased commercial diplomacy. How do you translate that kind of activism or is China going from that kind of activism to influence, and are there tangible examples of influencing things diplomatically in their own interest?

It's one thing to be present, to be getting contracts. It's another thing to start to use your diplomacy to shape things more in your world view in line with your policies. I'm wondering if you're seeing any of that, if you can comment on the differences between activism and influence that you're seeing in those regions, and if you see a point at

which activism will turn into influence? Anyone of you or all of you?

DR. CALABRESE: I guess I have in response a question to the question. Influence I guess over whom or for what purposes?

HEARING COCHAIR BLUMENTHAL: Let me put a finer point on it. Influence over, say, we all presume that China has influence over Iran to denuclearize. We all say that over and over again. China is certainly more active in Iran. Does China have influence over Iran to actually to--does it have the influence first?

DR. CALABRESE: I'm not sure whether China has more influence over Iran than Iran has over China. With the acute sense of vulnerability and need that attaches to China's desire for Iranian oil and in the longer term, Iranian LNG, which partner has greater influence over the other? The fate of the Yadavaran energy deal is an interesting case in point. Why isn't it finalized? Are these technical obstacles, and if they're not technical obstacles, is there a waiting game that both sides are playing? Does it rest on the positions taken and the outcome of the diplomatic crisis over the Iranian nuclear program? Is it the Chinese holding out or is it the Iranians holding out? It's not clear to me.

HEARING COCHAIR BLUMENTHAL: What about another pressing issue like Sudan? Does China have the influence that we think they have?

DR. WILSON: I think you've asked absolutely the right question, which is the movement from sort of presence to influence to action that we actually care about, and in Sudan, a U.N. vote is one place where you might see that. We would anticipate, sort of one scenario would be that as China becomes more influential among African states, by pressing its diplomatic efforts more--they have a Chinese-Africa Council that meets once every couple of years; the head of state goes there--we would anticipate that more votes in the U.N. would go China's way than was the case prior to China's increased activism.

But we haven't seen a lot of that yet. I've been asking around to say, well, in U.S. national interest terms in Africa, can we point to a couple of instances where the Africans did something we didn't want them to do because the Chinese used their hard power or soft power, and the folks I asked sort of were hard-pressed to find examples.

Now, if you ask those same officers and diplomats and experts, do you feel that Chinese presence is expanding, they say absolutely, and I think all of us have a sense that the Chinese are putting influence into their little piggybank.

The other way to think about this is the Chinese are, with all due respect to the Chinese, are pretty new at this world power, diplomacy game. They are pretty inept in some ways.

HEARING COCHAIR BLUMENTHAL: Right.

DR. WILSON: In some ways. They've also been in the oil market for only about a decade so they're not used to petro diplomacy either. So

I think in some ways absolutely everybody is trying to figure out how the Chinese are putting their influence coins in the potential influence bank. There's not been a lot of evidence that that has paid off a lot of dividends yet. We think that it probably will, but at least in the Africa context, there's not a lot of evidence in fact that that has happened.

HEARING COCHAIR BLUMENTHAL: Thank you. Dr. Watson?

DR. WATSON: I would say the same thing in Latin America. In another setting I actually used the same analogy, that they were putting investment into their kind of capital for the diplomacy down in the future. And it goes to Commissioner Mulloy's question. I don't think at this point that they do have a lot of influence. Yes, they have a growing presence, but that's what I mean when I say now. I can't guarantee. It will depend how the U.S. relationship frankly goes with Latin America 25 years from now.

But the one difference between Latin America and the other two reasons we're discussing today is geographic proximity and 200 plus years of U.S. sense of what the world looks like with little lines across the north-south, across the Pacific and the Atlantic. We believe the Western Hemisphere is our hemisphere. That's a very different concept than even the Middle East or Africa.

HEARING COCHAIR BLUMENTHAL: Thank you all very much. We need to wrap up this panel now, but I think you provided us with a lot of enlightenment and informative information that I'm sure we will work into our annual report. Thank you very much for your time. We will take a five minute break.

[Whereupon, a short break was taken.]

#### **PANEL IV: CHINA'S INVOLVEMENT IN THE SHANGHAI COOPERATION ORGANIZATION**

COMMISSION VICE CHAIR BARTHOLOMEW: We're going to move on to our next panel. Welcome to our witnesses. Our fourth panel of the day will discuss China's involvement in the Shanghai Cooperation Organization, the SCO, a regional security and economic arrangement whose member states are: China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

Dr. Ariel Cohen will testify regarding the implications of China's involvement in the SCO. At the Heritage Foundation, Dr. Cohen's areas of study range from economic development and political reform in the former Soviet republics to U.S. energy security and the global war on terror.

Our second speaker, Dr. Dru Gladney from the University of Hawaii, is an authority on Chinese ethnic policies and Sino-Muslim relations. He has served as a consultant to several international policy institutes and has conducted long-term research in Western China, Central

Asia and Turkey.

Both of our panelists today are going to be talking about extremely important issues to the security of the United States and we welcome them. Dr. Cohen, will you start?

**STATEMENT OF ARIEL COHEN, PhD  
SENIOR RESEARCH FELLOW, RUSSIAN AND EURASIAN STUDIES  
AND INTERNATIONAL ENERGY SECURITY, THE HERITAGE  
FOUNDATION, WASHINGTON, D.C.**

DR. COHEN: Thank you, Madam Chairman. Thank you, the commission, for inviting me. I appreciate it very much. I'm especially glad to testify before Dr. Larry Wortzel, my former boss at the Heritage Foundation.

In 1996, five countries--China, Russia, Tajikistan, Kyrgyzstan, and Kazakhstan--formed an organization, The Shanghai Five, to resolve border disputes and pretty fast, with the addition of Uzbekistan in 2001, the SCO was formed with obviously Russia and China as its two leaders. But it's important to stress that the headquarters were located in China, and it's called Shanghai Cooperation Organization, not, let's say, the St. Petersburg Cooperation Organization.

Five years later, it has grown not only in size with addition of Mongolia, Pakistan, India and Iran, as observers but also in influence. The group primarily focuses on security issues of the Chinese trifecta of "terrorism, separatism and extremism." But for China it's also a vehicle to promote its long-term economic interests in Central Asia.

China has suggested an SCO-wide free-trade area designed to improve the flow of goods in the region by easing trade restrictions. Chinese sources reported \$500 million of investment in 2003. I consider it inflated.

The SCO's security agenda is vast. The organization has been compared to the Warsaw Pact and referred to as "NATO of the East." Its agenda is infused with Chinese and Russian suspicion of U.S. designs in Eurasia and U.S. influences in Central Asia. This is evident in both 2001 SCO declaration and 2005 bilateral Russo-Chinese declaration regarding the "World Order for the 21st Century."

Such statements target U.S. campaigns in Afghanistan and Iraq as well as democracy-promotion efforts in authoritarian former Soviet Republics, efforts which both China and Russia, as well as authoritarian Central Asian countries, find destabilizing and threatening. The SCO has urged the U.S.-led coalition to announce a timetable to withdraw from Afghanistan.

Politically, China regards the SCO as means of creating a new Eurasian order to reduce U.S. military power and limit democracy promotion abroad. At this point, China is feeling strategically deterred by

the U.S. from both East and West Central Asia and Asian Pacific, and it's reengaging the SCO

The case study that sheds light on these developments, is expulsion of the U.S. forces from the K2, the Karshi-Khanabad Air Force Base in Uzbekistan. What happened there is the following: Russia took a lead, but China acquiesced to strong anti-American move by Russia.

I believe from my trip to Uzbekistan last October, the Uzbeks believed or were made to believe that we somehow supported the Islamic insurrection in Andijan. It may be a case of major disinformation operation vis-à-vis Uzbekistan by Russia, but possibly others as well.

China is considering expanding its military influence in Central Asia. Beijing contacted Kyrgyz officials exploring possibility of Chinese military bases in Kyrgyzstan and, as militarization in the region is growing, there is a possibility of utilizing military means in addressing regional issues, especially religious radicals, terrorism and narcotics trafficking.

The People's Liberation Army has been involved in several joint exercises with troops from other SCO states. The most prominent one was last year, Peace Mission 2005. The kickoff ceremony was 30 miles off the North Korean border in Vladivostok, but the war games on the Chinese territory involved 10,000 troops including 1,800 Russians, scores of advanced aircraft, heavy bombers, TU-95s and TU-22s, with cruise missiles, army, navy, marine, airborne and logistics units from both countries.

It was a classic combined forces operation, which included an amphibious landing, and of course Russia and China said that this is part of training for the war on terrorism.

The U.S. is concerned that Beijing and Moscow are using their diplomatic alliance to limit America's role in Central Asia. Both Russia and China would prefer that Central Asian countries' contacts with the West be managed or at least approved by Moscow and Beijing.

The chief beneficiary of the SCO is China. Beijing's standing in the SCO as the founder, and with relatively good relations with U.S. and Europe, give China an opportunity to serve as intermediary with the West.

The Russian-Chinese relations on the energy issues are extremely sensitive. Russia's reluctance to construct an oil pipeline between Daqing and Siberia indicates that the Russian concern about Chinese control over its natural resources is real. My counterparts in Moscow tell me that they would like to build the more expensive pipeline to Nakhodka on the Pacific coast through which they would export on to Japan and Korea, and they will have a spur to Daqing.

I was in a meeting with Putin last year where Putin spent some time talking about how he envisages this pipeline, and the Russian design for the pipeline keeps changing. So China is pushing--it's putting pressure on Russia to ensure supply in the future.

What should our policy be vis-à-vis the SCO? We tried to obtain an observer status. We did not succeed so far, but I do believe that we should expand a dialogue with SCO. NATO may explore expanding relations with it. Options for cooperative efforts may go beyond the existing NATO-Russia Council and Partnership for Peace, in which most Central Asian states are members.

We can use our good relations with Kazakhstan and Mongolia to obtain either an invitee status with the SCO or in the future negotiate conditions for observer status, but regardless of what's happening with our relationship, we should oppose Iranian membership in the SCO that President Mahmoud Ahmadinejad lobbied for when he was a guest of honor at the last SCO summit in Shanghai in June of this year.

If Iran joins the SCO, it will be a clear indication that Russia and China side with Iran on the issue of nuclear proliferation. Furthermore, inclusion of Iran would give SCO significant influence over one of the world's largest suppliers of oil and gas reserves, in addition to another nuclear arsenal.

Russian President Vladimir Putin's suggestion of forming a natural gas OPEC, the cartel that would be similar to the Organization of Petroleum Exporting Countries, with Iran and Turkmenistan is of particular concern. Such a cartel would have control of the first, third, and fourth largest reserves of natural gas respectively.

COMMISSION VICE CHAIR BARTHOLOMEW: Dr. Cohen, I'll have to ask you to summarize and conclude, please.

DR. COHEN: I am almost done. If the United States hopes to get an observer status in the SCO, as I said, it should engage Central Asian states by balancing democracy promotion and democratization with our other national interests including security and energy. We have good relations with the majority of Central Asian countries with the exception of Turkmenistan and Uzbekistan.

We should use this remaining leverage to promote our friendly relations, working on military-to-military relations, governance, legislative reform and economic collaboration. Working alongside these governments in combating jihadists and terrorist organizations, we can appeal to common goals and secure American strategic and energy interests in the region.

Thank you for your patience.  
[The statement follows:]<sup>1</sup>

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you, Dr. Cohen. Dr. Gladney.

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<sup>1</sup> [Click here to read the prepared statement of Dr. Ariel Cohen](#)

**STATEMENT OF DR. DRU C. GLADNEY  
PROFESSOR OF ASIAN STUDIES, UNIVERSITY OF HAWAII AT  
MANOA, HONOLULU, HAWAII**

DR. GLADNEY: Thank you, Madam Chairman. It's an honor to address this Commission. I am particularly delighted to see my former colleague and good friend and fellow China watcher Larry Wortzel here. I have not seen him for several years in Hawaii, and I think it's a tribute to the hard work of this Commission that he never has time to come out to Hawaii. Always going to Asia or here.

COMMISSION VICE CHAIR BARTHOLOMEW: Don't ask him about how much time he's spending fishing. I also want to express my congratulations to the Commission for focusing on this part of China, particularly on the Shanghai Cooperation Organization. I'm in many week-long conferences on China. It is never, if ever, mentioned. I've been in seminars, semester-long courses on China in which China and Central Asian relations are never mentioned, and particularly in Western China, I will be focusing in on a particular problem that the Shanghai Cooperation Organization I believe was created to address, that it has still not solved, and in fact if I can go back to the remarks of Chairman Bartholomew earlier, this is one problem that China cannot solve by throwing money at.

And it is called in my paper "the Uyghur problem." I looked through all the other testimonies here and also scanned the Web site of earlier testimonies. I believe mine is the only testimony with a map.

DR. GLADNEY: The reason I give you a map is because if I was addressing the Tibet problem, I wouldn't need to do that, but for most even informed observers of China in the last many years, the word "Uyghur," let alone the word "Xinjiang," where the Uyghurs are located, is extraordinarily obscure and generally unknown and unpronounceable, so therefore often ignored.

I think we ignore this problem to our peril, not only as China watchers, but also as people concerned about U.S.-China relations. The Uyghur problem is at the center of U.S.-China-Central Asian relations, and I do believe it does have some impact on us in U.S. policy, so I'm very delighted that Ariel Cohen, my good colleague, has provided an excellent summary in this paper on the rise of the SCO, and so I was saved the effort of having to go over that.

But briefly I'll summarize my position on the SCO, on the Shanghai Cooperation Organization. It's not in Shanghai. It involves little cooperation and rarely organizes anything. So that's my comment on the SCO. I believe that it was formed at an important time to address very important issues. In 1996, China began another important campaign in the region known as the "Strike Hard" campaign at the very same time the Shanghai Five was organized.

That did not include Uzbekistan. In 2001 Uzbekistan was added and then it became the Shanghai Cooperation Organization, which is based in Beijing of all places.

Now, I believe that the SCO was created to address very pressing issues in the region. It has still not solved most of those issues. Every issue that it has raised, it has made progress only on border agreements.

That's why I do give you another map and the list of the accomplishments of the SCO, and one of them I think is tremendously significant, it is that of resolving all of the border delineations with the former Soviet Union and the new nation states on its border in less than ten years, and that's a remarkable accomplishment. China should be given due credit--its foreign service, and its negotiations.

However, the border issue with India is still unresolved and India has not been invited to be a member of the SCO. That should tell you something about the role of the SCO. It's mainly a bilateral organization. It has no other role than bringing the member countries together to discuss issues that are only and ever addressed bilaterally and resolved bilaterally as were the border delineations.

Now, I think the important points that I make in the paper are spelled out in detail. I'll just mention that in my opening line, I signal the importance of the Uyghur problem when I mention that this spring, earlier this spring, five of these Uyghurs were released from Guantanamo Bay detention center to Albania, and that China, until their release, was among the leading four countries to have the largest number of detainees in Cuba. In other words, there are more detainees from China in Cuba than any other country except for three.

This was, I think, surprising to many people, not only could they not pronounce Uyghurs and Xinjiang. They didn't know that 22 of them are in detention in Guantanamo. The majority, some lawyers tell us, have been determined to be noncombatants, but the United States is still trying to find a third country in which to relocate most of them. The dilemma is that, of course, we cannot send them back to China because of our concerns of terrorism and almost certain execution.

Most Uyghurs that have been repatriated to China have been almost immediately executed. I do mention in the paper one concern about one Uyghur, a Canadian citizen, who was recently repatriated from Uzbekistan to China, and the Canadian government is desperately trying to get him out. There's been no information.

SCO, I think, has played only a role in the sense that bilateral relations with the governments in the member countries have been strengthened to the extent that these repatriations are happening on a regular basis.

I go on to discuss this Uyghur problem and give the history about it. But basically what we're looking at is that China has about 21 million Muslims, nearly half of them are Uyghurs and 95 percent of those



Uyghurs are concentrated in this western province known as the Xinjiang Uyghur Autonomous Region. The interesting thing about that province, of course, even the word itself, suggests that it's of recent addition to China despite Chinese histories that suggest that China has been occupying the region for centuries or for millennia.

The word itself means "new region." And it's only been in use in Chinese for about a hundred years. China has only really secured control of the region for about 50 years. The Uyghur problem became important to China in the late 1990s with the dissolution of the former Soviet Union. Suddenly, these nearly 10 million Muslims became pawns, as Owen Lattimore once said, in the pivotal relationship between China, Russia and Central Asia, and that relationship of course affects us, as Ariel Cohen has mentioned, and it's why, I think, we should be concerned about this Uyghur problem.

[The statement follows:]<sup>2</sup>

#### **Panel IV: Discussion, Questions and Answers**

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you, Dr. Gladney. Chairman Wortzel, first question.

CHAIRMAN WORTZEL: When the Shanghai Five first formed back in 1996, the Chinese Foreign Ministry had encouraged United States observation, participation and involvement. Most of us that were in the Embassy and involved in the government side of policy looked on that suggestion from Beijing as a way to dilute American diplomatic influence and a way to promote China's new security concept. This concept was the idea that diplomatic power should be exercised in a multi-polar world, and that the United States should not be a pre-eminent leader there.

Today, however, Dr. Cohen, you seem to suggest that the U.S. does not need to be too involved. Did we make a mistake back in 1996 in not somehow getting involved in the Shanghai Five processes? Should we pursue it aggressively today to be a formal observer?

DR. COHEN: Larry, I don't know if you remember that or not, I suggested in a Heritage paper that we published in 2001, when SCO was officially formed, that we would pursue an observer status. Prominent geopoliticians with spectacular background in U.S. government in the 1970s said at the time that SCO is of no consequence.

There are some people who still say that, but more and more people in Washington today do believe that something is going on, especially when we, in the span of one year, lose an Air Force base and our fees for another base in Kyrgyzstan's Manas Airport go from 2.5 million to 150 million. I think this is bad business, so, yes, I do believe we should have

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<sup>2</sup> [Click here to read the prepared statement of Dr. Dru C. Gladney](#)

been involved. I think Central Asia especially before 9/11 was a bridge too far. The Clinton administration did not put a lot of emphasis money wise or otherwise.

By the way, the ones who took the lead on our involvement in Central Asia, and I must commend and praise them, CENTCOM, is the Central Command of the U.S. military. They were very interested in that. But after 9/11, there is more understanding that this is strategically important region because of the vast Muslim impoverished population in Central Asia, especially in Fergana Valley. These are authoritarian and totalitarian regimes--by totalitarian, the regime of Turkmenbashi in Turkmenistan--China is very interested in gaining both oil and gas supplies regardless of the nature of these regimes.

We are constrained, because we don't want to deal with the bad guys. So, yes, we should be involved. We should expand a dialogue with both China and Russia without giving up our agenda, without giving up our national interest in that important region.

Thank you.

DR. GLADNEY: If I could respond to that, to Larry, I'm not sure that the United States needs a chair at the table with other observers such as Mongolia, Iran, Pakistan and India. Those are the only four new observers that have been admitted. I believe the United States should be interested and should keep a close eye on things, but more importantly, much more importantly, the United States should be more directly engaged in Central Asia, and as a matter of fact, since the initial beginnings of the Shanghai Organization in 1996, the U.S. involvement in the region, particularly since 9/11, has increased dramatically.

The SCO has done almost nothing to limit that. The limits to U.S. engagement in the region have really been regional. In other words, political developments in Uzbekistan, political developments in Turkmenistan, I think resulted in the lack of U.S. engagement in the region. I don't believe observer status in SCO will resolve any of those bilateral issues.

But the U.S. does have a lot at stake in the region, and to the extent that it can become engaged, particularly on energy and ethnic security issues, particularly in the border areas between Tajikistan and Kyrgyzstan and Uzbekistan, if you look at those borders internally, not with China, but internally, they are a mess, and particularly Kyrgyzstan and Tajikistan, probably where we have the closest relationships, also the weakest states in the area, we can do a lot in terms of humanitarian assistance/resolution, economic investment, et cetera, and has real strategic interests for us.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. Commissioner Wessel.

COMMISSIONER WESSEL: Thank you to our witnesses and I'm quite pleased. As someone who has not worked for Larry Wortzel in the

past, I do have some questions. Earlier today, Secretary Christensen indicated that China has actually been a supportive actor on the question of our fight on terrorism. I have to say I have not seen a great deal of evidence to support that claim and wanted to get your views on that because of your deep knowledge of the region as well as the Uyghur issue, et cetera, your views on whether China has been supportive of the war on terrorism? Is there a role for the SCO in terms of cooperative efforts, of course, determining what our long-term role or relationship there might be?

But are they helping? I look at the mega-ports and a number of other initiatives as it relates just to port security, and there seems to be very little track record of support by China, but on many other areas, what do you see?

DR. COHEN: First of all, I think that after 9/11, the Chinese military were startled by the success and the scope of U.S. deployment in the heart of Eurasia. That made them uncomfortable. So while I think there were applauding us smashing the Taliban, I did not see a lot of evidence of China's military or Chinese intelligence community, security community, reaching out to us and saying, hey, guys, let's cooperate.

If I have to compare China with Russia, at that time, I would say that Russia did much more in terms of granting access, using the railroads for shipping U.S. cargo to Afghanistan, approving or agreeing to Central Asia's granting us overflight rights, landing rights, bases, et cetera.

China did nothing of the kind, but the question is also did we explore on our part the community of interest and to what extent concerns about treatment of Uyghurs, for example, would stand in the way of our talking to, and maybe cooperating with, the Chinese--in terms of monitoring radical Islamist activities be it in Xinjiang or along the periphery of China. For example, I'm sure there is some concern in China about presence of terrorists in places like Malaysia or southern Thailand or even in the Philippines.

So if China is looking at the region, it must realize that this is a threat that in ten, 20 years, may grow and affect shipping lanes, affect Chinese interests in Middle Eastern oil.

In the future, China will be increasingly dependent on oil imports including oil imports from the Middle East, and the more Middle East destabilizes and, the more Russia is playing a destabilizing role in some cases, by supplying weapons, by supporting Iran. In such a scenario: oil prizes will go up, and herein lies the rub of the contradiction between Russian interests in the Middle East and Chinese interests in the Middle East.

Russia is a high cost oil producer. China is an oil importer. China should be interested in low cost of oil, imported oil, and any kind of rise in the terrorist threat in the Middle East or in Asia, in Southeast Asia, would negatively affect Chinese well-being.

COMMISSIONER WESSEL: Dr. Gladney.

DR. GLADNEY: I think Secretary Christensen's point earlier today was very important in that relationship we are working and developing with China is to convince the Chinese when certain issues are that involve our interests are also in their interests and that we have mutual stakes and should be responsible stakeholders in the region.

I think, however, on this issue of antiterrorism cooperation, it's been really a double-edged sword. I think the Chinese have used that cooperation to their benefit, not necessarily to ours. In Ariel Cohen's paper, he used the Confucian notion of "li" to talk about the center-periphery and that the Chinese have this notion of a center, and that the borders were never that important until the modern national era.

I think that's an important idea and that China traditionally under Chinese government has never been expansionist. It's only been protectionist, protecting its own home territories, and I would agree with that. But I think a better concept that comes out of Chinese history, more traceable to Sun Zi than to Confucius, is the notion of "yi yi zhi yi," or "use the barbarian to defeat the barbarian."

And I think on the anti-terrorism cooperation with China, what China has been doing is using the closer U.S. relationship to control its own interests, particularly again back to this Uyghur problem. China has used the excuse of a terrorist threat to expand its control of a region that until recently was on the back burner.

Under Deng Xiaoping, under Jiang Zemin, the "Develop the West" campaign did not exist. It's been Hu Jintao that's been moving toward the West and sees the region as strategically important for energy and other issues. The Uyghur problem to some extent, if we follow Oxford Analytica's analysis and others, is really what they call a "scapegoat" terrorist problem. In other words, they're not a threat.

My paper and other analyses suggest that they have not been a threat for some time. Prior to 9/11, most of the violent incidents which were probably civil unrest, not real separatists or terrorist incidents, of a rather oppressed population, that were made to look more like a terrorist threat, and therefore the Chinese used that and cooperation to their own advantage, and I think in the end we did not look very good in supporting them, particularly in crackdowns on an organization that most people did not think was very viable.

The one important point in my paper that I make is that the United States has put pressure on China on some issues that have been important for our own interests. One of them is sitting right here behind me. I mention her in my paper, Ms. Rebiya Kadeer, and due to U.S. pressure and other human rights organizations' pressure, she was released from over seven years in a Chinese prison, merely for trying to meet with a delegation somewhat like yourselves, never a threat herself to the Chinese, a successful businesswoman and now an elected leader of an

external Uyghur organization that advocates peace and peaceful resolution and abhors terrorism.

So I think on some issues, we have been able to respond, but I think on the anti-terrorism cooperation, we have not gotten the kind of cooperation with the Chinese on interests of our own, such as in the Middle East or in Southeast Asia.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Madam Chairman, Chairperson. Dr. Cohen and Dr. Gladney, your prepared testimony is really very helpful, and from reading it, I get the impression you guys really know China pretty well. So that leads me to the question I have based on page seven of Dr. Cohen's testimony where he tells us China's "Realpolitik philosophy is that the international system is characterized by a constant struggle for domination, and that China must engage in that battle, its main adversary being the United States."

That pretty much lays it right out. And then he tells us later in that same page: "China has departed from its traditional isolationist philosophy and is seeking to project its influence abroad. China is, at present, a regional power with global aspirations, and if it continues on the path of economic growth and projection of influence, its aspirations may be realized."

Mr. Christensen here earlier and he puts it this way: "China's global emergence is a natural consequence of its economic growth and development." And, he says, "need not be seen as a threat to the United States."

You say they see us as their main adversary. So I think our economic policies are a little crazy because I think we're feeding China rather dramatically through our economic policies and then aiding this growth that you guys, at least Dr. Cohen says helping them grow rather dramatically against their main adversary, us.

Do you think that China can become a global power and still be not a democracy and can still be authoritarian one-party ruled system? I got the impression Dr. Christensen was saying, well, the economic growth will in time ameliorate that other problem, and I wanted to get the experts to tell me your views on that particular issue.

Dr. Cohen, I'll start with you and then Dr. Gladney.

DR. COHEN: I think we saw in the past that the rise of great powers, including the United States, sir, includes two stages. The first stage is the economic development stage and the second stage is when the economic wealth can pay for a decent military. And China has legitimate interests for which it may expand its military.

Sometimes, we'll feel uncomfortable with that because, for example, to protect the shipping lines for energy, for oil, from the Middle East, it will get a blue water navy. Now blue water navy can be used for

defensive purposes to have presence in the Indian Ocean and closer to the Arabian Peninsula, or it can be deployed in the Pacific, where we may come to friction.

But what I don't want to guess, having forgotten my crystal ball at home, is whether we are predetermined to come to a Cold War style confrontation as we did with the Soviet Union, or we will work our differences and our interests in a more cooperative way. I think this is too early. I think China is growing. I don't think we really have the clout. I'm not a global economist--but I don't think we have the clout to stop Chinese economic growth for the reasons of our national security. Maybe there are people who disagree with that.

But China having reportedly 50 percent manufacturing capacity for consumer goods in the world, and this is an amazing achievement in a relatively short period of time, just as oil producers have their surplus cash flow from producing raw materials, the Chinese have their cash flow from producing consumer goods at this point.

So the question is to what extent we engage and how do we engage China, and I think the approach is going to be the approach that is nuanced under such an approach, we will make clear where the red lines are, what our vital interests are, but also recognize, for example, in the energy field, which is very important, that China is justified in pursuing energy interests in Central Asia, in the Caspian Basin, in the Middle East and beyond the Middle East, because without that energy, China will not be able to grow.

COMMISSION VICE CHAIR BARTHOLOMEW: Dr. Gladney, any brief comments?

DR. GLADNEY: I'll be very brief. As an anthropologist, I have a very difficult time trying to figure out the Chinese view on anything when we're talking about 1.3 billion people. Also, I think it's just as difficult to characterize United States' view within the Beltway about U.S.-China relations. We can clearly delineate sort of red and sort of blue nuances or directions in policy, but also I think we can now find every shade in between except for maybe pink.

I think that the China attitude towards the United States shifts dramatically as you move across the country from north to south, whether Shanghai versus Beijing or interior versus border areas. One interesting point, though, on that, I will assert, is that 21 million Muslims in China makes it one of the top ten Muslim countries in the world, more than almost every Middle Eastern country except for Iran, and until recently those 21 million Muslims were very pro-American.

As an American, for 25 years doing field work in Western China and Central Asia, wherever I went I was warmly welcomed. I was cheered for someone who was interested in their people, in their languages and their histories. I'm concerned, and just as I think the majority of Chinese are rather pro-American and traditional, I'm very concerned that U.S.

policy has contributed to a shift in those views and recently was jeered at by a Muslim on the streets of the capital of this region just for being an American. I feel a kind of growing sympathy for radical Islam in the region and that has directly to do with U.S. policy as well as Chinese policy towards the region.

I don't believe these Muslims are moving towards China, but I do believe that many of them are moving against the United States.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. Dr. Gladney, having been trained as an anthropologist myself, I am pleased to see a humility in an anthropologist in declining to characterize the views of a group of people.

Commissioner Donnelly.

COMMISSIONER DONNELLY: Thank you. Before I get to my question provoked by Dr. Cohen's last analysis of the rise of the United States as a great power, to indulge myself in the pedantry that I've avoided all day, it seems to me that the United States avoided building power protection navy for the better part of a century, content to let the British do the job and to content itself with Jeffersonian gunboats and commerce traders, and that a measure of Chinese stakeholderhood would be to continue to allow the U.S. Navy to patrol the blue waters and to secure international shipping lanes, and certainly would be a cost that they could afford to avoid.

Now to my questions. First of all, I'm interested in your characterization of Karimov's decision to boot us out of Uzbekistan as being subject to Russian influence or outside influence. I wish you could tell us a bit more about that. My personal view is we are well off out of there one way or the other, given the nature of that regime, and that they had plenty of reason, given their own internal unrest at the moment, to want the Americans to stop hectoring them, I think to get out.

Secondly, particularly for Dr. Gladney, the question of Han migration or relocation because it's governmental policy to Xinjiang is also an element in the ongoing tension in the region, and apropos of your last remark, wonder whether not only--part of the propaganda is that separatist organizations--Uyghur separatists--are influenced by Wahhabis and becoming radicalized. I'm wondering if whether not only our own policy, but also China's "Strike Hard" campaign, there's a certain logic just to be able to resist what you may observe as intrusion from outside in your traditional homelands, whether there's any hard evidence that separatist organizations are, if for no other reason, turning to Islamic networks as a source of succor and possibly financial or military support.

So sorry for the long question, but--

DR. GLADNEY: Could I take the last question first? I probably remember that one better.

COMMISSIONER DONNELLY: If you want to comment on the development of the U.S. Navy--

DR. GLADNEY: Basically I do think that China's developmental policy has encouraged migration. Most people analyze it as integration through immigration. The Inner Mongolian population of Mongols is now only ten percent. 50 years ago, it was probably more like 35 percent. 50 years ago Han population in Xinjiang was about five percent; now it's pushing 40 percent. The Uyghurs are by far the largest group of people in the region by any means of measurement, though statistical measurements weren't very accurate back then.

Mr. Cohen mentioned the whole issue of growth of countries and national destiny and some Chinese scholars look to the United States' example of its growth as a nation and its movement west, and said they should follow this pattern as well, basically rid the land of all the natives, and this is a Beijing sociologist. A Beijing University sociologist wrote this policy, that these peoples are regarded by many in China to be backward, to be resistant to modernity, to be a threat to Chinese identity, and some of that policy comes out of American anthropology from Lewis Henry Morgan and then into Marx and issues of who's developed and who isn't and things like that.

So it's not an easily addressed issue. I think the United States can play a role in saying "learn from our experience; don't make the same mistakes." And that we've learned to regret a lot of the earlier mistakes we made as a country.

COMMISSIONER DONNELLY: Is there any suggestion that there's a fundamental difference? I mean anthropological difference, as it were, between Native American societies and developed? Is there anything remotely like the cultural gap that, again, not to excuse, but simply to at least explain the dimension the American experience?

DR. GLADNEY: No, you're dealing with 3,000 years of civilization in Central Asia. Some of the representatives of these ancient cultures are here today who can point to the development of many of the sort of modern inventions of weaving and silk technology, the ancient Silk Road.

So these great civilizations which are in danger of extinction because this policy set them apart, I think, particularly in terms of history. However, I do believe that there are very important parallels about languages, cultures, religions, that are under threat, and I think the problem with Han migration to the region is not so much--you can't really build another Great Wall and keep these people out, but the policy has privileged these newer immigrants and is divesting the indigenous people of their land and their rights, and I think that sows the seeds for unrest and future problems that China will have to face.

And I think to some extent, China should be encouraged to really think hard about this policy and its long-term impact.

COMMISSIONER DONNELLY: So is there any evidence--

COMMISSION VICE CHAIR BARTHOLOMEW: I'm sorry. We're



going to have to move on to Commissioner Houston and then we'll try to circle back if we have a little bit more time.

COMMISSIONER DONNELLY: Okay.

COMMISSIONER HOUSTON: Thank you very much. I have a question that goes more back to the SCO specifically. Anybody who ever tried to get into the economic, eastern economic coast of China knows how difficult that is. You have all kinds of layers of God knows what just to get off a plane or a boat.

The Shanghai Five was originally to discuss border delineation and has grown from there. But my question is do they just address delineation or do they get into border control and monitoring as well? And one of the reasons I'm asking this question is a U.S. national security question. We know that all over the world the terrorist organizations are going and basically have recruitment rallies for non-Arab Muslims, and I'm concerned particularly about Xinjiang, and so perhaps, Dr. Cohen, you could address more broadly and, Dr. Gladney, a little bit more narrowly the actual border control in that region and anything that the SCO may or may not have to do with it?

DR. COHEN: They are expanding the mandate. They are moving into things like border control. They're looking at narcotics. They are looking into counterterrorism. They were not up to speed before 9/11. There were a lot of complaints about the presence of the Islamic Movement --

DR. GLADNEY: Hizb ut-Tahrir?

DR. COHEN: No, no, no, no. The real terrorist organization.

DR. GLADNEY: Yes, the Islamic--

DR. COHEN: The Islamic movement of Uzbekistan--

DR. GLADNEY: IMU.

DR. COHEN: --which now morphed to Islamic movement of Turkistan. And that means Turkistan is a broader geographic notion than Uzbekistan so that means that people who are really affiliated with al-Qaeda took it upon themselves a mandate to promote Wahhabi-like radical teachings in Central Asia and recruit for terrorism.

As far as specific border control issue, I would say based on my travels and reading and experience in talking to people in the region, the problem is low pay of the border guards and other low-ranking officials and high level of corruption, including penetration of organized drug traffickers into the establishments, especially in the more impoverished countries like Tajikistan and Kyrgyzstan.

As far as the Chinese border controls and customs, I would defer to my colleague here, but more broadly I think there is a process in that part of the world where Islamist preachers go there or they bring younger people to the Middle East, to the Gulf region, and educate/indoctrinate them, and then send them back. Cases like that do occur in Uzbekistan, especially in the Fergana Valley area, and elsewhere. You mentioned

Hizb ut-Tahrir. Hizb ut-Tahrir is a global organization with a presence in Central Asia that is indoctrinating and preaching for the creation of Khilafah, which is the Caliphate, the global Islamic theocracy and empire. To what extent it's spread into Xinjiang, I have no information.

Thank you.

DR. GLADNEY: The interesting thing about organizations like Hizb ut-Tahrir is despite all the efforts of the SCO, and actually prior to 2001, SCO did have some anti-terrorism cooperation. There was that meeting in which they did raise issues of terrorism prior to 2001 in the Shanghai Five, but it's been totally ineffectual in limiting the growth of groups like Hizb ut-Tahrir which are gaining widely in popularity and a great threat to governments like Uzbekistan.

So the SCO has only strengthened the hand of regimes in power and some of us believe sows the seed for discontent and dissent and their undoing.

The other issue, I think, really is, I think you're mentioning there may be a more direct question: are Uyghurs willing recruits to Islamic radical terrorist causes? I don't think so. I think they are probably one of the least engaged. We've had very little evidence of Uyghur participation in other Islamist causes around the world, maybe a little bit in Chechnya, but certainly nowhere else.

Uyghurs who have been apprehended, as far as we looked at testimony from detainees in Guantanamo Bay, are a threat to China in a sense they are concerned about their homeland and they are willing to fight for their homeland, but they have no stake in the Middle Eastern politics or in establishing a broader Islamic caliphate. Indeed interestingly enough, most of Uyghur nationalists in the past have been radical secularists, and the region has rarely been open or interested in fundamentalist Islam historically, though, as I did mention in the paper, one of the few organizations that's really giving them support are more Islamist organization. So there is some attraction there, particularly if they are marginalized to such an extent that particularly in the region, young Uyghur males, there's no work. They are systematically excluded from jobs in the private and the public sector.

As far as border controls, they also can't get out. If you are a Uyghur, you cannot travel. It's harder even to travel domestically now, but internationally forget about it, whereas that didn't used to be the case ten years ago. So it's really a pressure cooker situation for these young males, and they are really, I think, a kind of ticking time bomb problem for China.

COMMISSION VICE CHAIR BARTHOLOMEW: Thanks very much. I also would like to acknowledge the presence of Rebiya Kadeer, who is here in the audience, and there are a number of members of Congress, some of whom have testified before us, who helped in the campaign to get her released. So we thank her for her leadership in trying

to spread freedom for other people. Thank you.

And Dr. Gladney, I'd like to acknowledge in some ways your clarification. You started out by mentioning the number of Uyghurs who had been held in Guantanamo, and I think it's really important that we be clear on the record, that you were not reflecting there any sense that Uyghurs were involved in attacks on America.

DR. GLADNEY: Right.

COMMISSION VICE CHAIR BARTHOLOMEW: Or have been disproportionately involved in the violence in Afghanistan and in the ongoing war against terror on one side or another.

DR. GLADNEY: Thanks for clarifying that.

COMMISSION VICE CHAIR BARTHOLOMEW: I think that that's very important. I have one question, and then we're going to have to end. There's been a sense over the years that China's proliferation of weapons of mass destruction technology to Islamic countries in the 1990s was done essentially in exchange to make sure that some of those countries did not engage with the Uyghurs but kept them isolated. Is there any evidence of that? I've always had that sense that that's been rumbling around out there.

But has there ever been any evidence of that, that there was sort of a quid pro quo. We'll give weapons technology, missile technology to Pakistan, and in exchange they stay out of what's going on with the Muslims in China?

DR. GLADNEY: In 1994, I met with the former Iranian ambassador to China in Teheran and I asked him if there was ever a widespread massacre of Muslims in China--I didn't mention Uyghurs specifically--what would be the Iranian response? And he said we would not respond; it's an internal problem. And I said what about the streets, the people of the streets, popular? We can't control that.

So I think there is an awareness of other Muslim countries. I think China is very aware that its treatment of its Muslim population is watched, but I do believe the governments, who are often quite authoritarian themselves, are not going to encourage social unrest, and so I don't believe there's any evidence of a quid pro quo. I think there is an understanding that to interfere and to support unrest within China will have severe consequences both politically and economically and China carries that much larger stick than carrots on this issue, it holds both the stick and the carrots on that issue.

COMMISSION VICE CHAIR BARTHOLOMEW: Dr. Cohen, any comment on it?

DR. COHEN: I have not come across explicit quid pro quo or explicit discussions of that issue. What I do see, though, is that China and Russia in the context of SCO or bilaterally are mum, are not raising the issues of democracy, human rights, violations of freedom of the press anywhere in Central Asia. In that sense, this is a wrong signal to the

leaders of Central Asia.

And the earlier question of the commissioner about Uzbekistan, one of the reasons why Uzbekistan abruptly ceased the relationship with the that they developed after 9/11, a quite broad relationship of military cooperation, is because we pretty consistently in the Democracy Report of the State Department and otherwise, raised the issues of the nature of the regime, and for Mr. Karimov, for Turkmenbashi, and for many others in the world, not just in Central Asia, the survival of their regime is the most important thing, and our approbation of the practices of that regime or lack thereof matters for the elites and for the people in those countries.

So I think there is a quiet understanding between authoritarian regimes, be it Islamic or Chinese, that we won't talk about yours if you won't talk about ours.

COMMISSION VICE CHAIR BARTHOLOMEW: Wonderful. Thank you very much to both of our panelists. We'll break until 1:15.

[Whereupon, at 12:35 p.m., the hearing recessed, to reconvene at 1:12 p.m., this same day.]

A F T E R N O O N S E S S I O N

[1:12 p.m.]

**PANEL V: CHINA'S ACTIVITIES AND DIPLOMACY IN ASIA**

COMMISSION VICE CHAIR BARTHOLOMEW: Welcome to all of our panelists. Our fifth panel today will examine China's involvements throughout the Asia Pacific region.

Joining us is Dr. Karl Jackson of the School for Advanced International Studies at Johns Hopkins. Dr. Jackson has served in various government posts including as Assistant to the Vice President for National Security Affairs, Special Assistant to the President for National Security Affairs, and Deputy Assistant Secretary for Defense for East Asia. He has written extensively on ASEAN affairs, Indonesia, Cambodia and U.S. relations in Southeast Asia. Dr. Jackson will speak about China's diplomacy in Southeast Asia and its involvement with the Association of Southeast Asian nations.

Rear Admiral Michael McDevitt and Dr. Robert Sutter will both speak about China's diplomacy in Northeast Asia with a special focus on Japan and Taiwan.

Admiral McDevitt is the Director of the Center for Strategic Studies at the Center for Naval Analyses. Admiral McDevitt previously served as a career officer in the U.S. Navy and was the Director of East Asia Policy in the Office of the Secretary of Defense during the first Bush administration.

Dr. Sutter, Professor of Asian Studies at Georgetown University, specializes in Asian and Pacific Affairs and U.S. foreign policy. He has published widely on East Asian and Pacific countries and their relations with the United States.

We thank you all for your willingness to appear before us today and look forward to your testimony. Dr. Jackson, I think we're going to start with somebody else because I know that Commissioner Blumenthal is on his way back and he particularly wanted to be here.

Rear Admiral McDevitt, can we go ahead and start with you. Am I throwing everything in chaos by changing the order?

**STATEMENT OF RADM MICHAEL McDEVITT, USN (Ret.)  
DIRECTOR, CENTER FOR STRATEGIC STUDIES, CENTER FOR  
NAVAL ANALYSES, ALEXANDRIA, VA**

REAR ADMIRAL McDEVITT: I assume that one of the reasons I was asked to testify today is because my organization has partnered with the National Defense University, with the Institute for Defense Analysis and Pacific Forum, a think tank in Honolulu, to conduct a series of workshops on the Sino-Japan relationship. So the bulk of what I'm going

to say will address Sino-Japanese relations, but I did want to briefly cover Russia and the two Koreas since the topic is Northeast Asia.

With the exception of Japan, I think it's safe to say that China's relations with its Northeast Asian neighbors have been very good. This is an interesting transition because during the '80s, the Soviet Union and China did not have good relations, and China's relationship with South Korea were not particularly good until the late '80s. But there was a transition period that took place in the late 1980s, early '90s, following the end of the Cold War, following Tiananmen, and following the collapse of the Soviet Union in which China's relationships with Russia and with both Koreas improved considerably.

In other words, over the past 15 years or so, Beijing has done a remarkable job of improving poor or moribund relationships with these countries.

It's interesting to note, that as those relationships improved, its relationship with Japan started to go downhill. This is probably a coincidence rather than a well-thought-out plan, but it is something that has taken place.

Chinese power both economic and military, and increasingly political, has underwritten these improved relations. It has also underwritten what I would call China's grand strategic objective, which is to ensure peace and stability on its periphery or near abroad so that it can continue to develop economically and strengthen the country.

One of the things that is related to this development is China's reemergence as a leading power in Asia. China is beginning to move back to the role that it had in Asia prior to 1850. The circle of history seems to be coming all the way around. During the imperial period of China, its role as the "Central Kingdom" was a bit illusory in terms of its real capability. Today, China actually has real power. The lure of the China market is alive today. Not only has it mesmerized Americans for 250 years, it has also mesmerized entrepreneurs throughout Asia. So as China's economy develops, as the Chinese actually have money and disposable income to buy things, the lure of the China market is also providing an incentive for all of the rest of the Asia to increase trade with China and maintain good relations. Beijing has made it easy to do that because of very low trade barriers.

With regard to Russia, China has established what they call a strategic partnership. One of the first partnerships they made was with Russia in 1996. That in turn led to a treaty in 2001, the Treaty of Good Neighborly and Friendly Cooperation. Since 2001, the relationship with Russia has continued to improve. Before 9/11, it definitely had an anti-U.S. cast to it. In other words, anti-global hegemon, anti-uni-polar world, trying to create the notion of a multi-polar world. In the wake of 9/11, that went away.

We see that reemerging. Over the last 18 months or so, a Sino-

Russian cooperation seems to be aimed at deliberately thwarting U.S. interests, and Iran and North Korea would be the most recent examples in terms of that phenomenon.

With Korea, they normalized relations with China in 1992. Trade led the way. Now a warm political relationship as matched trade. Again, this is interesting because after all it was the Chinese intervention in 1950 that prevented Korea from being reunited when MacArthur got to the Yalu. Had they not intervened, Korea would be a unitary state right now.

But nonetheless, the relationships between the Republic of Korea and China are quite good. Lots of Koreans are studying in China. There is an enormous amount of direct Korean investment in China. There is among young Koreans a cultural attraction toward China. Lots of Korean students learn the Chinese language. I think a lot of this is dictated by the fact that these young people are looking where the jobs are going to come from and they think that the economic relationship with China is going to continue to grow. Since I've got the red light, I'll just go ahead and stop now and let somebody else talk about Sino-Japanese relationships.

[The statement follows:]

**Prepared Statement of RADM Michael McDevitt, USN (Ret.)  
Director, Center for Strategic Studies, Center for Naval Analyses,  
Alexandria, Virginia**

**Introduction**

In Northeast Asia China's neighbors are the Koreans, Russia and Japan. Mongolia could also be included depending on how elects to define "northeast." My testimony will focus on the Sino-Japanese relationship, but I will make a few preliminary observations about Russia, the Republic of Korea (ROK), and North Korea.

In Asia, the enormity of China is a reality. Its central position on the Asian mainland, its enormous population, physical size, booming economy and modernizing military all condition how the comparatively weak contiguous states interact with Beijing. There is no question that China is unquestionably the leading economic and military power on the continent of Asia. Beijing relations with its neighbors are dictated by its **grand strategic objective** of preserving peace and stability in its "near abroad" so that economic development can proceed.

To translate this objective into reality, some scholars argue that there is an ongoing "revival" of the ancient Chinese tributary system mentality in Asia. Some historians of China don't talk about the "rise of China" as something unique. Rather, they address the "re-emergence" of China, referring to the fact that until 1850 China was the *de facto* pre-eminent power of Asia. China's strategic objective of stability in its own neighborhood was also one of the principles of the tributary system. The requirement for a stable external environment, immediately surrounding the Middle Kingdom, to ensure its internal stability and prosperity is not very different from what Beijing wants today.

In this regard, China is in a discrete and benign way, re-creating an "imperial" security system and environment in Asia, through the use of economic tools such as market access. According to one

informed observer in Singapore (Eric Teo Chu Cheow):

“China has ‘conceded’ trade surpluses to all its smaller Southeast Asian and Korean neighbors, in line with the tributary principle of ‘give more, take less’; it is these trade surpluses that are spurring regional economic growth, thus confirming China as the ‘heart’ of the present Asian economic system. Beijing’s “generosity” was previously at the heart of the imperial tributary system, which was *de facto* Asia’s trading system and WTO of that time. There are no doubts that China is reportedly ‘according’ these trade surpluses to secure the goodwill and respect of its smaller Asian neighbors, especially after resisting attempts to devalue the RMB during the 1997 Asian Crisis, for which China’s neighbors thanked Beijing enormously.”

It would be a mistake to over draw this historic analogy; especially since today China has real power, as opposed to its often illusory power during its imperial period. But, it is a fact that Chinese power (economic and military) and the lure of the China market has underwritten a decade and a half of very adroit diplomacy aimed at eliminating points of tension and disputes with its contiguous neighbors. This is especially true in the area of reconciling boundary disputes with Russia, Vietnam and to a degree with India. Beijing has also put in place military confidence building measures with Russia and its Central Asian neighbors. It has created a multi-lateral dialogue group—first called the Shanghai Five, and now the Shanghai Cooperative Organization (SCO)—to facilitate these confidence-building agreements and deal with transnational issues such as terrorism.

The SCO is a multilateral manifestation of Beijing’s single-minded strategy aimed at ensuring good relations with its neighbors. It also is way to ensure that Beijing has a voice in “shaping” the security landscape in Central Asia while also providing a credible example to all of Asia of how China’s “New Concept of Security” would work in practice. (Beijing’s conceptual alternative to bi-lateral military alliances.)

### **Relations with Russia**

Beijing has been establishing “strategic partnerships” since the mid-1990—yet another approach to ensuring good relations with neighbors and key trading partners. One of the first was with Russia (1996). Five years later the strategic partnership became a *formal* treaty relationship. In July 2001 a new Sino-Russian “*Treaty of Good Neighborly and Friendly Cooperation*” was signed. This treaty confirms the strategic partnership and in 25 articles lays out the concerns of both capitals about a new world order dominated the US and its European allies.

This treaty was pre-9/11 and for a time its anti-US orientation seemed to have been overtaken by shared the anti-terrorist interests of Moscow, Beijing and Washington. Over the last year or so, however, the notion of an anti-US relationship between Beijing and Moscow seems to have reemerged and both countries have taken action to “oppose US influence.” Impeding, or at best not supporting, US policy objectives toward Iran and North Korea are the two most obvious examples.

Today, in an interesting historic juxtaposition, Russia is the weak party compared to its neighbor. Up until the collapse of the Soviet Union it was China who was the weaker of these two enormous continental neighbors. The economic weakness and attendant exodus of Russians from the Russian Far East has over the years suggested to some analysts that eventually China would attempt to reclaim parts of the Russian Far East that had once been part of greater China. In fact, it is not hard to find Russian analysts who worry about this very point and are concerned that selling Russian high tech weapons to China could, over the long run, backfire. So while some in Moscow may quietly fret about the growth of Chinese power, and Russian weakness in its Far East, a Sino-Russian confrontation on this point seems very unrealistic. The treaty essentially rules this out, and it would be counter to Beijing’s desire for a peaceful neighborhood. Further, changing international norms and Russia’s massive nuclear arsenal make it very unlikely that a weakened Russia will suffer the same fate as China in the 19<sup>th</sup>



century.

### **Relations with the Republic of Korea**

Since normalization in 1992, relations between the Republic of Korea and its Korean War foe the Peoples Republic of China have developed at a remarkable pace. Initially trade inspired, the subsequent political normalization between Seoul and Beijing has also been dramatic. In normalizing relations with Seoul, Beijing ignored the protests of its North Korean ally and acted in its best interests. Beijing tries to assuage its old allies in Pyongyang by characterizing its current policy toward both Koreas as “equidistant,” suggesting that Beijing is attempting to even-handedly balance its interactions between Seoul and Pyongyang.

In truth, for well over a decade Beijing’s actions have explicitly signaled that it recognizes that it is Seoul who ultimately will determine the policy orientation and strategic alignment of the Korean peninsula whenever reunification finally takes place. Having reached that judgement Beijing has been quite effective in improving relations with Seoul. The improvement in political relations is really quite remarkable when one considers that it was only 56 years ago that the intervention of “Chinese volunteers” prevented the peninsula from being reunited in 1950. The MacArthur led UN forces were on the verge of reaching the Yalu River frontier between Korea and China following the successful flanking assault at Inchon.

Growth in political and economic relations have both been so dramatic that at this point it is difficult to characterize one or the other as being the driving force. At the end of the Cold war trade had pride of place. Since 1992 the bilateral trade relationship has grown at a double digit annualized rate of around 20 percent, and by 2002 China had supplanted the US as Seoul’s number one trade partner. As Korea specialist Scott Snyder has written, “ Korean companies are pouring investment into China in a wide variety of sectors including automobiles, textiles, information technology, telecommunications equipment, machinery components/equipment manufacturing and the chemical/petroleum sector.” As mentioned in my introduction, Korea runs a trade surplus with China. (By the way, the best way to keep abreast of bi-lateral relationships throughout Asia is through a quarterly e-journal called *Comparative Connections* that is published by the Honolulu based research center Pacific Forum/CSIS.)

Political relations have not lagged. All members of the CCP Central Committee have officially visited Seoul; cabinet level exchanges have been regularized, high-level defense ministry exchanges started in 1999. Political and economic interactions have generated cultural and social interactions in Korea. Reportedly Koreans are looking back to common Confucian and Buddhist roots with China. Korean students are traveling and studying in China in very large numbers. Over 30,000 Korean students are studying in China, and according to Seoul National University, Chinese has replaced English as the most popular language studied among liberal arts majors. In short Chinese “soft power” is proving to be as big an attraction economic linkages. Of course, to some degree, economic and trade linkages beget language training and interest in Chinese culture, since young Koreans are sensitive to future employment opportunities.

But, China also looms large to South Korea because of North Korea. Since Kim Dae Jung’s initiated his “sunshine” approach to North Korea (in other words, engage them) the interests of Beijing and Seoul have converged in policy approaches that are aimed at economically stabilizing North Korea. The objective is to prevent an implosion, with the hope that eventually Kim Jong-il will follow the Chinese model of economic development with “socialist characteristics.”

Seoul has persuaded itself, after closely studying German reunification, that a collapse of North Korea and rapid de-facto reunification would destroy the South Korean economy. They want a long period of peaceful coexistence between the two Korea’s while North Korea gets its economic act together before proceeding to reunification.

For its part China is equally worried about a collapse of the North Korean state and the attendant flood of economic refugees into China. They also appreciate the importance of having a buffer between the US military in South Korea and Manchuria. That after all was one of the primary reasons why they intervened in 1950. This is especially true so long as the cross-Taiwan Strait situation has the potential to lead to Sino-US conflict.

As a result, Beijing continues to gently prod Pyongyang regarding its nuclear weapons program. I believe that Beijing is sincere in its position that it would like to end North Korea's nuclear program. But it is not concerned enough to apply serious economic pressure that could cause the Kim regime to collapse. It does not fear North Korea nuclear weapons per se, and apparently does not worry that Pyongyang will share nuclear weapons with anti-Chinese Islamic terrorists. Beijing is content to balance economic support to the Pyongyang against the political pressure necessitated by being a central player in the Six-Party process.

Its goal is to maintain a reasonably stable situation. But, Beijing is also aware that as long as the situation is not resolved it has the potential to introduce instability and conflict on China's doorstep (witness the July 4<sup>th</sup> missile launches), which it certainly wants to avoid. On balance Beijing hopes that Washington will eventually compromise and deal directly with Pyongyang, so it does not have to make the hard choice of really applying serious pressure on Kim and his regime.

### **Sino-Japanese Relations: What has Happened Over the Last Decade**

The current downward spiral in Sino-Japanese relations—characterized by some as poisonous— is a significant departure from the overall situation since Sino-Japanese rapprochement throughout much of the Cold War period. Compared to today, the period of 1971 to 1992 could be called the “heyday” of Sino-Japanese reengagement. During this time Japan gave China considerable aid and transferred much-needed technology as a proxy for reparations for Tokyo's aggression in the 1930s and 1940s.

Beijing politely acknowledged Japanese statements of contrition, and high-level meetings were cordial in a period during which Tokyo's financial aid was crucial to Beijing's domestic reform agenda and Cold War imperatives demanded stable ties. In other words, Beijing's larger strategic agenda, at home and abroad, resulted in cooperation and the minimization of “history” as an issue between the two countries.

In the wake of the end of the Cold War, and especially by the end of the 1990s, latent tensions in the relationship began to surface in both countries. Causal factors included a post-Tiananmen focus by Beijing on nationalism/patriotism, and, as its economy took off, China became less dependent on Japan. This trend was symbolically underscored by Jiang Zemin's unpleasant visit to Japan in 1998— during which he publicly hectored the Japanese regarding history. The visit made relations worse instead of better. It made direct public criticism of China not only politically acceptable in Japan, but also politically beneficial. Since that time, relations have been characterized as “hot economics and cold politics.”

Currently, the Chinese public's perception of Japan's purported lack of remorse over the many depredations and atrocities committed by the Imperial Armed Forces—created by sundry textbook flaps, Yasukuni Shrine visits, and disputes about the Nanjing massacre—has shaped and constrained the political space that Beijing has to operate. I believe that China would prefer a politically “correct” relationship with Japan, and almost certainly does not want the Japanese public to conclude that China poses a security threat to Japan.

History Alone Not the Only Problem

It would be a mistake to blame history alone for the current downward trajectory. However, Beijing has so far not been willing to be diplomatically accommodating with Tokyo until the questions of history are resolved. Tokyo's perceived failure to be appropriately contrite about its past was used as the public pretext for Beijing's open opposition to Japan's attempt to gain a UN Security Council seat, the issue that sparked demonstrations in China in April 2005. This is especially true since President Hu Jintao became personally involved in attempts to resolve the dispute triggered by the Yasukuni Shrine visits of his Japanese counterpart.

In fact, there are other fundamental sources of friction: competition for regional leadership; growing nationalism in both societies; territorial disputes; Taiwan; military modernization in both countries and the concomitant perceptions of threat in both capitals and a growing competition over potential energy resources in areas close to both Japan and China—especially in the East China Sea and Siberia. Many of these concerns overlap: disaggregating them is difficult, especially since they go to fundamental issues of national security, national psychology, and self-image.

Today is a unique historic circumstance in Northeast Asia. For the first time, a powerful Japan and powerful China are facing one another. For the 75 years between the Meiji Restoration and WWII it was the weakness of China and the growing power of Japan that created instability. A politically coherent China that is economically vibrant, nuclear armed and globally influential is a unique geopolitical fact for the Japanese in the modern era—as it is for the rest of Asia and the United States.

Has the United States Contributed to the Current Situation?

The US was certainly not at the center of this problem. Despite the assertion that Chinese often make at unofficial gatherings, it is not in Washington's interests to promote the rivalry as a way to make Japan cling even more tightly to the US-Japan Alliance. Beijing acknowledges that Washington did not instigate tensions, but it apparently thinks Washington enjoys the current situation very much. Otherwise Washington would try to ameliorate tensions by pressuring the Japanese.

Bad Sino-Japanese relations are definitely not in Washington's interest, and the possibility of a military confrontation – deliberately or by accident -- between Japan and China over territory and resources in the East China Sea is a cause for great concern.

Despite past instances when the US has sought to exploit the rivalry (e.g., Nixon playing on China's fears that Japan might seek to take over Taiwan as a spur to US-PRC normalization), neither the Clinton nor Bush Administration consciously attempted to create differences between Tokyo and Beijing. Still, our alliance with Tokyo means that the United States is not an impartial observer in the rivalry. Over the past five years the Bush Administration has encouraged Japan to take a more equal role as a partner—as outlined in the Armitage-Nye Report of 2000--primarily to strengthen the alliance.

A strengthened alliance with a democratic Japan, which we should not forget is still has the second largest economy in the world, would be in the US national interest even if China were weak and self-absorbed. Because it is not, a strengthened alliance is also motivated by a need to “hedge” against an assertive China. (Both the 2006 National Security Strategy of the United States and the Quadrennial Defense Review Report from DoD are explicit in stating a need to “hedge” against China.) Our explicit hedging strategy has not been lost on Beijing and contributes to its views that Washington is “complicit” in Japan's more assertive policies.

The alliance, as it exists, also strengthens Tokyo in its dealings with Beijing. Japan is wrestling with how to deal with Beijing without bowing and scraping. The alliance empowers Tokyo so that Japan does not have to either kowtow or to militarily confront. In other words, it gives Tokyo greater flexibility in how it chooses to interact with Beijing.

### *Neither Tokyo nor Beijing is Content to be Number Two in Asia*

I believe there is a rivalry between Japan and China over who is recognized as Asia's leading power. My colleague at CNA, Dr. David Finkelstein has pointed out in a recent paper that the Sino-Japanese rivalry is not ages old. It has its roots in the relatively recent disruptions to the traditional Asian order occasioned by the coming of Western powers in the 19<sup>th</sup> century. This caused "national emergencies" in both China and Japan and brought these countries into full contact with one another. To be sure, the Chinese had been traditionally dismissive of the Japanese, who were referred to as "eastern barbarians," "island barbarians" or "dwarf bandits." The Japanese were a lesser caste in the Sino-centric world order. Japan, for its part, understood it was part of the Sinitic culture zone, but never saw itself as part of China's traditional world order, nor was it part of the tributary system. The two countries peacefully coexisted—largely ignoring one another.

Since the West began to interact with Asia in the 19<sup>th</sup> century, it has been the objective of both Japan and China to be treated with respect and as an equal in dealings with the "West." In dealing with one another, however, no such feelings existed. Since the Meiji restoration, Japan has considered the rest of Asia as backward and appointed itself to lead the region. The national myth that WWII was an attempt by Japan to "liberate" the region is but one manifestation of this "conceit." "It was America, not China, that defeated us in the war" is one expression of this attitude one sometimes hears from Japanese.

Post-war Japan saw itself as the natural leader of Asia since it was the first Asian economy to take off. Its economic development would set the pace for the economic development of the region—the so-called "flying geese" concept. Today, we still see Japanese preoccupation with its leading role in Asia: the notions that—Japan should be the "thought leader of Asia" or that Japan needs to take a leading role in East Asian regionalism are contemporary examples. Nonetheless, Japan has recognized that the rules of the game have changed and that the "flying geese" model no longer applies. As a result, it is grappling with its conception of itself and its place in the regional order.

China, for its part, recognizes that, in the 19<sup>th</sup> and the first half of the 20<sup>th</sup> century, Japan took its leading role in Asia mainly at China's expense. Starting with the annexation of the Ryukyus, Japan began to nibble at the Chinese empire. The overwhelming Japanese success in the Sino-Japanese War of 1895 was a shock to both the Chinese court and to the "West."

Since that time, the Chinese have been involved in a "revolution" to transform a traditional civilization into a modern nation state, and Japan has played the largest role in that revolution, for good or ill, over the past 100 years. Today the government of the PRC is the self-appointed torchbearer for the historical legacies of over a century of resentment over Japanese abuse of China. As my CNA colleague Dr Finkelstein has written, the CCP is the official "curator" of the historical grievances the people of China harbor toward the Japanese.

What makes the history debate so contentious is that, for China, when it comes to Japan, history appears to have ended in 1945. Little credit is given for postwar Japan's "peaceful rise" or for its positive contributions to China's rise. The focus on the first half-century in part can be attributed to China's tactic in stressing the worst. But China is also reluctant to debate the history of the second half of the century since it contains too many contentious and detrimental aspects for China.

Globally, China's economic clout is yielding political influence that increasingly comports with its membership in the UN Permanent Five. In terms of comprehensive national power—a PRC affectation for calculation of its place in the world in terms of "power"—Beijing sees that it is roughly equal with Japan today, with trend lines in its favor. Chinese (and many others around the world) see that China's power is growing, while Japan's is stagnating. In truth, the situation is more complex, but these perceptions are vitally important.

### ***Being Number One to do what?***

This section addresses the point of being a stakeholder. In the case of Japan, I think its pursuit of permanent membership in the United Nations Security Council (UNSC) is as much a search for international recognition and prestige as it is a genuine interest in speaking for underrepresented Asian nations in an international forum or a willingness to shoulder the burdens associated with genuine “leadership.” Moreover, Japan and China are unable to act as honest brokers and stakeholders in dealing with the difficult issues in the region because their own interests are often at odds with international interests. China’s unwillingness to really pressure North Korea is a case in point.

I do think that Tokyo’s worries about being supplanted by China as Asia’s leading power contribute to its drive to become a more “normal” state, at least to the extent that it wants to be able to play a security role in maintaining regional stability—which is a stakeholder role Washington would welcome and encourages. At the same time this does contribute to tensions by providing Beijing an opportunity to conflate history with Japan’s current security ambitions. Beijing can assert Japan is a looming threat to the region because Japanese militarism is once again on the rise.

### **How Important is the Yasukuni Shrine Issue?**

Yasukuni and nationalism are inextricably linked. Many Japanese and some US experts believe that Yasukuni is just a pretext: if visits to Yasukuni by democratically-elected officials were made illegal, China would then lodge an official complaint to Japan about the content of history textbooks; in short, there will always be flash-points around the history question.

China makes use of arguments over history because it is politically convenient for it to do so. On the other hand, there is recognition in Beijing that the current level of stress between China and Japan is not in China’s interest. I believe that if Yasukuni can be resolved, absent some other precipitating event, China has no interest in keeping tensions high.

As a historian by education and avocation, I am troubled how WWII is portrayed in the newly renovated museum (Yushukan) collocated with Yasukuni. The portrayal of Japan as the aggrieved party manipulated into war by the US outrages most US visitors—including me. So I do have a degree of sympathy for the China’s insistence that Japan needs to get its 20<sup>th</sup> century history “right.”

### ***Implications for US policy***

The forces of nationalism and domestic politics in both Japan and China make this situation particularly resistant to third party intervention. Nonetheless, the U.S. must be conscious that some in Asia feel Washington is encouraging Japan to take a more militant line or indirectly profiting from it.

However, incidents between Chinese and Japanese commercial and military vessels in the East China Sea have for the first time since World War II made the use of force a possibility—with consequences that could lead to war. This is not likely, but remains a possibility. Plainly, then, U.S. interests are involved. For this reason alone, the USG should be concerned about the downward spiral in Japan-China relations. It is important that Washington understand that this is more a sovereignty issue than an energy resource issue, which makes it especially dangerous.

The US has to be clear about policy objectives. Washington is not going to solve the history question, nor is it going to make China and Japan like one another. But it is not in the US interest to promote or tolerate strategic rivalry; it is in the US interest to promote trilateral cooperation. While identifying a productive approach will not be easy, the USG cannot simply ignore the rivalry because, left unattended, there is no confidence that both sides would deal with it in ways that promote US interests.

A strong argument was made that the USG also needs to be candid about the fact that its interests and obligations means that it must “lean Japan.” That does not mean that relations between Washington and Beijing and Tokyo are a zero-sum game. This needs to be clear to both capitals. It does mean however, that it will be difficult for the US to be “objective” about the overall relationship. Nor, because of US interests at stake, should it be.

Washington must be particularly careful not to appear to be tilting toward China. This could have a negative impact on the alliance and on Japan’s efforts to achieve a leading role in Asia.

But, the idea of pressing China to become a responsible stakeholder in the international system makes sense in this context—especially since Japan is apparently anxious to play a stakeholder role. Having both Japan and China as common stakeholders with the United States is trilateralism at the grand strategic level.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Admiral McDevitt. Dr. Sutter.

**STATEMENT OF DR. ROBERT SUTTER  
SCHOOL OF FOREIGN SERVICE, GEORGETOWN UNIVERSITY,  
WASHINGTON, D.C.**

DR. SUTTER: Thanks very much for the opportunity to speak before the Commission. I submitted a written statement and it does two things: it answers the four specific questions you asked about importance of China's policy in Asia for domestic power in China and for China's relations with Taiwan and Japan; and number two, it's based in particular on extensive interviews with 70 to 80 government officials in China and in seven Asian Pacific countries in both 2004 and 2006.

My statement makes the argument that China's rising prominence in Asia, which Admiral McDevitt has underlined, while posing serious problems for both Taiwan and Japan, is much less significant than much U.S. media and many commentators would have us believe.

In particular, China does not and will not have the ability to dominate or seriously challenge U.S. leadership in Asia. In the interest of time, I will focus on some passages of my written statement and deal with other issues as needed in the question period.

Why rising China can't dominate Asia “China can't dominate Asia. There are too many governments in Asia.” This response by a senior Chinese official to my question during an interview in Beijing this May reflects some of the realities of power in Asia that make Chinese leadership and dominance in Asia unlikely in the foreseeable future.

The findings of my private discussions with Chinese and other Asian government officials about China's rise, the balance of influence in Asia, and Asian regional dynamics contradict much U.S. media and other commentary that depict a rising and powerful China coming to the leading position in Asia at a time of U.S. decline in the region.

In contrast to these commentaries which focus on Chinese strengths and U.S. weaknesses, government officials in Asia, in private interviews, show an equal awareness of Chinese weaknesses and U.S. strengths in the region. They also are aware of how the many independent-minded governments in Asia hedge in reaction to China's rise.

These governments work quietly among themselves and with the United States to ensure that their independence and freedom of action will not be negatively affected as China rises in prominence in the region. Such actions reinforce U.S. leadership in Asia as China rises.

Congressional and other U.S. policymakers can adopt the one-sided view of those U.S. media and other commentators who predict China's dominance and U.S. decline in Asia. U.S. policymakers tended to do the same thing in the late 1970s when the United States was indeed weak and divided after the defeat in Vietnam and prevailing U.S. media and other predictions said the rising power, the Soviet Union, would dominate Asia.

The same kind of pattern prevailed in the late 1980s when respected U.S. media and commentators said that Japan would dominate Asia as U.S. influence in the region declined. Of course, those earlier predictions were dead wrong. They focused on the strengths of the rising powers, the USSR and Japan, and did not adequately consider their weaknesses, and they focused on the weaknesses of the United States and did not adequately consider its strengths.

A more sensible path, in my view, is for U.S. policymakers to listen carefully to the more balanced and carefully calibrated views of Asian government officials. While media, vocal non-government elites and public opinion matter in some Asian countries, at the end of the day, it is the government officials who make the foreign policy decisions.

There are few failed states in Asia. Most governments are strong and are expected by their constituents to lead.

My research trip in spring-summer 2006 involved 50 public seminars and workshops dealing with China's rise and U.S. leadership in Asia that were attended by several hundred non-government specialists and elites in 21 cities in eight Asian countries: and more importantly, for this presentation, in-depth interviews and consultations on these subjects with 75 diplomats and government specialists in those countries.

The trip followed my past interchanges with Asian government officials including a similarly extensive research trip to the region in May-June 2004.

The main findings of this work are as follows: (1) China is rising in influence in Asia, the part of the world where China always has exerted greater influence, but China also has major limitations and weaknesses and has a long way to go to compete for regional leadership;

(2) The power and interests of the United States and most Asian governments work against China ever achieving dominance in Asia;

(3) The U.S. image in Asia has declined in recent years and U.S.

foreign policy continues to be widely criticized. However, U.S. ability and willingness to serve as Asia's security guarantor and its vital economic partner remain strong and provide a solid foundation for continued U.S. leadership in the region.

Overall, U.S. influence in the region has not declined according to every Asian official interviewed in 2006;

(4) Most Asian governments maneuver and hedge against China's rise and they find a strong U.S. presence in Asia fundamentally important and reassuring.

I thank you for your attention and I look forward to your questions.  
[The statement follows:]

**Prepared Statement of Dr. Robert Sutter  
School of Foreign Service, Georgetown University, Washington, D.C.**

**Why Rising China Can't Dominate Asia**

"China can't dominate Asia; there are too many governments in Asia." This response by a senior Chinese official to my question during an interview in Beijing on May 30, 2006 reflects some of the realities of power in Asia that make Chinese leadership or dominance in Asia unlikely under foreseeable circumstances. The findings of my private discussions with Chinese and other Asian government officials about China's rise, the balance of influence in Asia, and Asian regional dynamics contradict much media and other public discourse in the United States and some parts of Asia that depict a rising and powerful China coming to the leading position in Asia at a time of US decline in the region. In contrast to these media and other commentaries, which focus on Chinese strengths and US weaknesses, government officials in Asia in private conversations and interviews show an equal awareness of Chinese weaknesses and US strengths in the region. They also are aware of how the many independent-minded governments in Asia "hedge" in reaction to China's rise. These governments work quietly among themselves and with the United States to insure that their independence and freedom of action will not be negatively affected as China's rises in prominence in the region. Such actions reinforce US leadership in Asia as China rises.

US policy makers in the Congress and elsewhere can choose to adopt the one-sided view of those US media and other commentators who predict China's dominance and US decline in Asia. US policy makers tended to do the same thing in the late 1970s when the United States was indeed weak and divided after the defeat in Vietnam and prevailing US media and other predictions said the rising power, the Soviet Union, would dominate Asia. The same kind of pattern prevailed in the late 1980s when respected US media and commentators said that Japan would dominate Asia as US influence in the region declined. Of course, those earlier predictions were dead wrong; they focused on the strengths of the rising powers, the USSR and Japan, and did not adequately consider their weaknesses; and they focused on the weaknesses of the United States and did not adequately consider its strengths.

A more sensible path, in my view, is for US policy makers to listen carefully to the more balanced and carefully calibrated views of Asian government officials. While media, vocal non-government elites, and public opinion matter in some Asian countries, at the end of the day it is the government officials who make the foreign policy decisions. There are few failed states in Asia; most governments are strong and are expected by their constituents to lead.

What follows are the findings of a research trip in spring-summer 2006 that involved dozens of public seminars and workshops dealing with China's rise and US leadership in Asia that were attended by several hundred non-government specialists and elites in 21 cities of eight Asian countries; and—more importantly for this presentation—in-depth interviews and consultations on these subjects with 75 diplomats and



government specialists in those countries.(Please see the section beginning on page four of this document for specific findings in each country.) The trip followed the author's past interchanges with Asian government officials, including a similarly extensive research trip to region in May-June 2004 (Those are reviewed in his book *China's Rise in Asia: Promises and Perils* (Lanham Md.: Rowman and Littlefield, 2005).

The main findings of this work are:

- China is rising in influence in Asia, the part of the world where China always has exerted greatest influence; but China also has major limitations and weaknesses and has a long way to go to compete for regional leadership.
- The power and interests of the United States and most Asian governments work against China ever achieving dominance in Asia.
- The US image in Asia has declined in recent years and US foreign policy continues to be widely criticized. However, US ability and willingness to serve as Asia's security guarantor and its vital economic partner remain strong and provide a solid foundation for continued US leadership in the region. Overall US influence in the region has not declined, according to every Asian official interviewed in 2006.
- Most Asian governments maneuver and hedge against China's rise, and they find a strong US presence in Asia fundamentally important and reassuring.

#### Chinese Strengths and Limitations

Growing Chinese prominence in Asia is based on rapidly growing economic interchange and adroit Chinese diplomacy. Chinese and most Asian officials play down the implications of China's impressive buildup of military power, though Japanese and some Taiwan officials focus on this perceived Chinese threat.

Burgeoning trade and growing Asian investment in China are the most concrete manifestations of greater Chinese prominence in Asia. China has become the largest trade partner of many Asian neighbors, and Chinese trade expands at almost twice the rate of China's fast-growing economy. Entrepreneurs from the more advanced Asian economies provide the bulk of the \$60 billion in foreign investments China receives annually. Chinese wealth and economic importance support growing popular exchanges in tourism and education. Attentive Chinese diplomacy involves an often dizzying array of leadership meetings and agreements with Asian neighbors and increasing adroit Chinese interchange with the growing number of Asian regional organizations. As a result, China's positive image has grown, particularly in South Korea, much of Southeast Asia, and Australia.

Heading the list of limitations and weaknesses of China's rise in Asia is strong Chinese nationalism; this seriously complicates Chinese relations with Japan and Taiwan, and causes significant difficulties with South Korea, Singapore, and India, among others. Chinese territorial claims are a serious concern in the East China Sea, a major drag on improving relations with India, and an underlying concern in Southeast Asia. China's authoritarian political system is unattractive to many, though certainly not all, of China's neighbors.

Chinese economic and diplomatic strengths also reflect significant limitations and complications. More than half of Chinese trade with Asia and the world is processing trade, which leads to double and triple counting as a product crosses borders, sometimes several times, before completion and (often) export from China to the United States and Europe. The value added by China in this trade is frequently low, and the trade depends heavily on US and European consumers. Reflecting this reality, Chinese President Hu Jintao in 2005 said that China is "a major trading country" but has not yet become "a major trading power."

Chinese economic competitiveness means that Asian manufacturers often cannot compete directly with

China. In response, Asian entrepreneurs increasingly invest in and integrate their businesses with China, but Asian workers cannot move to China and often suffer. Investment in Asian economies declines and Chinese investment and foreign assistance in Asia remain very small and do not offset these negative implications.

China's "win-win diplomacy" focuses on common ground, which receives great positive publicity but does little to resolve differences or deal with issues. With few exceptions, China does not do hard things; it carefully avoids major international commitments or risks.

### US Weaknesses and Strengths

US weaknesses in Asia are widely publicized. They center on the decline in the US image in Asia amid widespread criticism of the US war in Iraq, the US position on North Korea, unilateral US actions on significant international issues, and perceived inattentive US policies regarding the economic development and other concerns in Asia. These weaknesses dominate the media and public discourse in most of Asia.

Nevertheless, Asian government officials interviewed during the 2006 research trip were almost uniform in emphasizing the positive importance of the US leading role as Asia's security guarantor and vital economic partner. The main exceptions were a Communist Party of India (Marxist) official, and to a degree, some Chinese officials, who criticized the US security role in Asia.

Asian government officials are well aware that Asian governments generally don't trust each other. The kind of suspicion and wariness one sees today between China and Japan characterizes most relationships between and among Asian governments. And yet the Asian governments need stability in order to meet their nation-building priorities. In this context, the United States looms very large in their calculations. Unlike their Asian neighbors, the United States does not want their territory and does not want to dominate them. It too wants stability and, in contrast with China's reluctance to undertake major risks and commitments, the United States is seen to continue the massive expenditure and major risk in a US military presence in Asia, viewed as essential in stabilizing the often uncertain security relationships among Asian governments.

Not only does the United States continue to occupy the top security position as Asia's "least distrusted power," the United States also plays an essential economic role in the development priorities of Asian governments, most of which are focused on export-oriented growth. It continues to allow massive inflows of Asian imports essential to Asian economic development despite an overall US trade deficit approaching \$700 billion annually. Against this background, when asked if overall US power and influence in Asia were in decline, Asian officials were uniform in saying no.

### Asian Maneuvering and Hedging

All Asian government officials consulted agreed that China's rise adds to incentives for most Asian governments to maneuver and hedge with other powers, including the United States, in order to preserve their independence and freedom of action. A Singapore official said that "hedging is the name of the game" in Southeast Asia, while an Indian official said that Asian governments "are not going to put all their eggs in one basket." Asian governments hedge against the United States and other powers as well, but their recent focus has been on China's rise. The governments tend to cooperate increasingly with China in areas of common concern, but they work increasingly in other ways, often including efforts to strengthen relations with the United States, to preserve freedom of action and other interests in the face China's rise.

In an Asian order supported by undiminished US security and economic power and influence, such hedging by Asian governments adds to factors that are seen to preclude Chinese leadership or dominance in Asia and that reinforce US leadership in Asia. The majority of Asian government officials assumed that China sought eventual "pre-eminence" in Asia; Chinese officials said no, though Chinese foreign policy specialists said that secret Chinese Communist Party documents over the years have continued to refer to a

general goal of Asian leadership. As noted above, when asked whether China sought leadership or domination in Asia, a senior Chinese official acknowledged the complications of US power and influence and the role of many independent-minded Asian governments. He responded that “China can’t dominate Asia; there are too many governments in Asia.” He nonetheless went on to advise that China’s influence in the region would grow as China’s “weight” would become increasingly important to the governments in the region and China would have increasing success in reassuring Asian governments of Chinese intentions.

### **Views in Specific Countries**

#### Australia

Australian official public commentary and media coverage are increasingly positive about China. Supporting this trend, Australia benefits greatly as a major exporter of resources to China. In private, Australian officials who deal with China regularly were much more inclined to stress the many problems in the relationship. Economic officers complained pointedly of a range of problems familiar to American counterparts, asserting that Chinese foot-dragging was hampering negotiations on a bilateral free trade agreement. Intelligence and defense officers remained wary of China’s ambitions, which were seen to focus on “pre-eminence” in Asia. Parliamentary leaders recalled with some bitterness China’s brass-knuckle pressure to insure that all possible dissent during Hu Jintao’s landmark address to the body two years ago was undisturbed by any possible dissent. Australian officials saw US power and influence playing a fundamentally important role in channeling China’s rise in constructive directions. Overall US power and influence in Asia were seen as unchanged, though China’s rise was seen by some as a net loss for US influence.

#### China

Chinese diplomats disavowed any intent to dominate Asia, saw US power in the region as unchanged, “respected” US regional interests, and criticized mildly and in general terms US military arrangements in Asia. They acknowledged that China’s “national security strategy” was not as clear as China’s “development strategy.” They advised that the former was defensive; China’s military buildup was said to focus on Taiwan and to be broadly compatible with the growth of China’s economy and interests. They forecast a continued Chinese effort over the next several decades to improve China’s influence in Asia through mutually beneficial economic and diplomatic contacts that would increasingly reassure China’s neighbors.

#### India

Indian media, elite commentary, and business groups offer much less attention to China than their East Asian counterparts. They are mixed in assessing the implications of China’s rise, with Indian manufacturers and other businesses expressing concern as much as optimism over economic ties with China. Indian government and non-government strategic specialists have remained very wary over China’s relations with Pakistan and other Indian neighbors and the slow progress in Sino-Indian border talks. In private, Indian officials said they saw US power in Asia as unchanged and the US role as central in fostering constructive Chinese foreign policy.

#### Japan

Japanese officials and foreign policy elites appeared seriously concerned about what they saw as China’s seeking dominance in Asia at Japan’s expense. They judged that China-Japan relations would not get much worse but that the two powers would continue to engage in long-term competition for influence in Asian and world affairs. They saw US power in Asia as undiminished and fundamentally important to Japanese strategy for dealing with China. They sought greater US diplomatic activism in Asian regional organizations, notably the East Asian Leadership Summit, as a means to bolster Japanese efforts to thwart perceived Chinese initiatives seeking leadership and dominance.

### New Zealand

Public attitudes toward China are much more mixed in New Zealand than in Australia. This is despite the fact that China sent 29,000 people in official delegations to New Zealand in 2005. Many of these delegates were seen as using the trips for vacation rather than work. Economic exchanges with China are seen as threatening as well as beneficial by New Zealand media and private official commentary. The pros and cons of the influx of Chinese students and other migrants in recent years have been actively debated in public and private. China's so-called dollar diplomacy in the Pacific Island states has prompted sharp criticism from concerned government officials and academic specialists. New Zealand officials privately expressed strong support of the US role as "the principal arbiter" of regulating in constructive ways China's rise in Asia. In their view, the US was not in decline—it was essential.

### Singapore

Singapore's public discussion of China emphasizes the positive benefits of major trade, investment, educational, and cultural links. Singapore officials were more mixed in private. Some emphasized the positive with China and others were wary. Continued strong US power in Asia was seen as essential in perceived efforts by Singapore and others in Southeast Asia to hedge as China rose in influence. Some officials worried about the United States mishandling relations with China, leading to tension over Taiwan or other issues that undercut Singapore's interest in regional stability.

### South Korea

South Korean officials underlined an increased wariness in South Korean attitudes toward China despite continued diplomatic bonhomie and burgeoning economic and other interchange. Suspicions rose over growing Chinese economic relations with North Korea seen fostering a stronger North Korean state fundamentally at odds with South Korea's goal of reunification. Nationalistic Chinese positions in dealing with historical disputes strongly alienated South Korean officials who deal with China. In response, the officials noted that South Korea has strengthened efforts to solidify relations with the United States. It welcomes the strong US military presence and sees no diminishment of US power in Asia. Also, one official emphasized after strongly criticizing China that "a strong Japan" is fundamentally important for South Korea's interest in regional stability.

### Taiwan

Taiwan officials and foreign policy elites were preoccupied with Taiwan domestic politics and divided along partisan lines in assessing the danger to Taiwan posed by China's rise. Pan-blue (Kuomintang and People's First Party) leaders said that China's increasingly effective international isolation of Taiwan would diminish with the end of the pro-independence leaning of the current Taiwan government. Taiwan officials saw US power in Asia unchanged and essential for Taiwan's security in the face of rising China, but some worried a future US government would tilt more toward China and against Taiwan.

### **Answers to Specific Commission Questions**

1. To what extent are China's domestic political power and legitimacy tied its position in regional exchanges and security relationships?

China's policies and behavior in Asia over the past 15 years show five priorities seen as important in support of the Chinese administration's primary goal, to sustain the rule of the Chinese Communist Party administration in China. The five—listed here in priority order—are: 1) to promote a stable environment allowing for undisturbed political stability and economic development in China; 2) to foster advantageous economic relations with Asian neighbors; 3) to reassure Asian neighbors, the United States, and other concerned powers that rising China is not a threat to their interests; 4) to isolate Taiwan; and 5) to enhance

Chinese influence in Asian and world affairs. An implication of this list is that China taking a leadership position in Asia is not a high priority.

## 2. How does China's diplomacy in the region and participation in regional organizations affect Taiwan?

In general, China's "win-win" diplomacy does not require Asian governments and multilateral organizations to do things they wouldn't ordinarily do (and China's low risk/low commitment diplomacy doesn't require it to do things it wouldn't ordinarily do). The main exception is Taiwan. Chinese officials for a decade have pressed Asian governments and regional organizations very hard in order to isolate Taiwan, and they have been increasingly effective. For example, Southeast Asia ten years ago was the main arena for top-level Taiwan officials to travel and meet with foreign (in this case Southeast Asian) counterparts, even though the Southeast Asian governments had official relations with China. During the Asian economic crisis, Southeast Asian leaders--even Prime Minister Mahathir from Malaysia--traveled to Taiwan for talks. Over time, Chinese pressure, backed by China's increasing importance to Southeast Asian countries, has made visits of Taiwan officials at the ministerial level difficult while visits of top-level Taiwan officials are very rare.

Meanwhile, the pro-independence tendencies of the current Taiwan government have undermined Taiwan influence and played into the hands of China's efforts to isolate Taiwan. They notably have prompted sharp rebukes from Singapore and other Asian governments that in the past tried to maintain an even-handed position in Taiwan-China relations. At bottom, Southeast Asian and other Asian governments do not want to see instability in the Taiwan Strait and tend to view Taipei's pro-independence maneuvers and rhetoric as provocative and unwelcome.

## 3. What are the causes of the recent downturn in Sino-Japanese relations? How has this tension affected US ties to the region?

There is no simple answer to *the first question*. A review of events over the past year or two shows a very complicated relationship. The sharp turn for the worse in China-Japan relations seen during the violent anti-Japanese demonstrations in China during April 2005 was marked by concurrent deterioration of relations regarding political and security issues on several fronts, even as economic relations prospered. Prime Minister Koizumi remained un-apologetic about visiting the Yasukuni shrine. Another textbook seen to white-wash Japanese aggression prior to 1945 was approved for publication by Japanese government officials. First China, then Japan, engaged in exploitation of gas in disputed waters in the East China Sea. Russia vacillated between strong incentives from Japan and China in determining whether to favor one or the other in building a pipeline to East Asia for Siberian oil. Repeated intrusions into Japanese claimed waters by Chinese "research" and other ships presaged the intrusion of a Chinese nuclear powered submarine that was found and tracked by Japanese forces in Japanese territorial waters near Okinawa. Growing Japanese concern about the implications for Japanese interests posed by the rapid Chinese military buildup focused on Taiwan elicited more explicit Japanese government expressions of concern and a variety of countermeasures, many involving strengthening Japan's alliance relationship with the United States. In this context, Japan engaged in bilateral consultations with the United States over the Taiwan situation; worked in a trilateral forum with Australia and the United States that dealt with Taiwan and other Asian issues; was explicit in noting Japanese government concerns over the Taiwan situation; and backed the United States in seeking curbs on European and Israeli arms sales to China. A large Chinese-Russian military exercise involving naval and air forces in the East China Sea in August 2005 was followed by Japan's detection in September of a flotilla of Chinese warships sailing near a Chinese gas rig exploiting resources in the East China Sea that are claimed by Japan.

Japanese leaders used the marked increase in Japan's international profile seen at the time of Japan's impressive aid and relief efforts after the Tsunami disaster in South Asia in December 2004 to launch a series of high-level international visits and associated economic and other gestures in an effort to garner support for a permanent seat for Japan on the UN Security Council. Despite strenuous government efforts, China remained way behind, in the second echelon among Tsunami relief donors. The Chinese government

opposed Japan's UN bid. Public opinion in China was fed by a longstanding Chinese government media and education campaign to build nationalism by emphasizing the evils done to China by past imperial powers, notably Japan. In these circumstances, whether by design or happenstance, tens of thousands of Chinese responded to an internet campaign against Japan's UN bid by taking to the streets, with many attacking Japanese businesses and diplomatic properties in April 2005. For several days, the Chinese police attempted to regulate but did not attempt to stop the violent anti-Japanese acts, bringing bilateral relations to the lowest point since the normalization of relations in 1972.

Subsequently government officials on both sides endeavored to restore order and maintain mutually advantageous business ties. However, neither side gave ground on the various political and security disputes that gave rise to the recent deterioration of relations. Fresh from his success in leading his party to a decisive victory in Diet election in September 2005, Prime Minister Koizumi again visited the Yasukuni Shrine in October, prompting shrill Chinese protests and cancellation of foreign minister talks to improve relations. Chinese officials refused to meet with Koizumi and Japan and China were on opposite sides at the December 2005 East Asian Leadership summit that was supposed to highlight Asian regional cooperation.

Regarding the *second question*, the crisis has reinforced Japan's close alignment with the United States. Japan also wants greater US involvement in Asian regional organizations like the East Asian leadership summit in order to prevent perceived Chinese efforts to dominate the groups at Japan's expense.

For its part, China quietly has sought US intervention and mediation. It presumably judges that US intervention will focus on Yasukuni and related issues and thereby implicitly undercut Prime Minister Koizumi and others in Japan seen as hard liners on China. US intervention also could provide a way for China to back away from its rigid policy toward Japan, which Chinese officials and strategists widely recognize is counterproductive for China's broader goal of promoting an image of peace and development in the region. These Chinese officials are well aware that from 1996 to 2001 China sandwiched a newly moderate and positive approach to Asian neighbors with strident opposition to the US alliance structure and security presence in Asia. This policy failed in part because Asian governments did not want to choose between the US and China. China changed it in mid-2001, eventually adopting the line of "peaceful rise" and "peaceful development" that sought cooperation and moderation with the United States as well as with most Asian neighbors. Today, China's anti-Japan posture is pressing Asian governments to choose between China and Japan. By conventional measure, Japan has half the wealth of Asia. For this and other reasons, Asian governments do not want to choose between Beijing and Tokyo. Under these circumstances, it probably is just a matter of time before China will have to adjust its anti-Japan policy, and US intervention would help it to "get off the hook" without a public demonstration of compromise or acknowledgement of policy failure.

#### 4. How has a rising China changed Japan's approach to international relations?

Japan has become increasingly determined to resist perceived Chinese pressure tactics and intimidation. It is more prepared than ever to give "tit-for-tat" in behind-the-scenes and sometimes overt competition with China for international influence, not only in East Asia but further away in arenas like the African Union, Central Asia, the Pacific Islands, and elsewhere. Japan is increasingly forthright in dealing with the military threat to Japan posed by China's military build-up; this reinforces Japan's own military modernization.

In dealing with the challenges posed by a rising China that is sharply critical of Japan, Japan seeks closer cooperation and support from the United States. The cooperation and support Japan seeks are not directed explicitly at China, but are focused on common US-Japanese positions that thwart perceived Chinese efforts to seek regional leadership in Asia and to marginalize Japan's international importance and role. In this context, Japan also appears more ready and willing to play a more active role in support of Asian governments that seek to hedge in the face of China's rise, providing support for their continued independence and freedom of action that implicitly limits China's ability to lead or dominate Asia.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Dr. Sutter. Professor Jackson, who was once my professor at SAIS, it's nice to see you.

**STATEMENT OF DR. KARL D. JACKSON  
SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS  
HOPKINS UNIVERSITY, WASHINGTON, D.C.**

DR. JACKSON: The table has turned. It is a cold and harsh day. It's a great pleasure to be here on this cold and stormy day. But I'd like to say just a few things. First of all, I agree with almost everything that Bob Sutter has just said and you'll find very much the same thing when and if you have a chance to look at my written testimony.

My basic message today is a good news message, followed by a plea for increased attention to Southeast Asia because our position there is slipping, not so much vis-à-vis China, but slipping for other reasons.

To begin at the beginning, with the exception of Burma, Southeast Asia, from an American point of view, is in much better shape economically and socially than most astute observers would ever have been able to predict 40 years ago.

If you had described the present condition of Southeast Asia, the policymakers in this room 40 years ago, they would have told you no, you're wearing rose-colored glasses. It is impossible that that sort of set of events would ever come to pass.

Secondly, China's role in Asia has changed over the last 40 years. 40 years ago, China was the regional troublemaker. China was the source of destabilization in as many places as they were capable of, and what has happened over the last 40 years, and especially in the last five years, is China has become a more responsible stakeholder.

However, I would emphasize that our ability to predict when China's policies will change is somewhat limited. For instance, I've been told, but it was before my time--Admiral McDevitt was there--

REAR ADMIRAL McDEVITT: It was my time; right.

DR. JACKSON: --that China did cross the Yalu to the total consternation of a certain General MacArthur. We also didn't anticipate the annexation of Tibet in '50-'51, nor did we anticipate China's invasion of India in '62, nor did the French understand how deeply China would be involved at the Battle of Dien Bien Phu. Nor did we anticipate China's seizure of the Paracel Islands just at the end of the Vietnam War, and in fact, it caught the Vietnamese Communist Party quite off base.

China's invasion of Vietnam in '79 was news to people in this town. The occupation of Mischief Reef in '95 was also a shock to the Philippines and to us. Likewise, missile practice in the Taiwan Straits, et cetera, et cetera. My only point being we are not omniscient. No one in

this room is and therefore if you're going to have a reasonable strategy with regard to China, you do what the rest of Southeast Asia is doing, that is you hedge your bets.

For this reason, every effort should be made to encourage the positive behavior of China, but we should be realistic. We must sustain our own role in Asia. We must make clear that conflict in the Taiwan Straits remains entirely and completely unacceptable, and the U.S. will use all necessary resources to avoid such a deplorable outcome.

We must remain fully involved. Without our involvement, ASEAN's sophisticated hedging strategy, which I describe in my written material, simply will not be sustainable. As long as the United States remains fully involved, the ASEAN countries are not going to jump onto the Chinese bandwagon.

The kind of trade interdependence that you find in Northeast Asia between China and Japan and between Korea and Japan simply does not exist in Southeast Asia if you bother to check the WTO figures.

Trade with China is rising rapidly, but in most instances, China is usually the fourth or the fifth largest trading partner of most Southeast Asian nations.

In closing, the paper outlines how sophisticated the ASEAN powers have become at playing their cards vis-à-vis China. ASEAN expanded to ten nations and that made no sense to a lot of us frankly, but we weren't asked. They expanded to ten nations because they wanted a hedge, a hedge in case China's behavior turned negative, turned back to the kind of aggressive behavior that we witnessed in the '50s, '60s and 1970s.

ASEAN further hedged its position by enticing China into signing the Treaty of Amity and Concord, one of the basic founding documents of ASEAN. And finally, ASEAN always hedges by engaging the Americans, insisting that the Americans stay engaged, and these strategies have been quite significant and quite successful.

Now, I've made several specific proposals at the very end of my statement. All of these amount to enhancing U.S. engagement in Southeast Asia. To boil it down to its absolute minimum, the Secretary of State for East Asia and the Pacific must not be allowed to become the Assistant Secretary for Northeast Asia or the Assistant Secretary for North Korea.

We have got to avoid a single-issue focus. North Korea is terribly important, but we've got to get our officials out into the area much more frequently than they are.

Secondly, we have to concentrate on soft power aspects. The United States did not win the Cold War on nickels and dimes. We won the war of ideas, and with regard to 9/11 and Islam in Southeast Asia, we're losing the war of ideas, and we better get our act together.

Thank you.

[The statement follows:]



**Prepared Statement of Dr. Karl D. Jackson  
School of Advanced International Studies,  
Johns Hopkins University, Washington, D.C.**

When we look at China we tend to concentrate on the most recent headlines or at least the latest major event, be it the East Asia Summit, China's accession to ASEAN's basic founding document, or China's occupation of Mischief Reef off the Philippines. Likewise, when we appraise U.S. policy effectiveness we tend to do it with an emphasis on short-term failings and ways in which U.S. policy might have been optimized, particularly if informed by the omniscience of hindsight.

This morning I would like to begin by appraising where we are today in Southeast Asia from the vantage point of four decades before discussing China's past, present, and future role in the hopefully peaceful evolution of Southeast Asia.

In the 1960s Southeast Asia was characterized as "the Balkans of Asia." Indonesia, under President Soekarno, was following an expansionist and nationalist foreign policy, intermittently attacking the US and engaging in actual warfare to prevent the formation of Malaysia, 1963-66. At one point in 1965 the U.S. Department of State thought it inevitable that Indonesia, the largest nation in Southeast Asia, would become a communist people's republic in close alliance with China.

As late as 1962 Singapore was thought to be a likely candidate for communist takeover. At that time Thailand was a poor country, ruled by a hard-nosed military clique that specifically eschewed any association with democracy, even as a distant goal. From the mid 1960s to the late 1980s, the Philippines was ruled by President Marcos, who began as a popular democrat but ended as a remarkably corrupt and violent autocrat. In the midst of these chronically weak societies and governments, China under Mao played a major destructive role in Southeast Asia, intentionally destabilizing as many non-communist governments as possible. Most Southeast Asian governments were profoundly distrustful of China because of its manifest willingness to provide money and guns to rebel groups seeking to bring down central governments. China's greatest success (before it turned into a failure) was its support to North Vietnam and its southern confederates in their externally supported internal war against the South Vietnam and the United States. Ultimately that conflict cost a million Vietnamese their lives as well as more than 50,000 Americans from my generation. Less than four years after China had backed the winning side in Vietnam, it found itself at war with a united Vietnam in retaliation for Vietnam's occupation of Pol Pot's Cambodia.

What a difference four decades can make for the role of the U.S. and for the role of China in Southeast Asia. Indonesia since the late 1960s moved from GDP/capita of approximately \$100 to in excess of \$1,000 per annum, in spite of the economic crisis of the late 1990s. After having no diplomatic relations whatsoever with China from 1967-1990, Indonesia and China now have relations that are normal and cordial in all respects. Furthermore, effective but authoritarian rule under President Suharto has been replaced, under President Susilo Bambang Yudohyono, by what appears to be the first government in fifty years that is both democratic and effective. From the vantage point of American interests, the prospect of a radical people's democracy, after considerable bloodshed and instability, has been replaced by the largest Islamic democracy in the world and one that by and large adopts a moderate line in both its foreign and domestic policies. Conditions in Indonesia have obviously improved over the long term and the U.S. policy of patient and professional long-term involvement and commitment have paid a clear dividend to the American people.

Singapore has gone from being a dusty, radicalized port city of the British empire to being stable and more wealthy than its former colonial ruler. Even though the system of government is at best semi-democratic, Singapore has obviously made great strides for its people and has consistently been a dependable partner for the United States in the region. Malaysia came into being in 1963 and was immediately confronted with an armed assault from Indonesia. Having survived this onslaught with the assistance of the Great

Britain, New Zealand, and Australia, Malaysia in the intervening four decades built a strong and open economy that has posted consistently high growth rates. Although the openness of its democratic life was constrained by the domination of Prime Minister Mahthir (1969-2003), as a nation Malaysia has been an obvious success and has maintained good relations with the United States.

The Philippines presents a more mixed picture. It emerged from the Second World War as democratic, English-speaking, and the second most developed country in Asia, following only Japan. Although the Philippines is a wealthier country today than it was forty years ago, it has consistently lagged behind the region in its growth trajectory. Furthermore, it has displayed serious problems with governance under both democratic and non-democratic regimes. Even though democratic elections have been a constant in Philippine political life for a hundred years, the same old elite families continue to dominate governments and rural alienation from oft rapacious elite activities has led repeatedly to social unrest and violence (the Huk Rebellion, New People's Army (NPA) and the Islamic rebellions in the South). At the end of the Cold War, the democratically elected Philippine Senate declined to renew U.S. access to the military bases at Clark Field and Subic Bay. In 1993 this led to a withdrawal of U.S. armed forces and what was perhaps a necessary downward readjustment in the bilateral security relationship. Two events subsequently resuscitated the U.S.-ROF security relationship: China's occupation of Mischief Reef in 1995 and the Philippine reaction to the 9/11 attack on the World Trade Center. President Arroyo immediately offered any assistance the Philippines could render, including access to the former bases. Although neither option proved necessary, the gesture of alliance solidarity was greatly appreciated. The Philippines is a major Non-NATO Ally of the United States but its internal social and political weaknesses continue to constrain its democratic stability and its economic prosperity.

Like the Philippines, Thailand has continued to be a mutual security ally of the United States. With a per capita income of nearly \$3,000 per annum it is roughly twice as well off as the Philippines. Likewise, Thailand's political system has evolved into a full democracy, with a series of democratically elected parliaments. With thirty years of experience with export-led growth and with its large Sino-Thai minority, it plunged into trade and investment in China almost as soon as China opened its doors to the outside world. Before the Asian financial crisis in 1997, one Thai conglomerate, the C P Group was the largest single foreign investor in China. In spite of the close security relationships with the U.S. (that led it to send Thai troops to both Afghanistan and Iraq), Thailand is generally recognized as having the closest relationship to China among the Southeast Asian nations. By any long-term standards the Thailand story is a great success although the political system remains vitally dependent on the authority of its highly respected but aging monarch.

For Vietnam, the second half of the twentieth century was dominated by warfare: 1948-54 against the French; the subsequent war with the United States until 1972; the triumph over South Vietnam, 1972-75; the unsuccessful invasion and occupation of Cambodia, 1978-90, and a six week border war and an extended period of low level conflict with China that continued for ten years after 1979. In combination with a quite substantial post revolutionary out-migration (1975-1985), ill-considered economic policies brought the country to a decision point in 1986 when it adopted doi moi, a set of economic reforms that have led to substantial a rapid growth over the past twenty years. By 1990, Vietnam had withdrawn its troops from neighboring Cambodia, whose occupation had completely isolated Vietnam diplomatically from 1978-91. The Paris Peace Agreement of 1991 and the subsequent U.N. supervised elections in Cambodia in 1993 led to the re-emergence of Vietnam as a normal nation, a country that could expect to trade and interact with everyone including former adversaries such as the U.S. and China.

The conclusion to be drawn from this brief circuit of Southeast Asia is that U.S. interests over the past 40 years have fared remarkably well in Indonesia, Singapore, Malaysia and Thailand and less well, but not disastrously, in the Philippines. Even in Vietnam there has been a recent flowering of relations between former enemies. All of the Southeast Asian states, with the exception of Burma, are stronger states and more capable of governing their territories and delivering services to their people. The remarkable thing is that many of these successes were accomplished in spite of the direct opposition of China in the early years and this leads me to be optimistic that American interests, as well as the interests of the more open societies

of Southeast Asia, can be protected quite adequately now that China has become a more positive and more powerful competitive force, strategically, economically, and diplomatically.

#### Southeast Asia and the China Market

The growth of intra-Asian trade in the 1980s and mid 1990s resulted from the rapid rise of China and ASEAN, the continuing expansion of Korea, and Japan's stature as the world second largest economy. China continued its rapid economic ascent in the 1990s while Japan entered a 15-year-long recession in 1990 and the remaining Asian economies were caught up in the Asian financial crisis of 1997-98. China's continuing advance in world trade has meant that trade with Southeast Asia rapidly expanded, albeit from a low base, in the opening decade of the new century.

Does this mean that China has become as important for the ASEAN countries as it has for Korea and Japan? In 2004 Japan was China's largest source of imports, and China was the largest market for Korean exports. Nothing like comparable statistics exist in Southeast Asia, even though trade with China is growing rapidly. According to WTO statistics Indonesia, Malaysia, Singapore, the Philippines, and Thailand all have substantially greater trade interdependence with the U.S. than they do with China. In many ways Thailand under Prime Minister Thaksin has been the most vocal advocate of increasing trade relations with China but in 2004 China was only the fifth largest market for Thailand's exports while China was the fourth largest source of Thailand's imports. Vietnam differs from the rest of ASEAN. Having a common border, China is the largest source of Vietnam's imports and the fourth largest destination for Vietnamese exports.

One of the downsides of the rise of China and the Asian Financial crisis of 1997-98 is that China continues to peg the RMB in a narrow band that makes investing in China very cheap for American firms and makes China's exports quite competitive. In contrast, the ASEAN countries by and large have floated their currencies in 1997-98, allowing values to be determined by supply and demand rather than by government fiat. This policy change on the part of Southeast Asia has made their exports less competitive in relationship to China and made China a more favorable destination for foreign direct investment, especially in manufacturing. In the ASEAN countries, the pegged exchange rates of the 1980s and 1990s had led to a vast misallocation of investments, supplying the structural cause of the crash of '97. No one in ASEAN wants to repeat this experience. The \$64,000 question of Asian economics is, "How long can China maintain its current peg and closed capital account?" In my opinion, China will not loosen the peg significantly or open its capital account until it is forced to by domestic economic developments.

#### ASEAN Diplomacy: Hedging Strategy in an Uncertain Region

During the forty-year period from the late 1960s to the present, the countries of Southeast Asia developed a regional association that has been remarkably effective in some ways and utterly impotent in others. When it was founded in 1967 it was supposed to foster social and economic integration. In its first years it did little more than increase the interaction among formerly separate and potentially hostile post-colonial elites. As a trading organization it remained ineffective. Its single greatest achievement was the agreement among its founding members to forgo the use of force among member states and to cease interfering in the internal affairs of the associated states. In effect, this froze the borders among members and brought to an end the possibility of open conflict among members.

When Vietnam invaded Cambodia in late 1978, ASEAN began to act like a security community, that is, the association banded together to oppose Vietnam's occupation of Cambodia. China provided military supplies; ASEAN organized the opposition in the U.N.; Thailand acted as a conduit for Chinese weapons, and the U.S. provided basic diplomatic and political support. At the time many academics said time was on the side of Vietnam in Cambodia and that Vietnam would never be forced to leave, but the persistence of the ASEAN organized opposition and the collapse of the Soviet Union made possible the historic turn-about that was then memorialized in the Paris Peace Agreements of 1991.

After having forced Vietnam out, ASEAN almost immediately expanded to include its former adversaries. This action tells a great deal about the ASEAN's unspoken *modus operandi* with regard to past and potential opponents. By drawing former adversaries into ASEAN, the founding members assumed that membership would resolve fundamental security problems. Until the original five countries formed ASEAN, there were serious security problems among them. ASEAN in fact became the gilded cage by which Indonesian expansionism was contained. Admitting Vietnam, and later Laos, Cambodia, and Burma, was costly to organizational effectiveness. Expansion meant genuine dilution of the capacity to act on matters such as the environmental haze, the financial crisis, and Timor. Why was ASEAN willing to expand and court therefore what was almost organizational dysfunctionality? First, creating the ASEAN 10 ended the security problems of the mainland Southeast Asian countries. All members, particularly Vietnam, are now committed to non-use of force and non-interference in the internal affairs of other members. This is a far cry from the period immediately after April 1975 when cocktail party chatter concentrated on just how long it would take the Vietnamese with 1,200 tanks to reach the outskirts of Bangkok. ASEAN assumes that it has relegated such grim scenarios to the dustbin of history and that under foreseeable circumstances ASEAN has brought an end to international war at least among the member nations. Second, expanding ASEAN to 10 members created a diplomatic barrier to any potential aggressive moves by China in SEA. Obviously ASEAN cannot stop China militarily; instead ASEAN assumes that if there is a blatant act of aggression, the ten countries can band together to oppose it in the way they successfully opposed Vietnamese expansionism in Cambodia.

One of the most important functions of ASEAN is always unstated, its security motivations. At the height of ASEAN's orchestration of the guerrilla war to force Vietnam to withdraw from Cambodia, its foreign ministries routinely refused to confirm the obvious facts of their interference inside Cambodia. For similar reasons, no one should expect ASEAN today to articulate its three-way hedge with regard to China. All ASEAN foreign ministries continually state they are positive the relationship with China will be peaceful in the 21<sup>st</sup> century (precisely what it was not in the 1950s, 1960s, 1970s, and 1980s.) However, ASEAN expanded to ten members as a long-term hedge to reduce its risks, on the off-chance that China again became aggressive toward Southeast Asia. In a second hedge, ASEAN welcomed China's willingness to sign the Treaty of Amity and Concord, even though it does not guarantee non-aggression by China and leaves unresolved territorial disputes in the South China Sea. In a third hedge, ASEAN members have continued to urge the U.S. to remain economically, militarily, and politically involved in Southeast Asia. The unarticulated assumption followed by ASEAN diplomats is that no single bi-lateral relationship can ensure security but that multiple relations, including partially contradictory ones, will build a sufficiently dense diplomatic web to ensure ASEAN security in the event that a) China turns out to be a responsible stakeholder or b) that China turns aggressive. Hedging involves making astute future investments to reduce risks in the face of unpredictable eventualities, and the Southeast Asian nations have played this game exceedingly well for forty years.

The East Asian summit of 2005 provides an interesting window on ASEAN's hedging behavior toward China. The idea of an exclusively Asian summit (excluding Australia, New Zealand, and the United States) was first broached in 1991 by Prime Minister Mahathir. The combined opposition of the U.S. and Japan, as well as China's reluctance at that time to participate in multilateral undertakings, led to the demise of the East Asia Economic Caucus. In the wake of the Asian financial crisis and changes in China's willingness to participate in multilateral diplomacy, ASEAN+3 was established including currency swap arrangements, called the Chiang Mai Initiative.

Whether the Chiang Mai Initiative would be effective in a new currency crisis was far less important than the fact that for practically the first time Asian countries were working together to create concrete economic agreements without the involvement of the U.S., Australia, or New Zealand. ASEAN+3 decided in 2004 to hold an East Asia Summit in 2005, and China and Malaysia took the lead in putting forward this unique arrangement. In the run up to the Kuala Lumpur EAS, it became clear that Indonesia, the Philippines and Singapore realized that such an organization would showcase the influence of China and decrease substantially the influence of ASEAN. Behind the scenes negotiation resulted in widening the

EAS to include India, Australia, and New Zealand (to the consternation of former Prime Minister Mahathir) and over the muted objections of China.

The December 2005 Kuala Lumpur meeting of EAS was marked as much by discord as amity, particularly between Japan and China, and the non-participation of the United States appeared to be less important than the growing tensions between China and Japan and the unwillingness of important elements of ASEAN to follow Beijing's lead. Thus a story designed to illustrate the rise of China ended up underlining the ability of ASEAN to utilize outside powers (India, New Zealand, and Australia) to frustrate Beijing. Rather than proving China's predominance, the EAS provided another example of ASEAN hedging behavior.

#### American Policy and the Future of Southeast Asia

It is clear that Southeast Asia has thus far accommodated the rise of China quite well, and rather than being drawn totally into China's economic and security orbit, Southeast Asian nations continue to maintain balanced economic relationships with non-Chinese markets while continuing to play a sophisticated diplomatic game that hedges the rise of China with the continued presence of the United States, the on-going importance of Japan, and the rise of India. Although the future remains uncertain, the current status quo (if it could be maintained) is quite comfortable for the United States.

The problem is that this is "not your father's China." China, for the first time in several hundred years is conducting its diplomacy in a highly sophisticated manner. Expectations had been so low for so long, that when China responded positively to the Thai currency crisis it reaped nearly infinite accolades (while never being required to deliver on its promised \$1 billion in financial support). Japan and the United States are expected to respond rapidly and responsibly and sometimes are given scant credit when they do. In the context of Asian financial crisis Japan supplied over \$70 billion in financial backing, the US effort amounted approximated \$15 billion, and China offered \$1 billion. Who got the credit? Answer: China. Expectations rule, in international as well as domestic politics!

Until the last 5-10 years China's leaders and diplomats appeared to Southeast Asians to laud the superiority of the Middle Kingdom. Furthermore China had a long past to live down concerning armed intervention on the side of insurgents. Today, the U.S. faces a much more skilled and competitive Chinese diplomatic corps, and yet the U.S. is perceived as giving short shrift to Asia (with the exception of North Korea). China today is no longer perceived as part of the problem; in fact, China is perceived as part of the solution for Asia's economic challenges in the 21<sup>st</sup> century.

China has begun to treat Southeast Asia seriously. In contrast, ever since 1975 Southeast Asia has been treated as an after thought. With the exception of the Vietnam War, most of Washington's policy attention, during and after the Cold War, has focused on Northeast Asia. This has been true in Republican as well as Democratic administrations. The question is whether this tendency to ignore Southeast Asia remains a sustainable strategy? China's relative military and economic importance to Southeast Asia is rapidly growing, and a healthy U.S. policy should adjust itself to increased competition. This can and should be done without antagonizing China.

What concrete steps might be taken?

- High-level U.S. officials should travel more frequently to Southeast Asia. If the Secretary of State cannot go to the ASEAN meeting in a given year, the Secretary of the Treasury should. However, ASEAN must play its part. For too long ASEAN Post Ministerial Meetings have been known primarily for funny shirts and silly songs. Focusing Post Ministerial Meeting on FTAs and on touchy subjects, from Timor to terrorism, would help to rekindle Washington's attention. ASEAN must alter the quality of its dialogue if it wants to be taken seriously.

- Middle level U.S. officials from State, DoD, and Treasury should travel more constantly to South and to Southeast Asia rather than just to Northeast Asia. Personal relationships remain the coin of the diplomatic realm in Asia. Time invested in frequent and regular consultations in Asia can become invaluable in time of crisis.
- More emphasis should be placed on soft power. Since the end of the Cold War there has been a precipitous decline in U.S. government support for training Southeast Asian students at the advanced level in the U.S. In contrast the number of opportunities for Southeast Asians to train in China has greatly increased. This is the kind of peaceful competition to which the United States should return, if it is serious about maintaining its position in Southeast Asia.
- Major reversals to the stability and prosperity of Asia and the Pacific become probable in the event of armed conflict over Taiwan or an uncontrolled legitimacy crisis within China itself. Judicious and balanced firmness toward the authorities in both Taipei and Beijing should be sufficient to preclude miscalculation by either party.
- In contrast, a legitimacy crisis on the Mainland could be precipitated by a system wide banking crisis. In the last several decades Sweden, the U.S., Japan, Korea, Indonesia, Thailand, Malaysia, and the Philippines have all faced system threatening banking crises. At present the Chinese banking system probably contains a greater proportion of bad loans than any banking system has ever successfully contained. The laws of financial gravity will eventually apply to China. Officials of the Federal Reserve and Treasury should provide their best offices to the Central Bank and other financial officials in China because it is in the interests of everyone to avoid 'the mother of all banking crises.' Means should be found to train an extensive number of Chinese officials in U.S. banks, at the Fed, in the Treasury, and at the IMF before the crisis becomes acute.

Not one of the above policy suggestions involves a major increase in annual expenditures. What they require are qualities far more rare than gold: the ability to anticipate crises and a willingness to invest time and resources wisely before a crisis begins.

### **Panel V: Discussion, Questions and Answers**

HEARING COCHAIR BLUMENTHAL: Thank you very much, Professor Jackson. I would say that was probably an A minus or so.

DR. JACKSON: You haven't heard about retroactive removal of degree.

HEARING COCHAIR BLUMENTHAL: Anyway, thank you very much to all of you. I have a question for each of you. Professor Jackson, since you mentioned the issue of surprises, also as a former DoD official, where would you now be telling the department and others to be watching most carefully in the area of Chinese surprises? I know you said it's very hard to predict, but--

DR. JACKSON: I think the logical place to look is the Taiwan Straits because of the fact that you have on one side of the Straits in Taiwan domestic politics driving in the direction of confrontation with China. On the other side of the Straits, on the mainland, you always have a reservoir of hypernationalism that you can activate by simply charging that China has been shamed and foreigners are trying to dominate China and trying to violate China.

These two forces are obviously on a collision course. And therefore U.S. policy must find a way to cool both these forces down when they tend to bubble up from time to time. In the short term, on a daily basis you may find that this is not a problem. Various people in charge of cross-Straits relations are about to go to Taipei. I saw in the newspaper this morning. But this is a long-term trend line we have to look at, and we have to watch out for that problem because its explosion would bring to an end prosperity in Asia and the Pacific and throw everything that we have collectively said into a cocked hat.

HEARING COCHAIR BLUMENTHAL: Thank you. For Admiral McDevitt and Dr. Sutter, Admiral McDevitt, on the issue of Japan, one sees many more stirrings now about concerns about needing different kinds of military capabilities, offensive strike capabilities, even possibly the nuclear taboo may be broken. Do you see that as a process that's sort of ongoing? Is that the trend line in Japan right now? Is there something we ought to be doing about that? Is there something we ought to not be doing about that?

REAR ADMIRAL McDEVITT: The U.S. policy since the beginning of the Bush administration is captured in the Armitage-Nye report, it has been to encourage Japan to become more normal in terms of its ability to use all of the tools of diplomacy which would include becoming more proactive in the security realm, more proactive in terms of using the military instruments to contribute regional stability.

So in that regard, the U.S. has been encouraging these trends that you talked about in Japan. I don't think we're encouraging them to think about nuclear weapons, however. In fact, one of the big issues will continue to be the Japanese belief that the U.S. nuclear umbrella remains valid? The rivalry with China, just accentuates this issue. That's going to be a big issue that the U.S. and Japan has to spend a lot of time on bilateral discussions talking about. I'm not sure that's happened yet.

On the one hand, I'm sympathetic with the Japanese desire to have an offensive capability to go reach out and touch North Korea's missile launching facilities. On the other hand, I think that that probably would not be helpful. The U.S. has this capability. If Japan did this it would suboptimize the capabilities they bring to this alliance.

I would much rather see the Japanese reinvesting more in anti-submarine warfare and supporting areas that they have traditionally been good at. Not only is this a strength, it would also keep them focused on what you would call traditionally defensive-oriented military capabilities.

There is no point in getting the rest of Asia even more spooled up about Japan by encouraging them to buy what are clearly offensive systems.

HEARING COCHAIR BLUMENTHAL: Thank you. Dr. Sutter, you mentioned talking about Chinese weaknesses. I wonder if you in your many consultations across Asia, you've ever encountered a fear that

actually this may not be going towards a rich and strong China, but actually all the economic problems will lead to a weak and collapsing China? And whether that is a fear? It's something we don't look at very much back here in Washington, but is that something that is more salient in the capitals of Asia that you've been to?

DR. SUTTER: Thank you for your question. I think it's in decline. I think it was very salient in places like Japan. In 2002-2003 touring Japan, doing these talks and talking to a whole bunch of people--this involved a cross section of business leaders and government officials and so forth--there was a lot of concern about China's fragility. That's over in Japan.

My last visit, they were much more focused on China as a danger. More than anyone else in the region, Japan is very focused on China as a rival, determined to dominate Asia in a way that would put Japan in a subservient position. And so they're very concerned about this. They're not talking about China's weaknesses and fragility.

If you probe, it will come up. But you have to probe. So the story is very much the image of China is a very strong image, of a rising China. That's just about everywhere you see that, everywhere I've been that you see that, and you don't find the collapse of China idea being raised very prominently at all, whereas it was prominent in Japan several years ago.

HEARING COCHAIR BLUMENTHAL: Dr. Jackson, did you have a point on that?

DR. JACKSON: What I'm struck by is almost the last people to know they're going to have a banking crisis are the people who live in a particular country. The Swedes had one; we had one; the Japanese had one; the Thais had one; the Indonesians had one. And talk to the stock analysts or the bond dealers the day before each of these crises broke out, and they would say no problem.

Ernst & Young published or tried to publish something a few weeks ago that said that the size of the nonperforming loan portfolio of the Chinese banking system was roughly equivalent to the size of China's foreign reserves. This was then suppressed at the demand of the Chinese government which lends a certain credibility to it, or at least this is as I have heard the story, and perhaps other members of the Commission have better information on this, but what we are facing in China is somewhere someday somehow maybe the mother of all banking crises, and I think it's in the best interest of the United States to train as many Chinese bankers as we possibly can, get them to the Treasury, get them to the Fed, et cetera, simply because we don't want to see total chaos on the Chinese mainland.

HEARING COCHAIR BLUMENTHAL: Go ahead, Admiral McDevitt.

REAR ADMIRAL McDEVITT: Just quickly on the issue of surprise that you asked Karl about earlier, two quick ones. First of all, we need to



be conscious of the possibility of waking up one morning and finding out that the “cousins across the Straits” had cut a deal. I think we need very seriously to keep that in the back of our mind, that “the family” could really get together and solve this problem. I would think that would be a happy surprise because it removes the prospect of conflict, but it would be a surprise nonetheless.

The second one has to do with the project we've been running. We did a tabletop exercise on confrontation in the East China Sea. We were all surprised by the intensity of the reaction by both sides to an incident. For example, following a collision of two warships in the vicinity of Japanese and Chinese oil claims the Japanese pushed back a lot harder than the Chinese side expected. That could be a big surprise, both in Beijing and in Washington. Not only did the Japanese push back a lot harder while the U.S. was trying to solve the problem, Tokyo was expecting us to chime in on their side. So that's another area of surprise.

HEARING COCHAIR BLUMENTHAL: Thank you. We had Chairman Wortzel and then Commissioner Wessel.

CHAIRMAN WORTZEL: We appreciate all of you being here. Thank you very much for the testimony. On Indonesia, almost exactly a year ago, on August 1, 2005, the Financial Times reported that according to the Indonesian Defense Minister, by 2007, military relations between Indonesia and China will make up 40 percent of the content of bilateral relations between the two countries. —According to say an Indian Defense journal and other reports the Indonesians and the Chinese are talking about different forms of base use and port access.

The Financial Times has stories of Norinco, China's Northern Industries Corporation, and the Indonesian military working on short-range ship-to-ship surface-launched cruise missiles, anti-ship cruise missiles. Given these reports, I'd ask Dr. Jackson and Admiral McDevitt to talk a little bit more about the potential for the growth of Sino-Indonesian military relations. Also, given the earlier problems between Indonesia and China and the Indonesian Communist Party, what are the limits of Sino-Indonesian cooperation?

I would also appreciate it if any of you would comment on the irony of the fact that the two U.S. allies in Southeast Asia, Thailand and the Philippines, have the largest security assistance relationships with China. The Philippines is sending five officers to China's National Defense University for education, and a good part of Thai military ground equipment and naval equipment comes out of the Chinese.

DR. JACKSON: If we could begin with Juwono Sudarsono's statement of a year ago. Juwono is a very smart and articulate man, and my guess is that any smart articulate Defense Minister of Indonesia, if you wanted to encourage the Americans to open up the relationship with Indonesia, might find a way to say a good word or two about his Chinese brethren. Reminds me of Winston Churchill saying in relation to Soviet

Russia that if he could convince the Soviets to go to war with Hitler, he might find a way to say a good word about them in the houses of Parliament.

Secondly, with regard to bases, the possibility of Chinese bases in Indonesia, never say never, but I'd bet my house on that not happening. And I don't have many houses to bet.

There is one consistent policy that has informed the Sukarno government, the Suharto government and every Indonesian government, that is Indonesia's independence and non-alignment, and if that is fractured in order to get a couple of Chinese cruise missiles, I would really be absolutely bowled over.

With regard to now Thailand and the Philippines, every one of the countries that is sophisticated in Southeast Asia is playing a hedging strategy, and I think this is part of it. The Chinese for the first time in living memory have some goods to hand out, and Thailand and the Philippines are more than willing to accept some of them.

However, I would note for the record that Thailand sent troops to Afghanistan and troops to Iraq, and so that seems to have fulfilled my definition of what an ally would do in a war situation. The Philippines sent some people also to Iraq, but then the exit was a little bit on the clumsy side, shall we say.

Thank you.

REAR ADMIRAL McDEVITT: Indonesia-Chinese relations, TNI-PLA relations, first thing which comes to mind is we're late returning to the game. From the mid-'90s, we ceded the field to first the Australians, which we were happy to cede it to, then the Indians, and the fact that the Chinese are now there shouldn't be a surprise to us. The Indonesians could not turn to the United States because of congressional limits on helping. They are way behind the power curve because former President Habibbi saddled them with 50 odd East German ships that nobody could maintain, that are sitting there rusting at the pier right now.

So I think that they're literally in the mode of any port in the storm—Now the one thing about the Chinese that they do around the world—they're doing it in Africa as well as in Southeast Asia--friendship prices and no strings attached. And that makes it a very attractive way to get new equipment. It's certainly better than what they have. So I'm with Karl, I don't think the Indonesians are going to throw their lots with the Chinese nor would I expect to see some sort of a Chinese “place,” or base, in Indonesia.

Again, I agree, Thailand and the Philippines, both the hedging, and again friendship prices/no strings attached would make PRC equipment attractive, it shouldn't surprise us, I think the Filipinos and the Thais both count very strongly on their relationship with the U.S. as a hedge against China.

CHAIRMAN WORTZEL: Bob?

DR. SUTTER: Just to reinforce, I agree with the hedging strategy completely. I haven't followed the military transfers. I do try to follow the foreign aid of China. This is very small. China doesn't give money and yet it gets an awful lot of publicity, and so when you look at it, you get very excited because you say, oh, my goodness, the Chinese are doing this and doing that, but when you measure it and see exactly what they're doing, it doesn't usually amount to very much.

In this hedging strategy that these governments are taking, we have to get used to this in the United States, and my argument would be we're not in a bad position to deal with this situation. But they're going to be constructive in their interactions. These governments of Asia are going to be constructive in their interaction with China, but they don't want to come under Chinese dominance. They don't want to come under Chinese sway. As China rises in importance, they're going to cooperate where they can with the Chinese, but at the same time, they're going to work very hard to make sure that their independence is secure because they really don't trust China.

CHAIRMAN WORTZEL: I take it, however, that at least two of you would suggest that the United States needs to find better ways to work with the Indonesian armed forces, and alternative means to address our human rights concerns in Indonesia?

REAR ADMIRAL McDEVITT: I've been singing that song since the mid-'90s. Absolutely, we need to address those issues, but we ought to address them in a way that doesn't automatically mean we cut off their water entirely and can't have the senior officer relationships. All of that pays dividends over the long haul.

DR. JACKSON: The policy we adopted in the early '90s was so counterproductive to U.S.-Indonesian relations that it's almost hard to believe that rational policymakers would have enacted it.

We are in a situation now where there is the last IMET trained officer of any significance in the Indonesian Army about to retire. How many connections do you think we have the army of the fourth largest nation in the world?

Now, there are terrible human rights violations that have taken place in Indonesia and these cannot be excused, but we should not make policy with a sledgehammer. We should try the scalpel every once in awhile.

CHAIRMAN WORTZEL: I'm sure I've sufficiently baited my cochairman that this discussion will continue.

COMMISSION VICE CHAIR BARTHOLOMEW: He baits me at every opportunity on this issue.

HEARING COCHAIR BLUMENTHAL: Commissioner Wessel.

COMMISSIONER WESSEL: I'm glad I'll leave the IMET and other questions to Commissioner Bartholomew and let her adjudicate all these issues and save my time.

Much of the focus here on China and, in fact, on unfortunately the region, is around the economic issue, and there are many who are pointing out that we should not be concerned about the economic rise of China because it is occurring at the expense of others in the region. And I'd like all of your responses to that because I think in part not only does it sell the other nations in the region short, but doesn't recognize the synergy and the increased economic interdependence among those countries with China, and that the region as a whole needs much more attention and not seek to do this, if you will, put each of the countries in a separate inbox, but rather deal with our relations with them not just one-on-one, but look at the region much more importantly as demanding more attention and prominence here on the policy debate.

Can each of you respond to that?

DR. SUTTER: I'd like to say something about China's economic importance, if I could. I think this has been somewhat exaggerated, and I think because people focus on trade, trade numbers, and more than half of China's trade, as you know, is processing trade. The commodity goes back across the border several times. It's counted each time it crosses the border. There's double and triple counting all the time with Chinese trade figures.

As a result, most of the time, these kinds of products are finalized in China. When they are finalized in China, the value that's added in China is relatively small, and so this integrated Asian network that we're talking about relies very heavily, since it's an export-oriented economy, on the consumers in the United States and in the European Union.

So China is really not yet a trade power. It's a trading country. It's a very big trading country, but it's not really a trading power because it's so dependent on these consumers in other parts of the world. And the government officials in Asia understand this. They understand that their interaction with China is very much in line with the need for keeping the U.S. market open. The U.S. market is very important for them in this regard.

A second point I would emphasize is investment. You hear an awful lot about Chinese investment, how important this Chinese investment is, and yet you look at the figures of Chinese investment, the official figures of Chinese investment are very, very small. Last year, the official figure for the whole world was \$6.9 billion left China.

The previous year it was \$3.4 billion for investment throughout the whole world and so this doesn't compensate for the investment that the Asian governments put into China. So this is sort of a net negative to some degree. The entrepreneurs of Asian countries make money because they invest in China; they can't compete head to head with China. They become part of these networks that export to the United States and the European Union. They're doing fine, but their workers can't go to China, and they suffer as a result.

So it's a very mixed picture, and investment into Southeast Asian and other countries is less than it would be otherwise. Their investment goes to China, not the other way around, and China does not compensate in this regard.

One final point in this regard, Chinese foreign assistance--this is a state secret--it's very hard to get this information precisely, but what you can put together shows that this doesn't compensate at all for the loss that the Southeast Asian and other governments face as a result of economic competition for China.

So I just wanted to point out that the economic area is the area where China has the greatest influence in Asia and yet there are some exaggerations and there are some weaknesses in this area as far as China's importance is concerned, and I think it does underline the fundamental importance of the open U.S. market and the open European market to these kinds of commodities.

COMMISSIONER WESSEL: I Understand. But just to follow up before the others respond, the synergies, and while one could look at textiles, and there certainly has been some displacement there, if you disaggregate the data, you would find that the region as a whole has expanded its trade relationships and power vis-à-vis the world economy which is a good thing. Is that correct?

DR. SUTTER: Yes, sir.

COMMISSIONER WESSEL: Okay. Please.

REAR ADMIRAL McDEVITT: Very briefly, I'm a historian by education, but it seems to me that in terms of being nonchalant about China's economic rise, that's official U.S. policy because the premise is that as China develops economically, it will eventually lead to political reform. Now whether that's true or not, that's the assumption that administrations since Bush have used to rationalize Most Favored Nation and PNTR for China, and the same argument was made in favor of China joining the WTO.

The Japanese that I interact with think that it was their access to the China market and the fact that China was able to buy Japanese exports that it has eventually turned around the Japanese economic malaise over the decade of the '90s. So they believe they understand that they're very beholden to the China market for helping turn them around. I think the South Koreans also believe that their increasing investments in trade with China is a key engine of their continued growth.

DR. JACKSON: My only comment would be that regardless of what most economists will tell you, having a pegged renminbi pegged at its level does hurt the rest of Southeast Asia, and it hurts it not only in terms of day-to-day trade, but it makes it incredibly cheap for Americans or Europeans to invest in China and more expensive for them to invest in Southeast Asia, and lo and behold, if you look at the figures for investing in Southeast Asia over the last ten years as opposed to investing in China,

there's been a substantial shift.

Now that doesn't mean there's no investment in Southeast Asia, but there has been a substantial shift and part of it has to do with pegging the renminbi on one hand and having the other currencies in Southeast Asia float. Now what's going to change Chinese behavior, I would contend nothing that we say in this room and nothing that is said in this building.

Instead, Chinese behavior will change when there are certain domestic economic events that lead China to want to widen the band substantially in order to dampen the possibility of inflation and overheating.

HEARING COCHAIR BLUMENTHAL: Thank you. Chairman Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. It's a good thing we have a little bit of time. I would say I could probably use my entire five minutes in responding to some of the issues that have been raised here.

One, because Chairman Wortzel loves to tweak me on the Indonesian IMET. I'm just simply going to say that the concerns had always been about who was being trained, what they were being trained to do, and what they were doing with that training, and a concern or a belief on the part of the American people that their taxpayer dollars should not, for example, be going to sniper training for Kopasis when that training was turned on to the Indonesian citizens. I think we'll probably continue to disagree on that issue, but I felt a need to say that.

Dr. Sutter, I'm interested in your comment about the Chinese needing access to markets and obviously that's the case, but we've yet to see that the Chinese concern about keeping access to the U.S. market has influenced its behavior at all, in terms of addressing any of the issues of concerns that we've raised with them.

I'd be interested in your comments or thoughts on that. I think some of it is reluctance or a resistance on the part of policymakers here to use that as leverage. Of course, that was what was behind the MFN debate. So that's one issue.

On a bigger issue, I find myself today questioning a lot of our use of terminology. I did that with Secretary Christensen. I'd ask all of you how do you define dominance? What is it that we are talking about when we're talking about dominance because if China can manipulate or influence the actions of other governments through the use of economics, through business deals, we're seeing that some with the Australians and all of the Chinese purchases of natural resources, is that a dominance of sort?

Is this dominance that we are talking about or using as a term of art dominance that's sort of a zero-sum game, dominance vis-à-vis us in the region, or is it dominance or power to influence what governments are doing?

Then one more question. Dr. Jackson, since you mentioned concern about what's going on with Islamic fundamentalist movements in Southeast Asia, I wondered if there are any thoughts on how China might or might not be positioning itself vis-à-vis those movements we heard in our previous panel about the Uyghurs? There's been some interest, of course, in what's going on with Muslims in China. So it's a lot of issues to cover, but I'd appreciate any comments. Dr. Sutter, let's start with you.

DR. SUTTER: You want me to start on Chinese behavior toward the United States.

COMMISSION VICE CHAIR BARTHOLOMEW: Yes.

DR. SUTTER: I think that's very fruitful. If you look at China's policy broadly and then China's policy in Asia, you see several phases. And where the importance of the United States comes into play is in various places, but in the mid-'90s, the Chinese had this good neighbor policy with all sorts of countries in Asia, but not the United States.

They were very much against the United States and its alliance structures in Asia, strongly criticized this. This went on for five years, and ranting against this every chance they got, and they recognized it didn't work. It didn't work for their interests in Asia. The governments of Asia didn't want to choose and, parenthetically, this is why China is in a really bad spot in its relationship with Japan, because it's forcing Asian governments to choose with Japan, and they don't want to do that either, and it will fail.

But the point is it failed then, and by 2001--Admiral McDevitt mentioned 9/11--this happened before 9/11, the Chinese came to terms with the U.S. dominance. They came to terms with the United States, and they said we've got to be nice to America. We've got to be nice not only to the countries in Asia, but America too. Even George W. Bush, we've got to be nice to him, and this led ultimately to the peaceful rise approach, which came in December of 2003.

Now what's the foundation of this? A good deal of it is this importance of the American market. What this means is what they don't do. I'm not saying what they will do. What the U.S. is asking them to do on human rights and other issues is too sensitive for them to do. But what they don't do is be aggressive. What they don't do is be assertive. What they don't do is try to get in the way of a lot of things. If they do it, they do it very quietly, and so their behavior, I think, underlines this point, and so therefore the importance of the United States to them is something they basically have accepted.

They live in a world that's dominated by the United States and they recognize going up against that frontally won't work, and so they have stopped, and for a whole range of reasons. Now, how long this lasts, I don't know, but it's lasted up to this point.

And then, on dominance, when I was in the intelligence business, we would define it this way: the Chinese would have the ability to veto

any decision by a government in Asia or by the United States that they felt would affect their interests in a strong way. They would have veto power and that's dominance where you can just make--now whether you do it passively or whether you do it aggressively is a different story, but that means nobody does anything against China's interests. Nobody does anything against China's interests, period. That's dominance.

DR. JACKSON: If I could pick up on the dominance question. An illustration of the absence of Chinese dominance was provided by the East Asia Summit exercise in 2004 and 2005. China and Malaysia pushed Mahatir's dream of the East Asia caucus that he started in 1981 and the initial reaction of ASEAN Plus Three was, yes, this is a good idea to have such a meeting, and then the fine points of how to arrange the meeting.

Pretty soon the Indonesians, the Singaporeans and the Filipinos said from within ASEAN no, the meeting has to include some other people. It has to include the Indians, the Australians, and the New Zealanders. Lo and behold, China's ability to dominate the meeting evaporated with that. China quietly opposed all three of those powers being invited to the meeting and, lo and behold, the meeting took place, and the meeting was completely incapable of reaching any significant agreements.

The only significant thing that happened there was that the Chinese representative used the Japanese representative's ballpoint pen without having permission--he did not however agree to have a bilateral meeting with him.

This is not exactly amity. Even by international diplomatic standards, this was a busted meeting, and it was something China wanted. ASEAN saw what the game was. ASEAN very quietly pulled the rug out from underneath them. That's not dominance.

REAR ADMIRAL McDEVITT: On the issue of dominance, my definition would be governments do what they don't want to do or don't do what they would prefer to do. I think talking about dominance of China and Asia is probably not an accurate way to characterize it.

I think there is a reality of Chinese power both military and economic and increasingly political that's a reality of life. We also need to keep in mind that the Asians, the Vietnamese, for example, are painfully aware that China has a history of using the PLA to teach lessons, and so, for example, they taught Vietnam a lesson in '78 even though tactically they were roughly handled. The bottom line is that Vietnam learned a lesson, and as a classic example of that, consider that Admiral Fallon, Commander of Pacific Command, was just recently in Vietnam, and wanted to try to move U.S.-Vietnamese military-to-military engagement down the road just a little bit beyond just a few ship visits. The Vietnamese politely and without offense essentially said, no, we don't think we want to go there yet.

They're very conscious of making sure that Beijing does not perceive Vietnam as being somehow caught up in a U.S. containment



strategy against China.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Donnelly.

COMMISSIONER DONNELLY: This has all been very interesting testimony. In fact, our hearings today and tomorrow are about what it would mean for China to be a responsible stakeholder, and what I'm taking from the collective testimony is, at least in East Asia, they are pretty close to being there. There's not nearly as much to worry about as there might be in some other places, the level of hedging talk, which is after all the word that the U.S. government has now authorized us to use vis-à-vis China.

So it leads me to the question: isn't it better to hedge together than to hedge alone? We may not be in the business of containing China in the very same way that we tried to contain the Soviet Union, but one of the strategic advantages that China inherently has in the situation is the potential ability to sort of pick up, divide and if not dominate, then divide and advance its interests.

American policy seems by its bilateral nature to facilitate the Chinese approach. So my question would be: (a) am I reading the atmospherics or the overall tenor of your testimony correctly; and secondly, would it be wise for the United States, if not to move to some formal overly militaristic NATO-like thing in the region, to adopt a more multilateral approach because that's where our natural advantage lies.

If everybody is predisposed to hedge against China's rise not being a peaceful rise, is there some way to sort of institutionalize that or again build upon that natural strength?

REAR ADMIRAL McDEVITT: I'll start--I think everybody will chime in--on hedging together as opposed to hedging alone. I think the key to that, of course, is that that means over the long haul China has to be reconciled to a permanent U.S. presence in the region. I agree with Bob, they accept it because they can do little about it now. What we don't know for sure is whether they would look at it with equanimity 15 or 20 years from now?

U.S. strategy in East Asia for the past 50 years that has included a strong military component. We think that brings us leverage that allows us to further our interests. Whether that premise is true or not remains to be seen.

So, one, China has to be reconciled to a U.S. presence in the region other than just an economic one; and two, I'm not entirely certain that the U.S., at least based upon, as you pointed out in our official strategy documents, is reconciled to assuming that China will be a benign force for the future.

So that's my hedge in response to your question. The reality is obviously if both of these inhibitions could be overcome and the U.S. and China would be willing to live and let live, with each pursuing our

interests where the U.S. maintained a military presence on the littoral of Asia and China focused militarily on the continent of the Asia, as we both have for the past 50 years, there's no reason why we couldn't hedge together. COMMISSIONER DONNELLY: I meant hedge together with others in the region.

DR. SUTTER: You meant hedging against China with others; right? I thought you were talking about U.S. and China hedging.

COMMISSIONER DONNELLY: That's how we define our own policy toward China.

REAR ADMIRAL McDEVITT: Right.

COMMISSIONER DONNELLY: Let me be more direct, if I can, with regard to what we would define as responsible stakeholder.

HEARING COCHAIR BLUMENTHAL: Go ahead.

COMMISSIONER DONNELLY: The status quo is that we have our military, and we are the guarantor of stability in the region. Is that something that we would make part of our definition of when we would view China as a responsible stakeholder, that they would accept our military presence and our legitimate pursuit of our security interest as--

REAR ADMIRAL McDEVITT: I think that's the objective of our policy, whether we can make that happen or not--

COMMISSIONER DONNELLY: Well, it's very difficult to actually put meat on the bones of what stakeholder means, to make some specific requirements about it.

DR. SUTTER: I'd like to say something about hedging together, if I may. Just two points I would make on that. Number one, I think it's important to remember the United States is by far the dominant power of Asia. In other words, it really is the dominant power, and so this hedging is going on with a power that is the dominant country militarily and economically. So what needs to be done is to do what Mr. Jackson said, pay a lot more attention to the region, clean up your act in lots of ways, but basically keep up U.S. strength in these two areas strategically and economically.

Number two, if you hedge with others, now the administration does talk like this sometimes--they do. Condoleezza Rice has said this in Sophia University in March of 2005. But it's counterproductive because Asian governments don't want to choose. Regarding Asian governments, you say, well, China is going to pick them off. No, I don't think so. I think what's going to happen is China is going to improve relations with these countries.

But the U.S. is in a strong position to improve its relations, too, and there are lots of different ways the United States can do this in this kind of an atmosphere. The issue was raised about Vietnam, which was a very good issue. But I would ask you to consider this.

The United States over the last several years because China has a benign image in the region, wants to be nice in the region, because of

this, China cannot make a fuss about all the things the U.S. is doing militarily throughout the region. The U.S. is beefing up its relationship with a whole range of countries that in the past, up to 2001 would have led to great vitriol from China and which would have compromised the abilities of these governments to do these sorts of things.

I'm talking about Japan, India, Indonesia, Mongolia, a whole bunch of governments, and the U.S. is doing all of these things. So the U.S. is just taking advantage of this because it is so powerful, and these governments gravitate to the United States in their hedging strategies. So I think you don't have to be overt in this. I would not be overt in this collective hedging.

You don't have to be, it seems to me. If you are the great power, they are going to hedge with you, and just have some confidence in yourself in this regard.

DR. JACKSON: I would also add that even at the absolute apex of the American military presence in Asia, we didn't find it all that easy to tell governments what to do. At least that was my experience in government. People didn't jump when I said jump, and you know so I don't think the Chinese are going to find it even as easy as we did, and we found it to be difficult. Why? Because China is a near and rising power, whereas we are across the Pacific, and that makes our involvement in Asia more acceptable.

There is one aspect of hedging together, if I understand your idea, that might make sense. That is APEC as an organization has more or less lost its rationale. It's certainly lost most of its spunk and I think it would behoove the United States government to put major effort into turning that into a real organization that would give a more powerful multilateral spin to our policies.

When we helped to create APEC, we did it very much in the ASEAN image. Organizational minimalism, all of the defects of ASEAN we replicated because we wanted ASEAN to go along with it. I think that time is now past. I think if the United States took a forthright position trying to rejuvenate APEC, create a real secretariat, create a real set of policy drives, it might help give a credible multilateral edge to our policies in the Pacific that we currently lack.

HEARING COCHAIR BLUMENTHAL: Commissioner Houston.

COMMISSIONER HOUSTON: I'm trying to decide if they've answered my questions already. You've done such a great job. My question is somewhat hedging related, but it has a military component. I grew up in Boston in the 1960s, and we had the Boston Strangler, so naturally we got a dog. It sat on the front porch and it barked, and so we all went about our business, and we went out to the car, and we felt a lot better because the dog barked. Even though it was a poodle, it was still very loud.

It's very easy for China's neighbors to drink at the trough of the

Chinese economy because they feel very safe and secure doing it. I would guess that one of the reasons that they feel safe and secure is because the U.S. is basically the global dog on the porch.

So my question, and perhaps, Admiral, we could start with you, is do you think there is a conscious thought in the neighbors of China that makes them feel safe in doing business with China because if China ever did another surprise move, like Dr. Jackson listed at the beginning of his testimony, that they feel that we would run in and protect them? And does this change either their economic behavior or their diplomatic behavior towards us or towards China even?

REAR ADMIRAL McDEVITT: Good question. I think anybody who has been in government--in fact, you don't have to have been in government--when you travel around the region and talk to leaders or elites in the region on a one-on-one basis, one of the messages you always hear, at least when I was in uniform or doing this on an official basis, is whatever you do, please don't leave the region. So there is a strong demand signal, if you will, from the countries throughout Asia that they want the U.S. to be present, that they want the U.S. to be the dog on the front porch.

DR. JACKSON: What a pleasant image.

REAR ADMIRAL McDEVITT: I prefer sea anchor or anchor to windward, that sort of thing, a hedge against any kind of unpleasant thing.

COMMISSIONER HOUSTON: His name was Rosie, too. I remember. How scary is that?

REAR ADMIRAL McDEVITT: But the point is everybody recognizes that the only country in the world that has the potential to counterbalance China is the United States in a military or in a power relationship, and so they're not anxious for us to leave.

And so they watch like a hawk every official statement from whatever administration, every speech from officials in government and testimony before Congress, to look to see if there's any weakening or any backsliding on the part of the United States in terms of our commitment to being an Asian power. We talk about being a Pacific power and an Asian power and being there and our commitment to providing stability. They watch that very closely.

And because we continue to repeat that mantra, and we have for many, many, many years, I think in fact they do feel more comfortable in dealing with China. But I think if we weren't there they would have to deal with China even more aggressively. What we do is provide them other alternatives if they want to push back gently against China.

The reality of Chinese power today is anywhere they can walk or drive countries have to be concerned. They haven't figured out yet how to very effectively project power. They're working on it, but haven't figured out very effectively how to project that power over the water. If and when they do, that's going to add another element to the issue, but right

now if you share a frontier with China, you're conscious of what Beijing thinks about what you do.

DR. SUTTER: I certainly agree with Admiral McDevitt. I think that's right on. I did want to talk a little bit about Chinese influence because I think that gets into the dominance issue and so forth, and we didn't get a chance to get into that too much. And the Chinese, I think, don't feel that they have a lot of ability to be influential in Asia.

I think the East Asian Summit that Dr. Jackson underlined illustrates this point, that China's approach to the region, it's trying to be more influential, but it's very defensive at the same time because they're in an atmosphere that other powers are very influential, and they recognize that the situation isn't all that great from their point of view.

So what their practice, therefore, under these circumstances, is that the Chinese don't really exert hard influence. Now I characterize hard influence, as Admiral McDevitt did earlier, as getting another government to do something it wouldn't ordinarily do or get them to stop doing something they would ordinarily do.

The Chinese don't do this except in a couple of cases; Taiwan is the main one. They definitely do it there, with Tibet and with the Falun Gong, and lately they've been doing it with Japan, but by and large, they don't do this because, not because they don't want to, because they can't. Their influence just isn't strong enough to do this sort of thing. So I just wanted to interject that at this point.

HEARING COCHAIR BLUMENTHAL: Professor Jackson.

DR. JACKSON: One aspect of China's influence that is rising is the soft power aspect of China's influence. If you look at the number of students going from Southeast Asia and from Korea to China, it has quite significantly risen over the last five years. That's partly because after 9/11, we hardened up a lot of our admission rules, et cetera, et cetera, for very good reasons, but we achieved unintentionally the opposite of what we intended to.

I think that effect is by and large finally washing through the system, but if China becomes the primary place in which other Asians go for higher education then, then we have a problem.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Mulloy.

COMMISSIONER MULLOY: I want to thank the chairman and vice chairman for pulling together such a good hearing, particularly for this panel. This is really a treat to listen to the advice we're getting.

Admiral McDevitt, you said official U.S. policy is that we want to help--this is your understanding--we want to help the economic relationship with China in the hope that that will influence the political transformation of China, and I think, Dr. Christensen this morning said essentially that.

Do you think that China can be an authoritarian one-party rule and

still be an economic powerhouse? I just throw that one out.

REAR ADMIRAL McDEVITT: My reaction is ten years ago when people talked about this and the inevitability of political pluralism following in the wake of capitalist economy, it seemed like a good argument. Now, ten years on, we haven't seen much change. It hasn't slowed down the economic development or not. So I would say that as an historian I'm naturally suspicious of any political science theory. So I'm not sure if this one is going to work out or not as the political scientists have predicted. I don't know.

COMMISSIONER MULLOY: Dr. Sutter, just quickly, and then I have a different question.

DR. SUTTER: Yes, sir. I think this is a standard and very difficult issue to answer. I guess I'm more of an optimistic realist in saying that it may not work to change China internally, but we can handle China because it isn't all that powerful and we are very powerful.

COMMISSIONER MULLOY: Dr. Jackson.

DR. JACKSON: The problem is the time scale. After all, Germany entered its industrial revolution later and eventually caught up quite nicely. It generated lots of economic power, and then there were these two minor perturbations, World War I and World War II, and the number one trading partner of Britain happened to be this place called Germany, but that didn't prevent the First World War from taking place.

COMMISSIONER MULLOY: Very good. That's nice to have on the record.

REAR ADMIRAL McDEVITT: Notice he used a historic analogy, too.

COMMISSIONER MULLOY: I come from a background on Senate Banking Committee and then was in a trade position in the Clinton administration, so I come out of the trade and investment. We always had what we called the "golden rule," meaning he who has the gold makes the rules. That leads me to your testimony, Dr. Jackson, where you talk about the Chinese peg, which makes it very cheap for American firms to invest in China and makes China's exports quite competitive coming out of China.

Dr. Sutter, you talk about all this double counting, but you do admit that all these exports are for the most part going to the United States and Europe, at least a major portion of it. So there is a tremendous transfer of wealth going on here.

You make the point, Dr. Jackson, that China is not going to loosen this peg until it's in its own domestic interest to do it, and we can't do it. Anything said here isn't going to change it, in this building even.

The problem is one of the things that makes the investment go to China is because we locked our tariffs in place at about 2.5 percent average tariff when China came into the WTO. We locked them in place. We didn't just do it on an annual basis, they're locked in. That increased

the investment flows and the shipment out of China back here, and the transfer of our industrial and technological base to China, which is going on.

But at the same time, same rules, which we're living up to, say you're not supposed to manipulate your currency to gain trade advantage, Dr. Sutter. So what are we doing here? Why are we sitting here letting this happen if they're not playing by the rules of the IMF and the WTO on this exchange rate issue which is very important in this whole mismanaged trading relationship? What do you think we ought to do? Right across the board give me a quick answer because we're looking for advice.

DR. SUTTER: I wish I could tell you. The record of the last ten years shows that the U.S. domestically is very conflicted on this issue. We went through these MFN debates every year on this issue, and nothing ever came out of it because the Americans are conflicted. We have interests on one side and interests on the other side, and business interests are very powerful, and they prevailed, sir. So that's the United States, and I think that that's the reality.

So what should we do? I could say lots of things what we should do, but it's irrelevant, it seems to me, because we have a record that shows the U.S. is not prepared to take this kind of action.

COMMISSIONER MULLOY: Anybody else?

DR. JACKSON: They could try the carrot and stick approach, but I fear that it would work out the same way it did when we used the carrot and stick approach with Ferdinand Marcos, that is Foreign Service Officer said to me once, yes, he eats your carrot in front of you while beating you with your stick.

But in the case of the currency, I think what we need to do is every mission going to China should have as its mantra, you've got to bring about these changes sooner, do not follow the same route that Japan did and Korea did and Southeast Asia did, because you do not want to have a banking crisis that will rattle your entire system.

It is in China's self-interest. That would be the first thing, and they're not going to believe us initially, and they're not going to do it initially, but at least my experience with China is that if the Secretary of State says it and the Secretary of the Treasury says it, and DoD says it, there is over time a willingness to begin to listen.

Then at some point in time, changes will begin taking place in the Chinese economy because as it gets more complex and as it uses up the surplus labor of inland China, all of a sudden they're going to begin to face some of the same problems that Korea faced, Japan faced, and Southeast Asia faced, and then the phone is going to ring here, and it's going to be China on the other end of the line, and they're going to want to know how do we prevent this from going completely off the rails, and at that point in time it will be in our interests to be as helpful as possible,

in my opinion.

REAR ADMIRAL McDEVITT: If I could add one point. Bob Zoellick's stakeholder speech, most of the commentary, of course, was focused on the notion of stakeholder, but he was also sending a very important signal, that you are losing the U.S. business community because of your practices and because of your nonchalant approach to protecting intellectual property, noncompliance with WTO. The very people who were the strongest advocates all during the '90s and you to get you to get permanent normal trade relations, get you into the WTO, they're rapidly changing their mind about the utility of having economic interaction with China.

I think that that was a very powerful message that has not been picked up in other policy statements. It ought to be.

COMMISSIONER MULLOY: Thank you both.

HEARING COCHAIR BLUMENTHAL: Thank you. We have time for a second round here. I'll start with another question, and that is on this notion, Dr. Jackson, and others as well, of policy prescriptions or revitalized APEC and so forth, and hooking onto Commissioner Donnelly's question about a hedging together or hedging alone, and then also some of your comments about soft power. To me soft power as well as the alliance structures we set up in Europe had a lot to do with, as Dr. Jackson said, the battle of ideas, and that idea was very much democratic, liberal democratic countries banding together, and it was as of much importance as the hard power and the military power we had in Europe.

We heard earlier testimony from Dr. Watson that the idea itself of liberal democracy within Latin America is not so attractive anymore. It seems to me we have in Southeast Asia in particular a number of countries struggling with democratic governance and trying to consolidate.

It seems to me also that that is a distinct advantage the United States has over China in promoting the success of these countries. It also seems to me that we have a rather successful experiment in Europe in terms of what some of these multilateral organizations based on democratic institutions were able to do in terms of consolidate the smaller democracies.

Since China is in the business of setting up institutions whether they work or don't to exclude the United States, I wonder why the United States doesn't get more creative about using its distinct competitive advantage to set up these types of institutions that would seem to me to speak to the needs, unless I'm mistaken, of many of these countries in Southeast Asia that do focus more on building of democratic institutions.

DR. JACKSON: There is a great deal of both publicly financed and NGO activity in Southeast Asia that is aimed at encouraging the growth of civil society organizations and encouraging the growth of democracy. The only problem is that obviously democracy isn't the easiest system in the world to operate and it's a very long hard tough go. But as I said in



my opening statement, Southeast Asia looks pretty good compared to where it was 30 to 40 years ago, when it had the same economic power as sub-Saharan Africa and it was all run by one kind of nasty authoritarian or another.

HEARING COCHAIR BLUMENTHAL: Is your sense then that the desire for their democracies to work in Southeast Asia is strong as compared to what we heard about Latin America?

DR. JACKSON: Oh, I think it is. Even though democracy in the Philippines has arguably produced the fewest number of benefits for the largest number of people, even though that is the case, you talk to a Filipino in any public opinion poll in the last 30 years, and there is one thing that stands out: they will say (a) the current government is awful; and (b) it's all going to get better after the next election.

There is an abiding faith in democratic outcomes. It's fabulous, and I only wish every once in awhile someone would deliver for them.

HEARING COCHAIR BLUMENTHAL: Admiral McDevitt.

REAR ADMIRAL McDEVITT: I was just going to follow up on what Karl said. East Asia offers a remarkable number of interesting case studies on moving from authoritarian or colonial governments into democratic regimes, many of them supported, most of them encouraged and supported by the United States.

Now our enthusiasm has waxed and waned over the years, but nonetheless it was a steady push, and so I think that that is a success story, and East Asia is an example of how the U.S. encouraging democratic development can, in fact, work.

The interesting phenomena of which you're talking about, institutions, there are two of them that are going on right now. Chen Shui-Bian about four years ago started a campaign emphasizing that Taiwan was a democracy. Kind of democratic outreach approach, saying that Taiwan ought to be able to affiliate with sister democracies throughout the region. Obviously, he was looking for an angle to try to break out of the political isolation, but nonetheless that initiative goes on.

Recently the Japanese Foreign Ministry has been pushing an initiative to focus on Japan as a democracy and be the democratic thought leader of Asia. The trouble is that this message is not going over well because of Japan's mishandling of the World War II history issues. But, nonetheless, those two countries are, in fact, actively promoting democratic institutions and democratic linkages throughout Asia.

HEARING COCHAIR BLUMENTHAL: Before we go to Dr. Sutter, I would link what both of you said and ask this question: it would seem then that China is a relatively unattractive model when you think about soft power, that countries in the region would actually say, well, this is not that attractive to us in terms of modeling ourselves, and there would be concern there about the actual political system which the United States would be able to take advantage of if we're in the kind of story that I'm

getting from all of you in this competition within Asia?

REAR ADMIRAL McDEVITT: I would just say, and both Bob and Karl know more about this than I, but I think a lot of people in Asia see China evolving towards a Singapore model which not all of them find all that unattractive.

DR. SUTTER: Yes, just on the soft power, I think you've hit on what I think is very important. Soft power is attraction. People are attracted to you. It's not so much what you do. It's what you are. I think the United States has a problem in recent diplomacy and recent foreign affairs because what they're doing is unattractive. It overshadows so many attractive things in the United States. Abu Ghraib, things like that, it just gets in the way, and it dominates the airwaves.

If that stuff is reduced, if the situation in Iraq stabilizes and so forth, then the United States will be in a much better position to look attractive, to be America, because America I think is inherently attractive in a whole range of ways to the people of Southeast Asia.

I would wonder if a government campaign to push democracy is the way to go. I think there is a division in Asia between those that like authoritarianism and those that don't. And so it's attractive to some, but it may not be attractive to everyone. I think what's more important, it seems to me, is that the United States is consultative, its attentive, it listens, and it's concerned about what the Asian governments are concerned, and they're much more concerned, it seems to me, with development, with economic progress, and the U.S. is concerned with that, too.

So these types of areas can be nurtured, I think, but the other point I would get at, and particularly when you compare the United States with China, is that China has all these agreements with all these countries, and they do that because they don't have a private sector that does this type of thing.

The United States has this enormous private sector that's interacting with this part of the world day in and day out. This is very attractive. China has to have all these agreements, all these government agreements, and it gets very artificial as a result. So I think your point, though, about soft power is, is the system attractive, and I think the American system basically is attractive.

I think it's overshadowed by the foreign policy issues of the United States, but I think that can be remedied, and Mr. Jackson and others have raised these points.

HEARING COCHAIR BLUMENTHAL: Before we go on. I think Dr. Sutter has already answered it, but what if we, for example, decided to promote a APEC democracy caucus or something of that sort? How would the Asians react to something like that?

DR. JACKSON: My own view is that if you want to have influence through an APEC structure, you begin first with making it a genuine economic organization. I wouldn't lead with pushing democracy because

you would be seen as trying to propagandize for your own ideology. The best kind of propaganda is that which is not seen to be intentional. And one of the great things that USIS and USIA used to do is they used to just be there, be there as libraries. Juwono Sudarsono that you were talking about, his education began in an American library in Jakarta, where he would go every afternoon after school. I got news for you. The library is not there anymore. No.

Instead, it's been replaced by an American corner. Do you know how big that American corner is? It's about this big. It's a corner. It's pathetic. It makes you feel somewhat ashamed when you go there. I actually went to the thing at Universitas Indonesia. It's a laughing stock. If we wanted to have an American studies program comparable to the Islamic studies program at Universitas Indonesia, it would only cost us--oh, I once did some back-of-the-envelope stuff. It might cost us \$300,000 a year. That's chicken feed. That's chump change, and yet our government, and at a bipartisan level, refuses to look at these things and that's most unfortunate.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. This is very interesting. One of the things that we are tasked with is examining the interrelationship of economic security and national security in the context of this relationship, and I find myself thinking about economic power and national power as we have been talking about all of these issues today.

I struggle with the Sun Tzu concept that essentially the goal is to defeat your enemy before you even get the battlefield. As I listen to all of you talk about China's role in Asia, I am still thinking about China's increasing economic role with all of these countries, and ultimately what that means. Purchase of resources--as these countries are being bound together, bound to China more tightly because of dependence on Chinese consumption, for example, of resources, what does that mean for us?

Am I just concerned about something that isn't happening or isn't going to be taking place?

DR. SUTTER: I just think it's a little more complicated because China itself is so interdependent. In other words, what you say is true, but it's part of a bigger process, and the bigger process is globalization, and China is very dependent on us, on the United States, on the Europeans, and so who is doing all this interaction? A lot of it is being done by multinationals integrating the various components of Asia to produce products.

China is very much in a position of not being able to call the shots, if you see what I mean. Yes, sure they have this influence. They are important to these investors, absolutely. But China itself has to be able to export. So it's a type of situation, what specialists who look at this issue

say, what China has used its diplomacy and its economic relationship with Asia to do is to create a buffer.

In other words, this creates a buffer so the governments of Asia won't align with the United States to contain China. That's one of their goals, and I agree, that that is their goal. But I think they're making the best of the situation because that buffer has always been there. These governments of Asia never would have chosen to work with the United States against China in any serious issue. When we would do estimates dealing with a contingency in the Taiwan Straits, we never assumed any other Asian country would be with us to deal with this kind of a situation.

Look at Tiananmen and the sanctions against Tiananmen, against China. What Asian country joined the United States even on the sanctions, just economic sanctions against China? So the buffer strategy already exists. These countries don't want trouble with China in a big way. And so I think the net gain for China in this situation really isn't that large, and I do think that the Chinese, their approach is not so much a strategy designed to dominate Asia. I think maybe they would like to do that.

Their approach is trying to deal with the situation that they're in, and so they have lots of different interests in their Asian policy. One, as was emphasized, keep the situation stable; number two, economic advantage; number three, reassure the countries in the region; number four, isolate Taiwan; and number five, have more influence.

if you look at it more broadly, I think you come to the situation where China really isn't in a very strong position to throw its weight around.

REAR ADMIRAL McDEVITT: I find nothing to disagree with Bob. I would just add, and this is probably a reflection of being culturally arrogant, but I find Sun Tzu greatly overrated. He's full of blinding flashes of the obvious. Who wouldn't want to defeat their enemy without having to fight? Come on. Everybody wants to do that. You want to have your way without having to fight. It all sounds exotic and somehow mysterious but we ought not to read too much into Sun Tzu's strategic thoughts.

DR. JACKSON: After that, it's hard to follow. But, no, the one thing, one of the attractive things about American political culture is we always test ourselves. We always hypothesize that we're falling behind the Soviets, that the Japanese are going to dominate everything, and now China is going to dominate everything. Now, it's a very healthy thing because we're always looking behind us to make sure that the footsteps aren't gaining on us, and that's a good quality.

But it's also probably not the best basis for making day-to-day policy because it tends to leave you to overestimate the physical stature, so to speak, of your opponent, and I think that China will continue to grow rapidly for a number of years, perhaps for another decade or two.

But there is no, and I repeat no major economy that has gone from a traditional society to a modernized economy without at least several internal economic crises.

just as in the late '80s, no one could fathom the idea of something going wrong with the Japanese economy, I would contend that the Chinese should adopt the American characteristic of looking behind them because of the fact that economic systems in the maturation process tend to face periodic breakdowns.

China has never had one. You have a very authoritarian political system, a very narrow top of the pyramid. At that point in time, then it will be a very interesting, very interesting thing to watch, and I would expect the American ship of state to go on sailing forward.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Donnelly.

COMMISSIONER DONNELLY: I appreciate the indulgence of the chair for an intervention here because this picture of essential American strengths and essential Chinese problems is a little bit difficult to square with like the recent behavior of the South Korean government, for example.

Am I misreading the South Koreans' behavior or are there outliers within the broad regional picture that you paint, some countries who are perhaps slightly more overawed by Beijing, and others may be a little bit further afield? So can you give us a little finer-grained analysis of that?

DR. SUTTER: I'd like to. Really this is my favorite area to talk about. If you don't mind, indulge me for a minute because the South Koreans are so volatile in their attitudes, and I would argue that in the past two years, you've seen them repositioning themselves because of their concern about China in particular. They're repositioning themselves in a way that's a bit more compatible with the United States. They've been doing this for about two years now.

And at the height of the China fever in South Korea--South Korea is the area where China has made the greatest gains.

REAR ADMIRAL McDEVITT: Yes.

DR. SUTTER: In dealing with the periphery. And in 2004, there was a real fever in China. Now I had interviews with lots of officials in South Korea at that time, and the bottom line, though, was a presidential aide who spoke to me, ranted against the Bush administration for 15 minutes, and was ecstatic about China for another 15 minutes, and I was ready to leave, and he says don't leave. I've got something important to tell you: we've got to keep the alliance relationship with the United States. If we don't have that alliance relationship, China will treat us very differently.

That's their calculus and that's not a diplomat. That's the Blue House and this guy said they have the nickname for these people, they call them the Taliban. This guy introduced himself to me and he said I'm a

Taliban, and he was. He really was very anti-U.S. And now in 2006, by this time, you see them, why do they have a free trade agreement with the Bush administration? Why did they send 3,000 troops to Iraq? Why do they do this sort of stuff?

COMMISSIONER DONNELLY: Why did they pull them out?

DR. SUTTER: Have they pulled them out?

REAR ADMIRAL McDEVITT: They're about to, yes.

DR. SUTTER: Yes, but they're not pulled out yet. Koizumi has pulled out his forces--totally unpopular, across the board. Why do they do this? They're going to keep that alliance with the United States, definitely going to keep that. So I think that, yes, they're going to move around, they're going to be close with China in a lot of ways, but do they trust the Chinese? Sir, I really think they're very careful about how they calculate their strategy insofar as any administration like this, which is a bit confused--I take your point.

But basically if you look at the record, the last two years, they've positioned themselves in a way that's a lot better vis-à-vis the United States than it was before, and it's a lot more wary of China.

COMMISSIONER DONNELLY: May I ask the question in another way? Japan has reacted to the perception of Chinese strength and Chinese hostility by getting tougher and thinking about modernizing its military. Do you expect that pendulum to likewise swing back, whether the Japanese begin to discount Chinese strength and say, well, we don't really need to move forward with military modernization and so on and so forth?

How do we account then for at least from an American perspective, what looks like a positive reaction to a perception of danger?

DR. SUTTER: The Japan-China thing is a real negative for China. I pressed Chinese strategists. I said, look, you can be nice to George W. Bush. He does all sorts of things in Taiwan against your interests. Why can't you be nice to the Japanese? They don't do this kind of stuff.

And they argue, but basically they can't do it. So they're trapped because of domestic politics inside China, nationalism inside China, and in the process they're fomenting this split with Japan which weakens their whole approach to Asia. The peaceful rise to Asia approach doesn't look very peaceful when you look at Japan-China relations. So my sense is the rivalry between Japan and China will persist. But I do think it's self-limiting. I think neither country wants big trouble with one another.

You could have a fight. Admiral McDevitt indicated a surprise, but basically I think it's more or less stable in this regard, and so I think that's what we have to look forward to, is a very wary China-Japan relationship which will hobble China's rise in Asia for a decade or two.

REAR ADMIRAL McDEVITT: Tom, I would just make a quick point. The Japanese are still increasingly concerned about the development of Chinese military power, particularly the submarine force. An island nation, they know how dependent they are upon everything that

comes in by sea, so they're watching that like a hawk. I'm not sure they're going to get nonchalant about that.

HEARING COCHAIR BLUMENTHAL: Thank you very much to all of our panelists for their excellent testimony and generosity with your answers to our many questions. With that, we have one more question.

COMMISSION VICE CHAIR BARTHOLOMEW: I want to join you in thanking our panelists and also to let the people in the room know that earlier the Capitol Police found a suspicious package down the hall, but it's all been cleared up. We are free to leave the room.

HEARING COCHAIR BLUMENTHAL: Perfectly timed.

COMMISSION VICE CHAIR BARTHOLOMEW: But you guys were so captivating nobody even knew that it was going on.

REAR ADMIRAL McDEVITT: By the way, I also submitted written testimony, but it had so many typos I'm going to resubmit it again.

COMMISSION VICE CHAIR BARTHOLOMEW: We'll take a 15 minute break.

[Whereupon, a short recess was taken.]

## **PANEL VI: CHINA'S RELATIONSHIP WITH COUNTRIES OF CONCERN**

COMMISSION VICE CHAIR BARTHOLOMEW: We'll get started a few minutes early after the excitement of the last panel. Thank you to our next panel of witnesses for hanging around outside for however long you were trapped out there. Fortunately, everything has been cleared up.

Our last panel today will narrow the focus of our discussion by examining China's diplomatic relations with countries of concern. Our speakers will offer testimony on three countries: Burma, Sudan and Venezuela.

Jared Genser, a Visiting Fellow at the National Endowment for Democracy, was the lead author of a report entitled "A Threat to the Peace: A Call for the U.N. Security Council to Act in Burma," commissioned by Vaclav Havel and Archbishop Desmond Tutu. He is also the author of articles on China, Burma and political dissent.

Dr. Eric Reeves, a professor at Smith College in Massachusetts, will speak today on China's relationship with Sudan. Dr. Reeves is one of the most prolific and, I would add, one of the most important commentators on the growing crisis in Sudan. He has spent the past seven years working full time as a Sudan researcher and analyst, and I'd really like to personally note that the fact that the world is paying attention to what is going on in Sudan is in great measure a response to the work of Dr. Reeves. So thank you for all of that.

Dr. William Ratliff has extensive experience with China, Latin America and U.S. foreign policy and will speak today on China's relations with Venezuela. Dr. Ratliff serves as a Research Fellow at the Hoover

Institution of Stanford University and he has written widely on Latin American issues including a book entitled China's "Lessons" for Cuba's Transition, and we had no idea when we invited you that it could be quite as timely as it's turning out to be. We haven't seen CNN all day today so you might have to give us an update. Welcome to all of you. Mr. Genser, I know that you have to leave promptly so why don't we go ahead and start with you. Then we'll have Dr. Reeves and Dr. Ratliff, and then we'll ask questions.

Thank you.

**STATEMENT OF DR. JARED GENSER  
VISITING FELLOW, NATIONAL ENDOWMENT FOR  
DEMOCRACY, WASHINGTON, D.C.**

DR. GENSER: Thank you, Vice Chairman Bartholomew. Members of the Commission, good afternoon. I appreciate the opportunity to appear before the Commission today on a topic that's close to my heart and I think is also close to all of yours. My remarks today are my personal views and are not made on behalf of any group or organization, and also let me apologize in advance for having to slip out and catch a flight out of the country. As many people do in August, I'm actually taking a vacation for a change.

COMMISSION VICE CHAIR BARTHOLOMEW: Oh, excellent.

DR. GENSER: So I'm looking forward to that. You have before you a more detailed statement of my testimony, and so let me just try to highlight the key points about China's relationship with Burma today, talking about briefly the history of their relationship, China's objective, how Burma benefits from its relationship with China, the downside of the bilateral relationship, and how this relationship has played out at the U.N. Security Council over the past year.

China has had relatively good relations with Burma since 1949 when Burma became the first non-Communist country to recognize the People's Republic of China. Events in 1988 and '89 solidified that alliance. Indeed, just before the uprising in Burma of 8/8/88, the two countries signed an agreement to legalize border trade, which was worth \$300 million at the time.

In terms of China's objectives in pursuing its relationship with Burma, they have at least two. First, China seeks natural resources, such as oil, timber and gas to satiate the Chinese population's needs and maintain its economic growth, and second of all, China wants to improve its security capabilities by expanding its access to the Bay of Bengal and the Andaman Sea.

China with a current population of 1.3 billion people produces 3.5 million barrels of oil a day, but consumes almost twice that amount forcing it to look elsewhere for its oil needs. China also needs Burma not



just as a source of oil, but also for its own more broad energy security. Its imports from the Persian Gulf travel along Burma's coast necessitating a good relationship between Burma and China.

China's most important Burmese import, however, is actually gas. Burma currently has the tenth largest known reserve of natural gas. In November 2005, PetroChina negotiated a deal with Burma for 6.5 trillion cubic feet of gas over the next 30 years.

China, however, is not the only country competing for Burmese natural resources. India is vying for gas and oil exports from Burma as well. Regardless of India's efforts, however, China continues to control most of Burma's mineral wealth. Despite intense competition between China and India over Burma's resources, China continues to outbid and outperform India.

The second motivation for the relationship that China has with Burma is security concerns. Burma in exchange for favorable trade agreements, arms and Chinese investment has provided China with greater access to the Bay of Bengal and Andaman Sea. China continues to be one of Burma's major trading partners in non-energy related goods, such as clothing, beans, fish and rice. In 2005, Burmese trade with China reached \$1.2 billion, equivalent to 20 percent of Burma's foreign trade volume, and both countries are trying to reach a target of 1.5 billion in bilateral trade.

At the same time, not only have there been preferential trade agreements, but China is the largest foreign investor in Burma. In 2003, in the wake of new U.S. sanctions, China loaned Burma \$200 million. More recently, in June 2006, they announced an intention to provide Burma a special low interest loan of another 200 million, and that was earmarked for five unspecified government ministries.

That said, some experts that I've spoken to about these transactions have told me that the funds, both sets of these funds have actually never been provided, although it remains really an open question as to whether they'll follow through.

By October 2002, just to give a sense of the foreign direct investment from China to Burma, Chinese companies had contracted for 800 projects for a total value of over \$2.1 billion. Finally, China's support has not been limited just to economic investment.

China is also the principal arms supporter and supplier to Burma, providing over 90 percent of Burma's armaments. Without China's 1.6 billion for military assistance and naval modernization, Burma would not have been able to create the second-largest military in Southeast Asia behind Vietnam.

While China views its relationship with Burma as beneficial, the alliance poses difficulties and has adverse effects on both nations. China's support of Burmese military junta not surprisingly has helped it remain in power, and Chinese investment in Burma does prop up a brutal

regime. Slave labor will inevitably build new pipelines and infrastructure. The military junta forces more than 800,000 people today in Burma to work for little or no pay.

As a result of the systematic and widespread abuses of the military junta in Burma, over a million Burmese refugees have fled their repressive homeland and a further one million have been internally displaced.

Burma's illicit trade in opium, heroin and methamphetamines has not only affected the Burmese people; it's also resulted in rampant addiction among residents of China's Yunnan Province, and the consequent needle sharing has spread HIV/AIDS at a devastating rate.

Moreover a separate strain of the virus, sub-type C of HIV-1, was created in Burma which has done little to nothing to prevent the spread of HIV/AIDS, and it's spread to neighboring countries through prostitution and drug use. Indeed, four-fifths of China's HIV/AIDS cases can be traced back to the unique Burmese HIV/AIDS strain.

The Chinese, however, in recent years have been increasingly frustrated with Burma's lack of success in the war on drugs. During a recent visit in February of 2002 of Burmese Prime Minister Soe Win to China, Chinese Premier Wen Jiabao pointed out in a public press conference that the spread of narcotics in the boundary area between China and Burma has, quote, "severely damaged the local society" and that this, quote, "must be controlled through severe measures."

That statement coming publicly from the Chinese in a press conference with the Burmese Prime Minister I think is quite significant.

In recent years, despite greater economic ties with China, Burma's junta has increased its self-isolation, and the Chinese leadership has lost face in a number of ways. The ousting of Khin Nyunt followed by the visit of Than Shwe to India in close succession was quite embarrassing to China. China was not told about Burma's move from Rangoon to Pyinmana and, adding insult to injury, the Burmese junta has failed to clamp down on outflow of drugs or HIV/AIDS.

Over the last year, China has been relatively quiet in its defense of the military junta in Burma since an effort was launched to push to get the situation in Burma brought to the U.N. Security Council. As it was mentioned, I led the team commissioned by Vaclav Havel and Desmond Tutu to produce a report on taking Burma to the Security Council, and we've now had two discussions in the Council to date, and the United States has announced its intention to pursue the adoption of a resolution on the situation in Burma.

Let me just quickly make some concluding remarks as I see my time has come to an end. The ongoing relationship between China and Burma is complex and evolving, consisting of numerous economic, military, and political ties. China does value its relationship with Burma in its quest for global resources and as a means to enhance its military presence in

Southeast Asia, but at the same time it's also on the receiving end of a lot of negative externalities from Burma.

Above all else, China values stability both internally and in its relations with its neighbors. In recent years, China has had ample reason to be concerned about the lack of stability in Burma. This is why I believe that although China will continue to fight attempts to bring Burma to the Security Council, I actually remain an optimist.

It's my hope and my belief that China may ultimately relent and allow a broader internationally-facilitated reconciliation process to advance through the Security Council because such a decision would ultimately be in China's best interests. Not only could it prioritize its more important interest in North Korea and Iran, but by allowing national reconciliation to proceed, it could actually maximize the chance for a soft rather than a hard landing in Burma, and with a peaceful and gradual restoration of democracy, it will maximize its ability to bring stability to its eastern border and enabling it to at the same time build a strong relationship with its transitional government. So thank you very much, and I appreciate the little bit of extra time you gave me.

[The statement follows:]<sup>3</sup>

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. Dr. Reeves.

**STATEMENT OF DR. ERIC REEVES, PROFESSOR OF LANGUAGE AND LITERATURE, SMITH COLLEGE, NORTHAMPTON, MA**

DR. REEVES: Thank you very much for this occasion to speak to the Commission. You have before you my more detailed comments. There is in all of Africa no more destructive bilateral relationship than that between China and Sudan. Certainly when viewed from the perspective of U.S. interests and those of the people of Sudan, Beijing's relentless military, commercial and diplomatic support of Khartoum's National Islamic Front regime has done much to ensure that Sudan remains controlled by a vicious cabal of unelected genocidaires.

This is so despite the comprehensive peace agreement signed in early 2005 by Khartoum and the southern Sudan People's Liberation Movement, designed to bring to power a "Government of National Unity." This political arrangement has done exceedingly little to diminish the National Islamic Front's monopoly on national power and wealth, including oil wealth. The National Islamic Front has renamed itself innocuously the National Congress Party.

Since the mid-1990s, China National Petroleum Corporation has been the dominant player in both exploration and production in Sudan's

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<sup>3</sup> [Click here to read the prepared statement of Dr. Jared Genser](#)

oil reserves, the vast majority of which lie in southern Sudan. China's behavior in oil exploration has from the beginning been marked by deep complicity in gross human rights violations, scorched-earth clearances of the indigenous populations, and direct assistance to Khartoum's regular military forces.

This assistance has taken many forms including the building a vast network of all-weather elevated roads that serve not only to move heavy oil production and exploration equipment, but permit the rapid deployment of Khartoum's mechanized military resources. Airstrips belonging to the oil development consortia and involving Chinese construction have also been used by Khartoum's military aircraft including deadly helicopter gunships.

At the same time that petroleum-hungry China was establishing itself as the dominant player in oil development, it remained engaged in an extremely active arms trade with Khartoum. China's large-scale shipments of weapons to Sudan has continued steadily for many years, including helicopter gunships, tanks, armored personnel carriers, heavy artillery, mortars, combat aircraft and light weapons.

These sales continue despite clear evidence that such weapons fuel genocide in Sudan's western Darfur region. During this time, China has not on a single occasion criticized the National Islamic Front machine for its vast and ongoing human rights abuses, for its ruthless arrogation of national power and wealth, or for a policy of severe political and economic marginalization throughout Sudan.

Indeed, the Chinese have been conspicuously contemptuous of human rights concerns for the consequences of oil development in southern Sudan. Hand-in-glove operations involving Khartoum's regular and militia forces along with Chinese engineering and construction teams have been standard operating procedure since 1998.

On Darfur, despite the catastrophic character of the crisis, China has from the beginning engaged in a relentless obstructionism. The currently deployed African Union force is widely understood to be desperately inadequate. The only hope for halting what the U.S. government has broadly determined to be genocide is the introduction of a robust U.N. force supplemented aggressively by first world military assets. Such a U.N. deployment must be under the authority of Chapter VII of the U.N. Charter.

Despite the clarity of what is required militarily and the explicit endorsement of such humanitarian intervention by U.N. Secretary-General Kofi Annan, China has refused to allow progress to be made on an authorizing resolution, indeed has clearly indicated that it would veto any authorization that did not derive from Khartoum's consenting to U.N. deployment.

To date the regime has adamantly rejected a U.N. peace support operation including yet another vehement objection today.

U.N. paralysis in responding to Darfur is conspicuously not in the interest of either the organization itself or of the United States, which in the wake of the Iraq War is even more dependent upon U.N. authority in acting abroad. Yet, China's powerful influence and interests in a range of international issues of geostrategic concern to the U.S.--North Korea, Taiwan, Iran, international terrorism, world trade--have so far paralyzed the United States as well as its European allies.

The Darfur crisis also raises important issues of regional stability, particularly in eastern Chad where genocidal violence is now rapidly spilling into this region, immediately to the west of Darfur. Khartoum's brutal military proxies--the Arab Janjaweed militias--are engaged in widening civilian targeting of the non-Arab or African tribal populations of eastern Chad as they have in Darfur for more than three years.

Equally worrying, Khartoum is supporting rebels seeking to overthrow the Chadian government of Idriss Deby with the potential to create massive chaos in the country. Violence in eastern Chad has already created instability in northern Central African Republic and could conceivably destabilize Cameroon to Chad's west. China is providing most of the weapons for the rebels supported by Khartoum.

Oil development in Sudan will improve the lives of Sudanese people only if there is a much more equitable distribution of oil wealth, but so long as Khartoum is convinced that its ruthless political tyranny will not be seriously challenged by the international community, it has no incentive to change its behavior or to share oil revenues.

Here nothing weighs more heavily in Khartoum's calculations than China's uncompromising support for the regime at the U.N. Security Council.

China will not be easily moved from its present position of intransigence. International acquiescence to date has only made the task harder. But unless there's a willingness to confront China over the critical issues facing Sudan, the current National Islamic Front regime will continue in its ruthless and immensely destructive ways.

Thank you very much.

[The statement follows:]

**Prepared Statement of Dr. Eric Reeves, Professor of Language and Literature, Smith College, Northampton, MA**

There is in all of Africa no more destructive bilateral relationship than that between China and Sudan, certainly when viewed from the perspective of US interests and those of the people of Sudan. Beijing's relentless military, commercial, and diplomatic support of the National Islamic Front regime has done much to ensure that Sudan remains controlled by a vicious cabal of genocidaires. This is so despite the Comprehensive Peace Agreement, signed by the National Islamic Front (which has innocuously renamed itself the "National Congress Party") and the southern Sudan People's Liberation Movement/Army, on January 9, 2005. Designed to bring to power a "Government of National Unity," this political arrangement has done exceedingly little to diminish the National Islamic Front's monopoly on national power and

wealth.

The National Islamic Front (NIF) came to power by military coup in June 1989—deposing an elected government and deliberately aborting the most promising chance for a north-south peace agreement since Sudan's independence in 1956. This brutal regime quickly purged the military, civil society, and economic spheres of all opponents, and developed a ruthlessly efficient security network. The NIF is responsible not only for ongoing genocide in the western Darfur region, but also for previous genocides in the Nuba Mountains of southern Kordofan Province (beginning in 1992) and the southern oil regions (primarily in Western and Eastern Upper Nile Province).

Since the mid-1990's, China National Petroleum Corporation (CNPC) has been the dominant player in both exploration and production in Sudan's oil reserves, the vast majority of which lie in southern Sudan. China became a partner with the NIF when it appeared that commercially viable oil reserves in the south would become secure enough for extraction activities. The 1991 split within the ranks of the southern rebel movement led to the disastrous 1997 "Khartoum Peace Agreement," which brought Riek Machar—the senior military leader from the Nuer tribe in the south—into the NIF government. Though Riek would fulsomely apologize years later, his decision to join the NIF effectively removed southern military opposition to oil exploration, which subsequently devastated those regions of Upper Nile Province in which the Nuer predominate.

China's behavior in oil exploration has from the beginning of its operations been marked by deep complicity in gross human rights violations, scorched-earth clearances of the indigenous populations in the oil regions, and direct assistance to Khartoum's regular military forces.

This assistance has taken many forms, including the building of a vast network of elevated all-weather roads that are dual-use: they serve to move heavy oil exploration and extraction equipment, but have also permitted the rapid movement and deployment of Khartoum's military resources. Moreover, these roads were constructed, primarily by Chinese labor and engineering, with no regard for environmental consequences, for flooding during the heavy rainy season (the roads were constructed without culverts), or for the consequences of blocking traditional cattle migration routes. This is true both in Western and Eastern Upper Nile Province.

Airstrips belonging to the oil development consortia, and involving Chinese construction, have also been used by Khartoum's military aircraft, including deadly helicopter gunships. These fearsome weapons of human destruction have been implicated in hundreds of deadly attacks on civilian, even humanitarian targets. For example, in the village of Bieh (Western Upper Nile) the UN reported on February 21, 2002 a brutal attack by helicopter gunships on women and children gathered to receive from the UN's World Food Program:

"A Sudanese army helicopter fired five rockets at thousands of civilians at a UN food distribution point, leaving 17 people dead, World Food Program officials and Sudanese rebels said Thursday. [ ] 'Such attacks, deliberately targeting civilians about to receive humanitarian aid, are absolutely and utterly unacceptable,' WFP chief Catherine Bertini said in a statement. 'This attack—the second of this kind in less than two weeks—is an intolerable affront to human life and humanitarian work.'" (Associated Press [dateline: Nairobi], February 21, 2002)

Bieh lies in the center of the oil region most aggressively being cleared of civilians in 2002-2003. Beyond the casualties reported, many other civilians died of their wounds or lack of food, as WFP was forced to conduct an emergency evacuation. Again, this was but one of hundreds of such attacks.

Although the helicopter gunships used on this particular occasion appear to have been of Russian manufacture, many of the helicopter gunships in Khartoum's arsenal were purchased from China, and many of these were purchased using anticipated revenues from oil extracted in the very regions being attacked in southern Sudan.

## ARMS TO SUDAN FROM CHINA

Indeed, at the same time that oil-hungry China was establishing itself as the dominant partner in both Upper Nile oil exploration and production consortia—the Greater Nile Petroleum Operating Company in the west and Petrodar in the east—it was and has remained engaged in an extremely active arms trade with Khartoum. Though China is largely secretive in its arms shipments, Refugees International recently found that:

“China National Petroleum Corporation contributes Chinese-made tanks, fighter planes, bombers, helicopters, machine guns and rocket-propelled grenades, firearms, and ammunition to the Sudanese military and SSDF [the Khartoum-backed militia forces in southern Sudan]. China has also established three arms factories in Sudan.” (Refugees International, “Sudan: Oil Exploration Fueling Displacement in the South,” June 14, 2006)

A recent Amnesty International report confirms yet again the intimate connections between China’s oil interests and arms dealing: “China’s arms exports, estimated to be in excess of [US]\$1 billion a year, often involve the exchange of weapons for raw materials to fuel the country’s rapid economic growth.” (“People’s Republic of China: Sustaining conflict and human rights abuses: The flow of arms accelerates” [AI Index: ASA 17/030/2006], June 2006)

China’s shipments of weapons to Sudan continue despite the clear evidence that such weapons fuel genocide in Darfur. Amnesty International also reported in June,

“More than 200 Chinese military trucks—normally fitted with US Cummins diesel engines—[were] shipped to Sudan in August 2005, despite a US arms embargo on both countries and the involvement of similar vehicles in the killing and abduction of civilians in Darfur.” [ ]

“Throughout the massacres in Darfur in 2004, Amnesty International and other human rights monitors noted that military trucks were being used to transport both Sudanese military and Janjawid [see below] militia personnel, and in some cases to deliver people for extrajudicial execution. In April 2004, Amnesty International reported the extrajudicial execution of 168 people from Wadi Saleh, in the west of Darfur, near the Chad border. The men were seized from 10 villages by a large force of soldiers, military intelligence officers and Janjawid militiamen, blindfolded and taken in groups of about 40 in army trucks to an area behind a hill near Deleij villages. They were ordered to lie on the ground and were shot dead.”

There have been many such reported mass executions. In this case the men and boys assembled and executed were all from the Fur, a non-Arab (African) tribal group. Trucks and aircraft have also been reported to have moved bodies from the sites of execution to remote locations in order to obscure evidence of genocidal actions.

A UN panel of experts, charged with monitoring the arms embargo that came into effect with UN Security Council Resolution 1591 (March 2005), recently found that:

“‘China has been, and continues to be, a major supplier of light weapons to the government of Sudan and many of the neighbouring states,’ said Ernst Jan Hogendoorn, one of four UN experts on a panel which recommended 17 players in the Darfur conflict be sanctioned for obstructing peace. [Hogendoorn] said [the panel] found no evidence China was defying the embargo and supplying arms directly to Darfur. But weapons they had sold to Khartoum were likely to end up there.” (Reuters [dateline: Khartoum], June 19, 2006)

In fact, small arms shipped to Khartoum by China have been the regime’s primary means of providing weapons to its deadly Janjaweed Arab militia, which are responsible for so much of the human destruction and displacement in Darfur.

But the arms trade with a regime actively engaged in genocide goes back many years. For China, desperate since the mid-1990s for offshore sources of oil because of burgeoning domestic consumption, has always been willing to engage in both secretive and in-kind arms trading (oil revenues and anticipated oil revenues for arms). Human Rights Watch reported (1998):

“Weapons deliveries from China to Sudan since 1995 have included ammunition, tanks, helicopters, and fighter aircraft. China also became a major supplier of antipersonnel and antitank mines after 1980, according to a Sudanese government official. The SPLA in 1997 overran government garrison towns in the south, and in one town alone, Yei, a Human Rights Watch researcher saw eight Chinese 122 mm towed howitzers, five Chinese-made T-59 tanks, and one Chinese 37 mm anti-aircraft gun abandoned by the government army.”

“Weapons deliveries since 1995 include ammunition, tanks, helicopters, and fighter aircraft. According to at least one published report, in late 1995 China supplied the government of Sudan with fifty Z-6 helicopters, a hundred 82mm and 120mm mortars, and other equipment by Iran. In 1997, the government of Sudan also was reported to have a new type of Chinese-made, lightweight antitank weapon in its arsenal—probably a Chinese copy of the Russian SPG-9—mounted on two wheels that could be pulled by hand by soldiers. One Sudanese army defector, formerly with an air defense unit, claimed he witnessed Chinese experts assembling Chinese-supplied jet fighters at the Wadi Saydna base north of Omdurman in 1993.” (“Arms Transfers to the Government of Sudan,” Human Rights Watch [1998], <http://www.hrw.org/reports98/sudan/Sudarm988-05.htm>)

The large majority of weapons in Khartoum’s arsenal are of Chinese manufacture, including not only light weapons, but also medium and heavy arms, including military aircraft. Moreover, as oil came on line (the first export cargo left Port Sudan in August 1999), China continued to assist Khartoum in developing a domestic armaments production capacity. The result is that Sudan is now increasingly self-sufficient in small and medium-sized arms, and the NIF regime also builds a range of heavy weapons, including Chinese-model tanks, in large industrial sites such as the vast GIAD complex outside Khartoum.

The lack of transparency in China’s oil production and revenue accounting assists the National Islamic Front in its own refusal to open up the books of the key Ministry of Mining and Energy, which includes the petroleum portfolio. This lack of transparency, by both China and Khartoum, has led to very serious tensions between the northern regime and the nascent Government of South Sudan, which is entitled to half the revenues from oil production in southern Sudan. To date, the desperately poor and underdeveloped south of Sudan has been denied hundreds of millions of dollars in desperately needed oil revenues.

At the same time, the National Islamic Front senses that it will enjoy virtually complete diplomatic protection from China and other international actors, and that the Western nations that helped bring the Comprehensive Peace Agreement (CPA) to fruition are not sufficiently engaged to ensure that key terms of the CPA are respected. This is extremely dangerous and may well lead to renewed war in the south, possibly in the near term. For example, Khartoum’s refusal to accept the findings of the distinguished international Abyei Boundary Commission creates of the oil-rich Abyei enclave a potential flash-point for renewed violence. Though the Government of South Sudan seems determined to seek international arbitration in its effort to force Khartoum to abide by the terms of the CPA, many in the SPLM have made clear that continued intransigence on Khartoum’s part could lead to war, which will almost certainly be the most violently destructive phase of a civil war that began in 1955, on the eve of Sudan’s independence from Anglo-Egyptian colonial rule.

In understanding why Khartoum feels so emboldened in its flouting of the CPA and many other agreements with Sudanese parties, over many years, it is important to understand the canny survivalism that defines the NIF. The senior members of the NIF, including President and Field Marshal Omar el-Bashir and Second Vice-President Ali Osman Taha, are the same men who came to power by military coup in 1989. Although the agenda of extremist Islamicization and Arabization for Sudan has been adjusted to accommodate



international perceptions, particularly after the terrorist attacks of September 11, 2001, these brutal men remain committed to that same agenda. They also remain committed to a domestic security policy of genocidal counter-insurgency warfare, as evidenced in Darfur.

None of this has mattered to the Chinese, who have not on a single occasion criticized the National Islamic Front regime for its vast and ongoing human rights abuses, for its ruthless arrogation of national power and wealth, or for a policy of severe political and economic marginalization throughout the peripheral areas of Sudan (geographically, Africa's largest country). Indeed, the Chinese have been conspicuously contemptuous of human rights concerns for the consequences of oil development in southern Sudan. This oil development, in which construction efforts have been overwhelming Chinese, has required brutal civilian destruction and clearances, creating a vast *cordon sanitaire* for oil operations. Nobel Peace Prize-winning Doctors Without Borders/Medecins Sans Frontieres reported in detail on one particular part of this deadly enterprise, the notorious oil road south of Bentiu (the epicenter of oil development in Western Upper Nile):

“According to [civilians from the road area], whose accounts were consistent, road clearing first began in 2000, often preceded by Antonov bombings and helicopter gunship activity. Then the government of Sudan and Nuer troops, along with Chinese laborers, brought bulldozers to clear the site of the road and the surrounding area. After the bulldozers cleared a track, troops arrived in vehicles and burned all the tukuls in the path alongside the road. Government garrisons were then established at 30-minute intervals along the road.” (Doctors Without Borders/Medecins Sans Frontieres, “Violence, Health, and Access to Aid in Unity State/Western Upper Nile,” April 2002)

This hand-in-glove operation, involving Khartoum's regular and militia forces, along with Chinese engineering and construction teams, has been standard operating procedure since 1998.

It is important to understand that China has a clear interest in sustained conflict in Sudan, at least at levels that do not threaten operations. Potential Western competitors for oil development contracts, concessions, and other parts of the rapidly growing oil industry have been loathe to do business with a government conducting genocidal counter-insurgency warfare against the indigenous populations of the primary oil regions (these include not only the Nuer tribal populations, but also the Dinka, Shilluk, and others). In the case of the US, comprehensive trade and economic sanctions imposed by former President Clinton (November 1997) preclude activity by US oil companies.

Western oil companies also realize that domestic political concerns will eventually overtake any profitability in southern Sudan. This was the experience of Talisman Energy of Canada, which was forced to sell its 25% stake in the Greater Nile Petroleum Operating Company in 2002 because of civil society protest and activism, including a targeted divestment campaign that brought share price down by as much as 35% and forced Talisman to initiate a C\$500 million share buy-back in an attempt to stabilize share price. Talisman's presence in southern Sudan was also a public relations nightmare that continues to this day, as it faces a massive lawsuit in US federal court, brought on behalf of southern Sudanese victims.

China has none of these concerns: it is accountable to no domestic political pressures; it has demonstrated complete contempt for all efforts to improve human rights in Sudan; and is not concerned if a few of its national workers should come home in body-bags—something Western companies could not tolerate (the killing of several US-national Chevron workers in 1984 precipitated the withdrawal of the American company).

In short, China views Sudan exclusively through the lens of very rapidly increasing need for off-shore petroleum sources. Though Iran provides a greater share of China's oil imports, China has no significant role in the Iranian oil industry. The case is quite the opposite in Sudan, where China is the dominant player in oil exploration, extraction, and infrastructure development. Indeed, Sudan is China's premier source of controlled off-shore oil production, without a close second in current activities. This elevates Sudan to a position of geostrategic importance in China's perceptions of national interest, and China's diplomatic

performance, particularly at the UN, reflects this extraordinary importance.

## DARFUR

As genocide continues to unfold in Darfur, a wide range of international actors are desperately seeking a means of extending protection to some 4 million conflict-affected civilians in Darfur and eastern Chad, as well as to some 13,000 humanitarian aid workers who are operating amidst intolerable levels of insecurity. Indeed, Jan Egeland, head of UN aid operations, has repeatedly warned that large-scale withdrawal of humanitarian workers could occur at any moment. This would leave no means in place for providing food, clean water, medical services, maintenance of sanitary latrines, shelter, and other desperately needed humanitarian services. Hundreds of thousands will die—these in addition to the almost 500,000 who have already died from violence as well as disease and malnutrition.

From the beginning of the Darfur crisis, China has engaged in relentless obstructionism. Although seven Security Council resolutions have been passed to date, none has had any effect in stemming the violence or in moving toward a peacemaking force that might be able to protect civilians and humanitarians, and to separate and disarm combatants. The currently deployed African Union force is widely understood to be desperately under-manned, under-equipped, without the necessary training, and inadequately funded. The only hope for halting what the US government has broadly determined to be genocide is the introduction of a robust UN force, supplemented aggressively by “first-world” military assets, logistics, intelligence, transport, and communications. Such a UN deployment must be under the authority of Chapter VII of the UN Charter.

Despite the clarity of what is militarily required, and the explicit endorsement of such humanitarian intervention by UN Secretary-General Kofi Annan, China has refused to allow progress to be made on an authorizing resolution. (China has had in this refusal substantial diplomatic support from Russia, which also has a very large arms trading arrangement with Khartoum, including the recent sale of more than a dozen MiG-29s, the most advanced fighter aircraft in the Russian arsenal). In voting for a May 16, 2006 UN Security Council resolution that compelled Khartoum to allow a UN Department of Peacekeeping assessment mission into Darfur, China made clear that it would vote for no more resolutions under the required Chapter VII authority. Immediately following the vote, China's deputy ambassador to the UN declared that this vote, adopted under Chapter VII authority, "should not be construed as a precedent for the Security Council's future discussion or adoption of a new resolution against [sic] Sudan." Moreover, China was instrumental in forcing the removal of language from the resolution that would have allowed some UN peacekeepers from the large force already in southern Sudan to move to Darfur.

China and Russia have subsequently had an easy time in obstructing forceful UN deployment, as the US and other international actors continue to insist that any deployment be consensual, i.e., that Khartoum accede to the entrance of a UN peace support operation. It has become inescapably clear that the regime has no intention of allowing the required force into Darfur, and the vigorous determination that informs this decision cannot be understood apart from China's expressed willingness to use its Security Council veto to obstruct non-consensual deployment.

This unconditional support from a veto-wielding member of the Security Council has encouraged the NIF to believe that it may with minimal consequences realize its genocidal ambitions in Darfur. The hopelessly inadequate African Union force has been funded through September, but there is no prospect of any significant improvement in performance. On the contrary, violence is accelerating, the AU is mounting fewer patrols, and (dangerously) seems to have sided with Khartoum and one particularly brutal faction of the Sudan Liberation Movement/Army (which, while signing the Darfur Peace Agreement (DPA), has subsequently engaged in extremely destructive attacks against those that refuse to support the DPA, including civilians).

A major escalation of fighting is imminent, and yet the international community is intimidated by the threat of a Chinese veto. Unwilling to force a vote that would reveal UN Security Council impotence in

responding to what has widely been described as the world's greatest humanitarian crisis, the UN Secretariat, the European Union, and the US have all indicated that they will wait to secure Khartoum's consent.

This UN paralysis is conspicuously not in the interest of either the organization itself or of the US, which in the wake of the Iraq war is even more dependent upon UN authority in acting abroad. Yet China's powerful influence and interests in a range of international issues of geostrategic concern to the US—North Korea, Taiwan, Iran, international terrorism, trade, and arms dealing—have so far paralyzed the US, as well as its European allies. Unless there is a significant diplomatic, political, or economic cost to China for its brutal obduracy, Beijing will remain convinced that Darfur is of only marginal interest to the West.

Here it is important to recall that the US, all the nations of Europe, Canada, and Japan are signatories to the 1948 UN Convention on the Prevention and Punishment of the Crime of Genocide. These nations are contractually obligated to "prevent genocide" (Article 1). The US Congress voted in July 2004—in a unanimous, bipartisan, bicameral resolution—to declare the realities in Darfur genocide. The President, as well as the former and current Secretaries of State, has determined that genocide is occurring in Darfur. The Parliament of the European Union voted (566 to 6) in September 2004 to declare that the realities in Darfur are "tantamount to genocide"; senior officials of both the British and German governments have determined that genocide is occurring in Darfur, as have numerous human rights, religious, and scholarly organizations.

There is a tremendous cost if this document, born out of the ashes of the Holocaust of World War II, loses the force of both moral and legal obligation. And yet acquiescing before China's protection of its client state—or more particularly the security cabal that rules in Khartoum—now takes the form of a conspicuous abandonment of this fundamental international obligation under the Genocide Convention. Moreover, the emerging norm of an international "responsibility to protect" civilians who are unprotected in their own countries is also being flouted by Chinese obduracy. At the September 2005 UN World Summit, all member states declared that they were,

"prepared to take collective action, in a timely and decisive manner, through the Security Council, in accordance with the UN Charter, including Chapter VII, on a case by case basis and in cooperation with relevant regional organizations as appropriate, should peaceful means be inadequate and national authorities manifestly failing to protect their populations from genocide, war crimes, ethnic cleansing, and crimes against humanity and its implications, bearing in mind the principles of the Charter and international law." (Summit Outcome document, Paragraph 139)

Darfur makes clear that this statement is utterly vacuous.

The Darfur crisis also raises important issues of regional stability, particularly in eastern Chad, where genocidal violence is now rapidly spilling into this region immediately to the west of Darfur. Khartoum's brutal military proxies—the Arab Janjaweed militias—are engaged in widening civilian targeting of the non-Arab or African tribal populations of eastern Chad, as they have in Darfur for more than three years. Equally worrying, Khartoum is supporting rebels seeking to overthrow the Chadian government of Idriss Deby (the rebels are armed primarily with weapons of Chinese manufacture). There is little that holds this rebel coalition together, and while Deby is a corrupt and cruel leader, his violent removal under present circumstances may well usher into Chad an era of what one regional observer has called "Somaliaization." Violence in eastern Chad has already created instability in northern Central African Republic, and could conceivably be destabilizing to Cameroon to Chad's west (the two share in an important oil pipeline project).

A refusal to confront the security demands in Darfur and eastern Chad also makes it difficult to convince Khartoum that it must honor the various terms of the north/south Comprehensive Peace Agreement. As indicated, many of the critical benchmarks stipulated in the CPA have not been met by Khartoum. Here again the regime calculates that for all the Western commitment to the Naivasha (Kenya) peace process that

secured the agreement, there will be no excessively punitive measures if Khartoum continues to renege. The National Islamic Front, which controls all oil concession and operating contracts, counts on Chinese protection at the Security Council. Without a willingness to challenge this reflexively protective response by China, the UN will be unable to impose or enforce serious sanctions against Khartoum, as the Darfur crisis has already demonstrated. Renewed war in southern Sudan would not only be extraordinarily violent and destructive of human life, but poses its own threat to regional security.

## CONCLUSIONS

Oil development in Sudan will improve the lives of the Sudanese people only if there is a much more equitable distribution of oil wealth. But so long as Khartoum is convinced that its ruthless political tyranny, including genocidal warfare, will not be challenged by the international community, it has no incentive to change its behavior. No single consideration weighs more heavily in Khartoum's calculations about the likelihood of any such challenge than China's uncompromising and unqualified support for the regime at the UN Security Council.

No solution to the Darfur crisis is possible without the introduction of a forceful international force under UN auspices; but China, understanding Khartoum's vehement opposition to such deployment, has clearly signaled that it will block any authorizing resolution from the Security Council for a UN peace support operation. In the form of China, Khartoum's genocidaires effectively wield a veto themselves in the Security Council. If the 1948 Genocide Convention is to retain meaning, the key obligation specified ("to prevent genocide") must outweigh a reluctance by the US and other Western powers to confront China over its willingness to give unconditional diplomatic support to Khartoum.

Regional stability must play a much greater role in US thinking about the consequences of letting ethnically targeted violence continue to bleed into eastern Chad, with potential effects on the central government in N'Djamena, Central African Republic, Cameroon, and possibly other neighboring countries

Nor can peace be sustained in southern Sudan in the absence of full compliance with the terms of the Comprehensive Peace Agreement. And yet China continues to support Khartoum in those military actions in southern Sudan that violate key terms of the security protocol within the CPA. Ongoing violence in the oil regions—recently escalating in several locations—is sustained in part by China's refusal to adhere to any human rights standards, its refusal to criticize Khartoum's atrocious human rights record, and through China's role in expanding the military infrastructure that threatens an ever-greater number of southern civilian populations in Upper Nile Province. In the increasingly likely event of renewed war, Khartoum's rapid deployment of mechanized military force will produce extreme violence, with massive civilian destruction and displacement.

The US invested a great deal of diplomatic capital and energy in the CPA; this risks being lost if Khartoum does not feel much greater pressure to abide by its terms. Ultimately this will entail demanding more of the UN Security Council, including the possibility of targeted and highly punitive sanctions on leading members of the National Islamic Front.

China will not easily be moved from its present position of unqualified support for Khartoum in all actions; international acquiescence to date has only made the task harder. But unless there is a willingness to confront China over the critical issues facing Sudan, the current National Islamic Front regime will continue in its ruthless and brutally destructive ways.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. Dr. Ratliff.

**STATEMENT OF DR. WILLIAM RATLIFF  
RESEARCH FELLOW, CURATOR, HOOVER INSTITUTION  
STANFORD UNIVERSITY, STANFORD, CA**

DR. RATLIFF: I want to thank the Commission for inviting me to meet with you today. Since this is one of the truly distinguished commissions working on U.S. policy issues, it is a special honor to contribute in whatever way I can to your work.

I applaud statements in your 2005 Report to Congress that the U.S.-Chinese relationship, quote, "is not inescapably destined to be adversarial, that it is vital for the United States to recognize that in many respects China has different interests, goals and values than the United States, and that perhaps the greatest challenge is to develop a coherent strategic framework for approaching China in a way that protects vital U.S. interests while recognizing legitimate Chinese aspirations."

Understanding China doesn't mean caving in on basic issues when they are at stake, but it gives us the possibility of working as pragmatic equals to make the world a safer place for all of us. I will break my comments down into three often overlapping categories intended to respond directly to the questions put to me in my invitation.

They are, first, how Chinese policy affects Hugo Chavez; second, the impact of Chinese policy in Venezuela more generally; and third, whether China's outreach poses a threat to U.S. and democratic interests in the hemisphere.

Hugo Chavez' attitude toward the United States preceded any relationship with China, and thus is no way a result of that relationship, and links between Venezuela's oil production and China began before Chavez took office. Chinese investments do bolster Chavez in a sense, but just as do investments from many other nations and companies. Chavez has already tried to pull China into its disputes with Washington, but the Chinese have not taken the bait. This is with respect to Venezuela.

The Chinese view Chavez as both an opportunity and a potential threat. To a degree Beijing does not mind Venezuela's creating some challenges for the United States in the hemisphere. However, since China's highest priorities are development at home and international ties that sustain that development, the PRC wants a stable Western Hemisphere where contracts are honored and deliveries are on time. China will not lightly tolerate production inefficiency resulting from political and ideological grandstanding or decision-making.

For the foreseeable future, China's impact in Venezuela will be mainly in investments in oil and infrastructure. This will be a largely positive thing for Venezuela and the world since China will supply both funds and expertise that will extract more oil for world use.

If some of this oil does not go on to the open market, its presence

will free up some other oil that is on that market, and it should be noted that these investments are not gifts from China. If the PRC did not invest in this development, someone else would. There are plenty of companies wanting to do so. The State Department has tallied almost 60 companies from 14 countries involved in one or more aspects of Venezuela's oil sector alone.

Chavez says he hopes to supply up to 20 percent of China's imported oil, which in 2005 was about 3.5 million barrels per day. If Venezuela were to supply that percentage today, it would be about 700,000 barrels per day, a bit over twice the projected goal for the end of 2006.

If Chinese exports rise to seven million barrels per day in decade, as many estimate they will, Venezuela would then have to provide some 1.4 million barrels a day, about what it currently sells to the United States. If Venezuelan production increases significantly in the years ahead, then deliveries to China would not have to come at the expense of the United States unless of course the increase were sold to India and other countries.

The increasing Chinese presence in Latin America is not likely to substantially alter political conditions in the hemisphere. In April 2006, Chinese Latin Americanists in Beijing reportedly told a top U.S. official that the PRC is not going to export any sort of "political model" to Latin America.

Indeed, the Chinese know that doing so would not serve their interests and not only because it would annoy the United States. A very high Communist Party official told me recently that China is quite satisfied with traditional Latin American power structure which consists of elite leaders who service foreign buyers of raw materials and other products.

Clearly, a Chinese presence is not likely to substantially advance democracy in Venezuela and the region. But then all of our own off-again/on-again efforts over many decades have hardly changed living conditions or equality of opportunity in the hemisphere. These have been essentially stagnant for more than 500 years, mainly because of the remnants of traditional Latin American/Hispanic culture and institutions.

In this respect, the Chinese presence is largely irrelevant. In fact, in economic terms, as more Chinese settle in Venezuela and Latin America, they may be something of an engine for growth as overseas Chinese communities have been in Southeast Asia.

Even China's limited military ties to Venezuela should not yet cause any alarm. In contrast to serious armaments provided Chavez by Vladimir Putin in Moscow, the most important item the Chinese have provided so far to Venezuela is the land-based JYL-1 mobile air defense system.

Even when supplemented by the air-based radar of the Russian SU-30 fighter jets that Chavez is just getting, this is still a strictly defensive

system. Thus far, most of China's activities in Venezuela have been largely what one might expect from a large, strategically located, rapidly modernizing nation seeking to overcome a century and a half of failure and humiliation and expecting to take its place as a major stakeholder in the modern world. If they should become otherwise, we would have to watch them very closely.

Thank you.  
[The statement follows:]

**Prepared Statement of Dr. William Ratliff  
Research Fellow, Curator, Hoover Institution  
Stanford University, Stanford, CA**

I want to thank you for asking me to prepare testimony on Chinese-Venezuelan relations and for inviting me to meet with you today. This is one of the truly distinguished commissions working on U.S. policy issues and it is an honor to contribute in whatever way I can to your work. These hearings are devoted to understanding what I think is the most important international relationship, the one with China generally, that the United States will have over the next few decades or more. Nothing in international affairs, including perpetual wars in the Middle East and Latin America's perennial inability to get its act in order, is nearly as important for the United States as devising a strategy that will encourage China to become a "responsible stakeholder" in the modern world. I applaud the Commission's statements in the *2005 Report to Congress* that the U.S.-Chinese relationship "is not inescapably destined to be adversarial, [that] it is vital for the United States to recognize that in many respects China has different interests, goals and values than the United States [and that] perhaps the greatest challenge ...is to develop a coherent strategic framework for approaching China in a way that does protect vital U.S. interests while recognizing legitimate Chinese aspirations."

As you all know very well, it is likely to become increasingly difficult to deal with this challenge. Analyses must be undertaken with cold objectivity and balance on the basis of as solid data as can be collected. Only then can we try to factor in the deeper level of China's aspirations, as best we can ascertain them, in the context of our own interests. And only then can we deal with the potentially disruptive encounter of two civilizations each of which has a very elevated vision of its own moral rectitude. Demonstrating that we understand China's "different interests, goals and values," as you said last year, will give us greater credibility when dealing with Beijing and, one hopes, encourage the Chinese to be ever more objective in their dealings with us. Understanding China doesn't mean caving in when basic issues are at stake, but it gives us the possibility of working as pragmatic "equals" to make the world a safer place for us all.

**Chinese Policy toward Latin America/Venezuela.** China's general foreign policy today is ultimately at the service of domestic economic development. Most of China's industrial output is energy driven and thus the country's rapid and sustained growth has led to unprecedented demands for energy resources. Maintaining anything like the current rate of development requires stability in China and the secure delivery of energy and other resources from abroad. Now that "abroad" has come to include even Latin America. Already trade with some Latin American countries is becoming quite important for both Chinese and Latins, though China's trade with the Hemisphere is still dwarfed (even in Venezuela) by Latin trade with the United States. Both deliveries of energy resources, and trade more broadly, require a substantial degree of international stability, a critical objective of China's policy today.

But China also wants to play an increasing role in world affairs, though often in a somewhat muted, non-committal way, and to promote this its leaders strive to reduce Taiwan's political representation around the world. Latin America happens to harbor about half of the countries worldwide that still diplomatically recognize Taipei over Beijing. When Chinese Latin Americanists met with U.S. Assistant Secretary of

State for the Western Hemisphere Thomas Shannon in Beijing several months ago, they reportedly told him that though China will not get involved in Latin politics generally, it will work to convert Latins who remain loyal to Taiwan to turn to Beijing.

China's emergence in Latin America has also been facilitated enormously by the virtual withdrawal of U.S. attention from the region. While President Bush once promised that he would devote special attention to the Hemisphere, assorted events ranging from 9/11 to Iraq have changed all that and it is decades since our relations south of the border have been as rocky with such a broad cross-section of Latins as they are today. The past few years have been a time when U.S. policy in Latin America required some very special attention, for a variety of reasons, and it has received nothing of the sort. For starters, there is an almost continent-wide frustration with the incomplete market-oriented reforms undertaken in many countries during the 1990s, whose general failures a high percentage of Latin Americans blame directly (and usually demagogically) on the United States. The most spectacular failure was, of course, in Argentina, where the National Congress cheered the largest debt default in world history. To that frustration, add what most Latins see as arrogant and self-serving American foreign policies generally, from Iraq to the war on drugs, and you have the perfect setting for a resurgence of anti-Americanism in the region. In reality, Latin America suffers fundamentally from cycles of failure attributable above all to its own culture, leaders, institutions and the perpetual search for scapegoats to explain failure rather than an knuckling down to change and get things done. So America is again under fire, not always undeservedly, in the region and in line with that there has been a resurgence of so-called "leftist" governments. Some like those in Brazil, Uruguay and Chile are "old leftists" and by and large fairly responsible, while others are more populist/fascist. The latter include Hugo Chavez in Venezuela, Evo Morales in Bolivia, along with their perpetual mentor Fidel Castro, and in many respects Argentina's Nestor Kirchner. As a developing country with a one-party government, China seems the perfect ideological, developmental counterbalance to the United States.

At this juncture China gets the benefits of many more doubts than the well-worn United States. Hu Jintao and some other Chinese leaders have managed to portray themselves not so much as anti-American as caring comrades coming from the same underdeveloped conditions as Latins and thus "one of them." For example, on his way to the Asian-Pacific Economic Cooperation (APEC) forum in Santiago, Chile, in late 2004, Hu Jintao broad-smiled and glad-handed his way through several of Latin America's most important countries and received positive media coverage in the others. He spent more time in Latin America on this tour alone than President Bush has during his entire presidency. Hu toured with a large delegation of Chinese businesspeople as the president of the world's most populous and rapidly growing country. He seemed to show some concern for and recognition of the frustrations and aspiration of the region and he made many offers and promises of trade and investments that appealed to Latins generally. Many promises have not materialized, but the generally positive impression has persisted.

Hu came over in stark, marked contrast to President Bush, who also attended the Santiago session, managing mostly to fortify Latin perceptions of him as a bully with no concern for the region. During his very brief visit in Santiago the American president is remembered mainly for a widely reported and highly ridiculed scuffle with Chilean security personnel. On his way home, he stopped in only one other country and for only a couple of hours: Colombia, to strategize on the drug war. The Latin reading was that the United States was as usual interested only in matters that directly interested the United States, U.S. security. During this same period the U.S. has been undercut as well by its own laws, which Latins (and others worldwide) have seen as unacceptably self-serving. One such is the doubtless well-meant but very counterproductive American Service-members Protection Act of 2002, which caused a dozen Latin American countries to break very long-lasting military ties to the States and opened wide the door for China to step in, which the PRC did, to provide military training and some light supplies.

**Venezuelan President Chavez.** Hugo Chavez is the essential ingredient in the development of the growing links between Venezuela and China. He is a renegade paratrooper who was overwhelmingly elected president in 1998 by an electorate that declared itself fed up with what it considered the failure of several decades of democratic governments to serve broad popular interests. Buttressed by petro-dollars, Chavez



has exploded on the Latin American stage as the filthy rich, self-appointed successor to Fidel Castro, the caudillo whose failures are too obvious to bother noting here and yet whose popularity persists because he defies the United States in a Hemisphere many still say is in America's pocket. Indeed, Chavez has been enthusiastically anointed by the Cuban *barbudo* himself who stretches out his hand, as he once did to the Soviet Union, to receive what the traditional Chinese might have called tribute, foregoing the kowtow, in the form of substantial petro-largesse.

Chavez is a colorful example of that cyclical Latin American phenomenon of the macho anti-American caudillo who is far more remarkable for his crude, punchy personality and popularity (with some) than for his progressive policies. He seems to offer hope where others have failed, though in fact he has little to offer besides a heady defiance that will guarantee future frustration and further failure perpetuating the same old cycles in Latin America. Chavez professes a profound admiration for Mao Zedong that is rarely found in China today and he wants Latin America to rise up against the United States, under his leadership and in Fidel's image, and create a so-called "Bolivarian" America that is no longer dominated by foreign exploitation and their Latin "leaches and stooges."

**China and Venezuela.** China is interested in Venezuela mainly for its oil. Chavez sees China as a country that is both critical in some respects of the United States and a major market for Venezuelan oil, and that market seems an ideal way to both reduce or end Venezuela's dependence on the United States and at the same time, and almost as importantly, to drive Washington crazy. In strictly business terms, the United States and other American nations are the natural markets for Venezuelan oil, but for Chavez anti-American politics very often trumps geographical realities and strict business sense, while the opposite is true of the Chinese. They like the development of additional regions of power to counter uni-polar Washington, and a bit of anti-Americanism in the Western Hemisphere, but not at the possible expense of receiving resources on time. In broad terms, Venezuela's links to China are at this point incomparably less "threatening" to the United States than its ties with Russia in particular but also to Iran and North Korea. Events and many interviews in the U.S., Venezuela and China convince me that at least for the foreseeable future, Beijing's interest in Venezuela is very largely economic and China, which does not have Russia's vast energy reserves, is more put off than enthusiastic about Chavez political campaigns which could result in turmoil in the region or conflict with the United States. At the end of the day, the problem for the ruling Chinese Communist Party is not just the delivery of resources, it is assuring continuing growth in China in order to sustain the credibility of and justification for the party itself.

**Venezuelan Oil.** Venezuela is one of the world's leading oil producers and it has extraordinary reserves, much of it a extra-heavy, sour, highly sulfurous crude and bitumen deposits in the Orinoco Belt in Central Venezuela. The reserves are either the largest in the Western Hemisphere or the largest in the world, depending on what expert opinion you accept, for much information on oil is on the speculative side. Heavy oil has become economically viable since oil prices have gone up so dramatically due to declining supplies of lighter crude oils at a time of rapidly rising demand.

Like other oil producers, Venezuela has taken windfall profits recently, but most independent sources believe that national production has in fact declined from about 3.1 or 3.2 million bpd in 2000 to about 2.6 million today. The Chavez government denies the decline and says it plans to double production by 2012, as the pre-Chavez plans of the state company Petroleos de Venezuela (PdVSA) had anticipated. In a typical act of macho bravado Chavez has threatened to blow up the fields if the United States invades the country, which he charges the Bush administration intends to do in order to overthrow him. Several factors have contributed to apparent stagnation in current Venezuelan oil production. First, the firing of some 18,000 PdVSA workers after a 63-day strike in 2002-2003 and the resulting depletion of technical knowledge and expertise, part of which may be overcome by the use of Chinese and other foreign experts. Other PdVSA problems have ranged from the diverting of company funds to domestic social projects to the rapid tightening of state controls over the oil sector, in the past year converting more than two dozen formerly privately run oil fields (involving 20 companies from Spain to China) into PdVSA-dominated joint ventures. Also, state taxes, many imposed retroactively, have increased greatly and predictably reduced, but not stopped, additional investment. Few were surprised when several months ago Venezuela was the only

OPEC country to call for production cuts, since PdVSA can't meet its current quota.

Another challenge is having so much heavy oil that is useless without special refineries that are not currently extant in China or most parts of the world. PdVSA owns all or part of nine heavy oil refineries in the States, and there are smaller refining operations in Venezuela, Europe, Curacao and the U.S. Virgin Islands. But if Venezuela sells its U.S.-based Citgo facilities now, which it seems set to do, it will not have facilities to refine much of its oil. Though China and others are exploring or building some heavy crude refineries, the process will take time. Besides working to increase refining prospects, PdVSA has announced that it will buy 28 drilling rigs from China and said that by 2008 it will be assembling rigs in Venezuela. PdVSA says it will manufacture its own rigs for the first time by 2010-11, with Chinese help.

**Where does Venezuela's exported oil go?** As the Chinese ambassador to Venezuela said in a long interview in Caracas in mid-2005, the natural markets for Venezuela's oil are North and South America. It takes only four or five days for a tanker to reach the States and as long as bilateral relations were good Venezuela was one of the United States' top five sources: about 1.5 million barrels per day of crude oil and refined petroleum products, such as gasoline and fuel oil, in recent years. But motivated by anti-American politics, Chavez has for several years threatened to stop selling oil to the United States as a key part of his political program to declare "Bolivarian" independence from the States, setting a Venezuelan precedent for what he considers a Hemispheric necessity. Deliveries fell slightly in the first four months of 2006 compared to the same time last year and a growing list of oil sales commitments in the context of stagnant production suggests that deliveries to the States will have to be cut further. Recent agreements have included India (two million barrels per month, for starters), several Latin American states and China.

**China and Venezuelan Oil.** The China National Petroleum Corporation (CNPC), which has operations in twenty countries worldwide, began its investments in Venezuelan oil in 1997, toward the end of the Rafael Caldera administration, and the relationship quickly matured. Hugo Chavez, who considers himself a "soul-mate" of Mao Zedong, was drawn to China for political and politically induced economic reasons. Besides panicking Americans, China is also a market and sales have grown from 12,000 bpd in 2004 to about 130,000 bpd at the end of 2005 with a goal of 300,000 by end of 2006. Chavez has spoken frequently of supplying up to 20% of China's future oil import needs. China also invests substantially in Venezuelan oil, just as it tries to invest in oil fields and production around the world, from Iran, Sudan, Nigeria and Canada to the United States. Many deals work out, though a few like Unocal do not. In 2004 China gained permission to develop and exploit fifteen mature Venezuelan oil fields and to build refineries in Venezuela to process that oil. In 2005, Chavez granted exclusive licensing rights to seven companies, including CNPC and companies from India, Iran, Argentina, Spain and elsewhere, to certify and quantify reserves in blocks of the Orinoco belt. China has shown special interest in *Orimulsion*, a patented product made mainly from bitumen in the Orinoco belt and classified as a non-oil hydrocarbon. It is a low-grade, dirty fuel used mainly in power plants. While *orimulsion* production generally may be on its way out, a 2001 agreement between PdVSA and China, designed to produce the fuel exclusively for shipment to China, is going ahead. A power plant built specially to burn this product was started in China's Guangdong province in 2003 with a completion date of late 2006. While some *orimulsion* has been going to China for several years, greatly increased production came on line in April 2006 and with the arrival of that *orimulsion* in China, Venezuela became China's second most important power fuel provider, still behind South Korea, but pushing Russia down to third place.

**Challenges Delivering Oil to China.** Of course Chavez couldn't play this economically ridiculous political game if it were not for the astronomical oil prices and profits that came his way in recent years. But money and vehemence alone are not enough for a successful reorientation of Venezuela's traditional oil deliveries from the U.S. to Asia, or China particularly. Besides resistance from many Venezuelans and outsiders, Chavez and potential foreign recipients have practical challenges they have far from overcome, among them production stagnation in Venezuela and inadequate refineries, as noted above, and transportation challenges ranging from distance and shortages of ships to the absence of pipelines or canals. Shipping oil to Asia can take five to almost ten times longer than shipping to the States, depending on routes around South America or South Africa and conditions. Very and Ultra Large Crude Carriers are the

obvious vehicles for such large cargoes but the Panama Canal, so close to Venezuela and “on the way” to China, can’t accommodate these supertankers. There is much discussion in Panama now of expanding the Canal with a “Third Set of Locks.” The projected cost of this project is about \$5.25 billion and it would require seven years to complete, possibly starting in 2007. In mid-July 2006 the proposal was approved by Panama’s president and submitted to the National Assembly. The proposal was also fully endorsed at mid-year by the President and CEO of China Ocean Shipping Co. (COSCO). This expansion would not be an immediate answer to Chavez’s problems, but it could be a major factor in planning Asian shipments in the long term, and Chavez plans to be around for the long term. Another contributor to more economical Asian sales would be a pipeline, either a considerable expansion of existing facilities that run parallel to the Canal in Panama or a new line from Western Venezuela to the Colombian Pacific port of Tribuga, which has already been agreed to by Chavez and Colombian President Alvaro Uribe. However, while construction of a Venezuelan-Colombian gas pipeline has recently begun, the oil pipeline seems to be on “pause.”

And while shipping routes remain a drawback to China deliveries, the lack of ships does as well. Triangulation is all very well if the necessary cargoes are available, but as is true with most companies they often are not. So Venezuela plans to increase its number of tankers from 21 to 58 over the next seven years, while China and some other countries could provide some ships of their own. Chinese companies are contracted to build 18 tankers for \$1.3B and China reportedly has committed to develop facilities in Venezuela for the construction and repair of vessels. Indeed, China has said it will transfer technology for the building of the final vessels to Dianca so that Venezuela will have its own construction program by 2012. PdVSA has opened an office in Beijing and plans to build a super-tanker shipping terminal east of Havana, Cuba.

**Other Chinese Ties to Venezuela.** China has other links to Venezuela, including a rapidly increasing level of bilateral trade which amounted to an estimated \$3 billion last year. (U.S.-Venezuelan bilateral trade was \$40 billion.) The State Department reports that Chinese investments in Venezuela are about \$2 billion, in the oil field discussed above, in mining and other areas. The other investments and agreements relate to the following. The China Great Wall Industry Corp was contracted by Venezuela to design, manufacture, test and, in 2008, put into orbit the VENESAT-1 satellite. Named “Simon Bolivar,” it will blast off from Xichang Satellite Launch Centre in Southwest China in 2008 atop a Long March 3B rocket. It is designed to have a mission life of 15 years during which it will “guarantee” Venezuela’s “autonomy in telecommunications” and facilitate the development of the country’s film, television, cultural and educational programs. An exchange program for TV and radio broadcasters was signed in 2006. Venezuela will be able to broadcast programs from two channels of Central China TV and have access to China Radio International programs in a variety of languages. Huawei Technologies, the biggest telecom equipment maker in Shenzhen announced it signed a network contract with Movilnet, the wireless business unit under Cantv, the leading provider of telecommunications services in Venezuela, making Huawei a leading provider of CDMA equipment in the country. Finally, in addition to computers with Chinese technology, selling some Chinese cars and other activities, Venezuela has received three JYL-1 mobile air-defense radar systems, including a command-and-control center, technical support and access to a satellite communications network.

### **Conclusions and Recommendations**

- So far most of China’s activities in Venezuela and beyond have been largely what one might expect from a large, strategically located, rapidly modernizing nation seeking to overcome a century and a half of failure and humiliation and expecting to take its place as a major “stakeholder” in the modern world.
- Where China’s actions do not seem to be part of the normal development of an emerging major international player, or seem to pose a significant threat to U.S. interests, those activities must be closely followed and objectively evaluated according to the kinds of guidelines in last year’s Commission report to Congress.

- Some Chinese leaders look at the history of Western colonialism in Asia and China, recent U.S. military campaigns from Kosovo to Iraq, and U.S. military ties to Taiwan and other Asian nations, and conclude that they have reason to fear a threat from the U.S. Recall the passage in the Commission's 2005 report (p. 119) quoting Paul Godwin that "a careful reading of China's defense white paper reflects a 'fundamental apprehension of U.S. power and military presence both globally and in the Asia-Pacific region'." Similar apprehensions are expressed in the current edition of the Communist Party's ideological mouthpiece, *Qiushi*. Some of the current actions of the Chinese government are founded in this concern.
- Thus the motivations for some of China's policies must be evaluated objectively by Americans seeking to devise policies that will both recognize China's concerns and protect legitimate U.S. interests. This means understanding that while we Americans think we are the great defenders of peace and virtue, the Chinese consider themselves the same. This adds to the challenge of bilateral relations in the global context.
- The "values" of China's "value neutral" foreign policy, by which it strikes deals with Sudan, Iran and Venezuela, among others, are national interest, first, and second, non-interference in the affairs of sovereign nations. This has drawn criticism from abroad, though the former at least is standard policy for us as well. Over time the U.S. has worked with Stalin, Saddam Hussein, Manuel Antonio Noriega, the Saudi Royal Family and military governments from Greece to Guatemala when doing so seemed to serve U.S. interests.
- Chinese leaders are convinced that their economic progress has come in large part because it was not accompanied by the give-and-take of substantial political reform. "Chaos" (luan), which has characterized so much of modern Chinese history, is undoubtedly the most feared condition to Chinese leaders and people. The leaders believe that order is still essential to continue productive economic change. Many outside commentators and some Chinese, however, believe the limitations on political and some other rights, and the absence of an impartial and effective legal system, are already threatening China's continuing progress.
- In 2005 China imported about 3.5 million bpd of oil. If Venezuela were to supply 20% of that amount today, it would be about 700,000 bpd, a bit over twice the projected goal for the end of 2006. If Chinese exports rise to 7m bpd in a decade, as many estimate they will, Venezuela's supplying 20% would mean some 1.4m bpd, about what the South American country currently sells to the United States. If Venezuelan production does in fact increase substantially, then the Chinese deliveries would not have to come at the expense of deliveries to the United States, unless the increase were sold to India or others.
- The increasing Chinese presence in Latin America is not likely to substantially alter political conditions there. In April 2006 Chinese Latin Americanists in Beijing reportedly told U.S. Assistant Secretary for Western Hemisphere Affairs Thomas Shannon that the PRC is not thinking to export any sort of "political model" to Latin America. Indeed, the Chinese know that doing so would not serve their interests, and not only because it would annoy the United States. A very high Communist Party member told me recently that China is quite satisfied with the traditional Latin American power structure that is controlled by elites and largely set up to service foreign buyers of raw materials or other products.
- Clearly a Chinese presence is not likely to substantially advance democracy or equality of opportunity and living conditions in Venezuela or the region. But then progress on those fronts has been very slow at best in the region since the Iberian powers departed long ago and in this respect the Chinese presence is largely irrelevant. The chief obstacles to change have always been traditional Latin American/Hispanic culture and institutions. The Communist Party official

himself noted above remarked that the current political systems in most Latin countries are not really very democratically representative.

- In economic terms, as more Chinese settle in Venezuela and Latin America, they may become something of an engine for growth as overseas Chinese communities have been in Southeast Asia. Some outsiders have worried that Chinese crime syndicates may become more active, and while that is in some degree probable, the positive developmental aspects of a Chinese presence are likely to be greater, particularly in a local culture that can't focus well on real change.
- For the foreseeable future, the Chinese presence in Venezuela will be felt mainly in economics as a result of investments particularly in oil and related industries. This will largely be a positive thing for Venezuelans, since the Chinese will supply not only funds but some expertise, and the result will be more oil on the world market. If much of that particular oil is earmarked for China, it will thereby free up other oil worldwide for other users.
- If the Chinese did not invest in this development, someone else would. Many foreign companies from Europe, the States and beyond have invested in the past and are still doing so today. In terms of taxes, China is evidently being treated much like other investors.
- China's strategy of buying into fields rather than relying on markets for oil is likely to prove wrong-headed for in a time of serious crisis shipping lanes from Venezuela will be subject to easy disruption by any major adversary. That is one of the main reasons China is developing its military, particularly its navy, to try to defend shipping lanes, though in a crisis that would probably be futile.
- Investments by China and all others do of course bolster Chavez, but the Chinese role in this is not significantly different from that of other Western and other investors, of which there are and will continue to be many, or of trade partners for that matter. It is important to keep in mind that according to the U.S. State Department, almost 60 companies representing 14 countries are involved in one or more aspects of Venezuela's oil sector.
- Hugo Chavez's attitude toward the United States preceded any relationship with China and is in no way a result of that relationship. Indeed, if the Chinese had their preference, it is likely they would get Chavez to back off or at least tone down his political activism in Venezuela and the region.
- The Chinese view Chavez as both an opportunity and a threat. He is an opportunity because without him there probably would be no significant Sino-Venezuelan relationship at all. Still his actions could very easily antagonize the United States and threaten deliveries of needed resources.
- To a degree, Beijing does not mind Venezuela's creating problems for the United States in the Hemisphere, because if American companies are driven out of Bolivia, for example, at least theoretically this opens the door to Chinese companies. That doesn't mean Chinese companies, expecting results, would in the end be any more successful in Bolivia or wherever. More importantly, Chinese leaders have higher priorities and they know this disruption business is dangerous in countries where they have invested and may ultimately be uncontrollable, raising fears on the global level of the chaos they fear at home.
- China's land-based JYL-1 mobile air-defense radar system is defensive, and its value will be supplemented by the air-based radar of the Russian SU-30 fighter jets Chavez has just arranged to get from Vladimir Putin, along with many other weapons. Chavez actively cultivates ties to any government Iran, North Korea and Russia, or any government that will provide some sort of moral

support and/or materiel backing. In armaments, thus far China is one of the lesser U.S. worries in Venezuela.

- Since China's primary reasons for involvement in Venezuela are related to development at home, Beijing is likely to insist just as much as any commercial company that Venezuela give value for investments. China will not lightly tolerate production inefficiency resulting from political and ideology grandstanding or decision-making. The Venezuelans may in time find "Ugly Americans" replaced by "Ugly Chinese." What a wake-up it will be for China when it becomes another scapegoat for Latin America's perpetual failures.
- Chavez has often tried to "use" China in his disputes with the United States – as when threatening to give China its F-16 planes that the U.S. does not want to update. But the Chinese are not going to allow Chavez to drag them into a serious dispute with Washington that would complicate broader U.S.-China relations.
- After his visit to Beijing in April 2006, Assistant Secretary Shannon said that China's military engagement in Latin America is "pretty light, by our standards." General Bantz Craddock of the Southern Command has said much the same thing, even warning that some U.S. laws, particularly 2002 Service-Members legislation, have greatly disadvantaged us in the region and opened the door to greater Chinese involvement. This law must be changed immediately to minimize damage. For practical reasons at least some of those Latin countries would undoubtedly be prepared to restore military relations with the U.S. that were terminated because of the Act.
- Some Venezuela-related Chinese interests in the region may offer opportunities to bring China in as a responsible stakeholder. For example, I agree with then Deputy Assistant Secretary of Defense Roger Pardo-Maurer who testified in September 2005, "to me the [Panama] canal is actually a classic example of how bringing **China** in -- or helping **China** become a responsible trading partner -- a responsible member of the world trading community -- is in our interest."

## **Panel VI: Discussion, Questions, and Answers**

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much. Commissioner Wessel, a question.

COMMISSIONER WESSEL: Yes. Actually several, and thank you all for being here. Dr. Reeves, if I could ask you a couple of questions regarding the Sudan and the region as a whole, as well as our own agenda. With regard to China's support of the regime there, what impact is that having with other nations in the region? Is it having any negative impact? Everyone deals with each issue separately and they connect the overall agenda. Are they getting any pressure?

DR. REEVES: The question is an exceedingly complex one in this exceedingly complex region. I think what we need to do is look at the various bilateral relationships in the area. For example, Eritrea and Ethiopia, as my cab driver assured me yesterday, who was from Ethiopia and listened very closely to the news, confirmed what I believed I already knew. And that is that Eritrea and Ethiopia are very, very close to another war. If that occurs, it will be not only immensely destructive, but it will have effects on relations between Khartoum and Asmara, Khartoum and Addis Ababa. There's a very, very important relationship between

Cairo and Khartoum.

To the extent that the National Islamic Front enjoys in the United Nations a virtual veto by virtue of China's doing its wishes, China is consolidating a regime that increasingly receives implicit support from Cairo, very strong support, and turns Asmara and Addis Ababa toward Khartoum seeking support as they want to ensure that they're on the best possible terms if war breaks out.

That's one example. I would say there are different issues, whether we're talking about the Central African Republic at the complete other end of the geographic regional threats, but Northern Central African Republic is now clearly threatened by the Khartoum-backed rebel movements, the FUC, which again are armed primarily with Chinese weapons that flow through Khartoum.

So to the extent that Beijing's support for Khartoum gives this regime a kind of legitimacy, gives it protection at the United Nations, it's going to have a host of effects within the region. We could talk about Libya. We could talk about Uganda and other countries, but the answer is, yes, it's enormously significant.

COMMISSIONER WESSEL: Significant, but China is not paying a price for it is what you're also saying. It is legitimizing and enhancing its role in certain ways with other countries.

DR. REEVES: It strikes me as extraordinary that China pays so little a price for such great complicity in what the U.S. government, both in the executive and congressional branch, have overwhelmingly determined is genocide.

COMMISSIONER WESSEL: In terms of our bilateral foreign policy and the recent meetings with the Chinese, where does this issue stack up in terms of--I know North Korea is probably one through five. Where in the agenda do you see it?

DR. REEVES: Very low. That's my own assessment. Others may disagree and they would point to the number of times that President Bush has used the word "Darfur" and "genocide" in the same press release.

COMMISSIONER WESSEL: Has it been used--

DR. REEVES: If you actually look at the commitment of diplomatic and political capital, either at the U.N., in Brussels, or elsewhere, there has been very, very, very little committed. And the Chinese are reading that quite accurately. When President Bush in February spoke about a NATO stewardship for a Darfur protection mission, the response out of Brussels the same day was "what is he talking about?; there's been no discussion here."

This was simply an off-the-cuff remark that was, in fact, dismissed by the Pentagon itself later that day. There's a great deal of talk about Darfur. As far as actually expending the political and diplomatic capital, it is simply not nearly high enough a priority if halting genocide is one of our central national interests.

COMMISSIONER WESSEL: Let me turn to the other participants as well. The question of the relationship of what claim to be private sector players in China. Many of them, of course, state-invested enterprises versus the government itself. We saw, of course, the question last year here of CNOOC and its attempted purchase of Unocal and claims by the company, which they continue to claim, that despite the investment and significant ownership by the government, they are, in fact, a free market enterprise and are governed only by free market forces and not governmental efforts.

In the areas you have expertise in where I assume not only the aid is also supplanted as, for example, in terms of energy with their private sector firms being engaged, what interrelationship do you see?

DR. REEVES: Say the last part again. I didn't hear.

COMMISSIONER WESSEL: What interrelationship do you see between the, quote, "private sector players" and the government in terms of carrying out policy?

DR. REEVES: In Sudan, I see no evidence that China is behaving as a country that is anything other than defined by corporations like China National Petroleum Corporation, Sinopec, that do not resemble in any way corporations in this country. What we have seen, though, is over many years in-kind trading so that China's arms industry corporations or entities will ship sometimes surreptitiously weapons to China for other oil revenues or, prior to the first shipment of oil in August of 1999, the promise of anticipated oil revenues.

China prefers in-kind trading. It prefers the opacity to which it contributes in the way of oil production numbers, oil revenue numbers. It's one of the things that is most difficult for the embryonic government of South Sudan is to get a handle on oil revenues, and the Chinese are a big part of the problem because their own presence there, corporate presence there, is thoroughly opaque and Khartoum is utterly opaque.

So I would say one of the real problems is that Chinese opacity, its refusal to behave as true, open and free. These companies are not behaving freely and openly is that they don't yield data, they don't have shareholders' meetings. They don't do what we would expect of oil companies from Western countries.

COMMISSIONER WESSEL: So they are simply agents of governmental policy masquerading, if you will, as free market companies?

DR. REEVES: I see no evidence of free market behavior on the part of Chinese companies operating in Sudan. On the contrary, they behave in ways that make it clear they are an extension of Beijing's contempt for human rights. We have many reports that the Chinese are hiring militias that serve to protect them in these vast areas that are now, Cordon Sanitaire quote, "unsanitaire," protecting the oil reserves.

Amnesty International reported a number of years ago that Chinese workers were armed and clearly prepared to use their weapons. The hand-



in-glove operation between Chinese engineering and Khartoum's military actions, which I highlighted, again are not the kinds of behavior you would expect from Total Fina or American oil companies or even Talisman Energy, which was a Western oil company involved in Sudan.

DR. GENSER: I would say there's also a similar story that you could tell, an analogous story in Burma. Just looking at the deal PetroChina negotiated with Burma Natural Gas. The natural gas sector is not as mature as in other parts of the world, and so they're building infrastructure from scratch.

I think there are at least three ways where China's state-owned company, in this case, PetroChina has advantages over, let's say, any U.S. company that would ever want to do business in Burma. Obviously, now they can't, but even a private sector entity in other places would not be able to compete with PetroChina.

First of all, of course, PetroChina is heavily subsidized by the Chinese government, making it very difficult to compete. Second of all, you also see that PetroChina is going to benefit substantially from forced labor. You can't really do anything in Burma or build anything in Burma without the use of forced labor, as I said before, 800,000 people involved.

Lastly, I'd say that China's presence, and indeed with the subsidy from the state behind it, is also then indirectly responsible for numerous human rights atrocities being committed by the Burmese junta, and I'm not even talking about all the weapons being sold, which account for more than 90 percent of Burma's armaments, but I'm talking about money being paid to the Burmese regime which spends more than 40 percent of its GDP on defense and less than two percent on health and education combined.

So I think you see in that just one example three effects of a China state-owned company coming into a country like Burma, which is highly, highly detrimental for the people of the country.

DR. REEVES: It's also worth remembering that PetroChina did not exist before 2000. PetroChina is entirely the creation of Goldman Sachs' effort to bring China National Petroleum Corporation to the New York Stock Exchange, and when it ran into a firestorm of criticism from Sudan Advocacy, Burma Advocacy, Tibet Advocacy, organized labor, Goldman Sachs was forced to restructure the deal and create PetroChina, 90 percent owned by parent company China National Petroleum Corporation, the beneficiary of about \$300 million from the IPO, in clear contravention of OFAC rules and regulations, and this is an entirely fictitious entity. It's not a corporation in any recognizable sense.

DR. RATLIFF: I might add, if I may, just a word on Venezuela. The story there I think is different. Clearly, China is interested in not being a typical run-of-the-mill player in the market. They like to go in and buy things and do things on their own and presumably guarantee that 50 percent or whatever it is of the oil produced in this facility will definitely come to China and will be theirs and doesn't go on the market.

I think that's a fallacious strategy myself because I think in the time of a crisis, they're not going to be able to guarantee arrival of oil from Venezuela anyway. And so if they own a lot of Venezuelan oil production it's not going to do them any good. But that's their business and I think they'll learn sooner or later.

Certainly they are not the typical free market operation. Certainly they are more opaque. However, in Venezuela, my own experience and the talking I've done to many, many Venezuelans about this issue, there are none of the kinds of issues that have been raised both in the Burma and the Sudan case of forced labor and things of that sort. In fact, Venezuela is treating the Chinese apparently just the way they're treating other people. When they were forcing all of the companies to convert their private companies into joint operations with the Venezuelan government company charged virtually every company in the country back taxes and they charged the Chinese back taxes along with everyone else.

COMMISSIONER WESSEL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Thank you. We have Burma, Sudan, Venezuela, you start to detect a pattern here without having to be a rocket scientist. You have energy rich pariah states where the United States can't compete, and it's obviously not a coincidence. You can go on and name others as well.

Given the fact that China is concerned about its security of the supply of energy and oil resources, I would gather that it makes sense to, at least from a Chinese perspective, whether fallacious or not, to build proxies if you will, to build countries that you think are going to be able to secure your supply, keep them away from the Americans, and that said, you're going to actually invest in not just arming these countries, but in fact putting your own people on the ground, possibly, again, not just for your conventional arms for oil trade, but also because in a time of crisis, in a time of energy disruption, you might want to call upon these proxies to secure your own energy supplies.

Dr. Ratliff, you minimized the military relationship between Venezuela and China, but couldn't all of you see this plausibly as the way the Chinese are thinking about these particular countries, as proxies in terms of as crisis over energy or oil?

DR. REEVES: It's certainly the case in Sudan. Sudan is China's premier source of offshore oil production and will remain so, and the Chinese don't want anyone else competing, and they are perfectly content with the current relatively low levels but still significant violence that occurs in southern Sudan. They know this level of violence will keep Western oil companies out.

So they have a vested interest actually in seeing the comprehensive peace agreement of January 2005 succeed only very partially. Total Fina

Elf of France has waited a very long time for its enormous concession area in southern, very southern Sudan, to come open. At a certain point, if instability rises again, as I believe it will, Total Fina Elf will consider selling that enormous and almost certainly very, very valuable oil-rich concession to the Chinese because the Chinese are willing to operate in arenas where there is violence, where their own national workers might come back in body bags and where human rights abuses of the worst sort make absolutely no difference in their operating procedures.

DR. GENSER: I think it's again a very similar story with Burma, and I agree with you completely, that locking up the resources for as long as possible is very much in the forefront of China's collectively mind. You look at the length of the contracts that they're signing exceptionally long deals with PetroChina trying to lock up oil resources. The reality is they have the ability with state-owned enterprises to massively subsidize these deals, and frankly I would hardly be one to defend the military junta in Burma, but because they're so isolated, the reality is they don't have the luxury of having a strong negotiating position because they're strapped for cash, and so not only is China getting these exceptionally long deals, but they're also getting them frankly for a substantial discount as compared to what they would have gone for ordinarily if Burma were not a pariah state.

So I think that that is very much in the interest of China. I would say, however, that the arming of the military, which I think you alluded to a little bit, these multiple military armings, at least in the case of Burma, wouldn't have much of a security benefit for the Chinese in that, as I understand it from actually having been there myself to the country but also talking to lots of people who are experts on this topic, the Burmese military is armed primarily with second and third-rate Chinese equipment.

They do have a lot of it, but basically it's their excess dregs of their supplies is what gets sold off to Burma, so they're pretty poorly equipped overall despite having the second-largest military in Southeast Asia.

HEARING COCHAIR BLUMENTHAL: Before turning to Dr. Ratliff, a follow-up question, which is are any of you seeing more of an actual Chinese military presence in these countries, military training, military exercises? And a related question, are we seeing, as we do with North Korea and Iran supporting each other, are we seeing these sort of gallery of the world's rogues supporting each other in any way?

DR. REEVES: Again, in southern Sudan, there have been many, many reports of Chinese workers being armed, many other reports of Chinese workers, oil workers with military backgrounds and able to utilize those military backgrounds.

The pipeline that ran from the Heglig base of operations to Port Sudan on the Red Sea, roughly a thousand miles, was built in very short time under brutal conditions--it cost many, many lives--was done with Chinese prison labor. China will send the labor that it thinks most

appropriate. In the case of southern Sudan, that labor entails needing military experience and clearly many of the engineering tasks are both commercial and military in nature.

DR. GENSER: With respect to Burma, there is a long history of collaboration between the Burmese military and the Chinese military in terms of joint training exercises, training on use of equipment and other kinds of things. So I think that relationship exists and will continue.

HEARING COCHAIR BLUMENTHAL: Venezuela, do you see any?

DR. RATLIFF: The Venezuelan situation is just a very different one from the one described by my colleagues. I think the Chinese do not see any value for themselves in instability in Venezuela. They are not involved so far as any of the sources I have which I believe to be very good ones in providing any kind of support for particular repression.

Hugo Chavez' government is not one of my favorites and it's not a government that I think is taking Venezuela or the hemisphere in a good direction, but I don't have any indication from anyone that the Chinese are involved in this in any way. They prefer I think the stability, as I said, and the contracts to be honored and the deliveries to be made on time.

One could argue that disruptions in Bolivia in the last few years and the over throw of two presidents there make it more difficult for western companies to invest and open the doors for the Chinese. Immediately after Morales took office he went to China and invited the Chinese to invest in Bolivia's Gas sector.

But so far the Chinese have not done so, and I think that the kind of problem that the kinds of problems Americans often face in Latin America are problems that the Chinese are going to face when they get more involved because they are running up against a traditional, Latin American system which is not going to operate in a way that the Chinese want it to operate.

So I think that the time is going to come in some of these countries where the feeling is going to be that the "ugly Americans" have been replaced by the "ugly Chinese," because the Chinese are going to stamp their feet, I think, and say deliver this oil, deliver this product that we want. I don't see them at this point involved in any of these countries in any kind of the activities that my colleagues have been describing for Burma and for Sudan.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you again for your testimony. We've been hearing a lot about the concept of China as a responsible stakeholder and I'm really struck, listening particularly on Burma and Sudan, if this is what the hallmarks of responsible stakeholding looks like, it's going to be an extremely rough century.

But given the Chinese interest in a continuation of the status quo, as you talked, Dr. Reeves and Mr. Genser, in particular, of a status quo that's characterized by violence in Sudan and by tyranny in Burma, why is

the United States government pretending that the Chinese either are or are going to be helpful in solving problems in these countries?

DR. REEVES: I don't think the United States even bothers to pretend that China can be helpful on Sudan other than not obstructing a U.N. resolution authorizing an appropriate force for Darfur. But we are as far away today as we were a year ago. What is occurring in Darfur is the most well-reported genocide in the history of genocide. We have known it at every stage, what is happening and what's necessary to be done.

While the North-South Comprehensive Peace Agreement was being negotiated, the United States was willing to trade out Darfur in order to get that done. That was a mistake in many ways, but that was a choice the U.S. made.

But if you look back over the last year, there is just no sign whatsoever that the U.S. is again committing the kinds of diplomatic or political resources necessary to get this in front of the Chinese, and there's no evidence that the Chinese feel pressure, and there is no evidence that the Chinese are going to back away from what they said after the last resolution required to get U.N. Department of Peacekeeping Officials into Sudan. Sudan had actually said no, we're not going to allow them in, as they refused to allow the International Criminal Court to enter Sudan.

China said after that last vote "we voted for this under Chapter 7. We will make no further votes under Chapter 7," and there is no way that a meaningful peace support operation can move into Darfur without Chapter 7 authority, so we're at a stalemate, and this stalemate is not being highlighted, even as China is at the very center of it.

COMMISSION VICE CHAIR BARTHOLOMEW: Mr. Genser.

DR. GENSER: Yes, I think that with regards to Burma, also I believe that the United States isn't pretending that China is going to be helpful with respect to solving the situation in Burma, but I think more so the administration which has raised the Burma issue with China on many occasions is really trying to outmaneuver the Chinese. And I think frankly was helped in a great respect in doing so both by the actions of the Burmese junta itself, which continue to mystify the international community as they reject the entire world's advice on a whole range of topics, including a recent extension of Daw Aung Suu Kyi's house arrest two days after Under Secretary Gamberi said that he believed that Burma was turning a new page in its relations with the international community, so I think China is cornered a little bit by that.

China is also cornered by the fact that the junta is keeping even them in the dark on a number of these things, and indeed they are receiving these negative externalities. So I think the United States is trying to outmaneuver the Chinese on Burma, and ultimately I think China has bigger fish to fry in the Security Council, which is why I hope that

things might change.

I think the best illustration of it is really the first discussion that took place in the U.N. Security Council on December 10 of 2005, and how we got to that point and how we got to China agreeing, being unanimous, 15-0, to have a private briefing on the situation in Burma.

China obviously opposed having the discussion; they didn't want to do it. They don't believe that Burma should be in the Security Council at all and, as you said exactly, they would like to see the status quo because it allows them to capitalize on the proximity and their relationships and to extract the natural resources of the country.

But what ended up happening is that the United States rounded up the nine votes necessary to put it on the formal agenda, and put China into the untenable situation of either risking having a formal agenda item, which means a public debate on the situation, which means having to prospectively publicly defend the junta, or agree to have a private discussion on the situation in Burma.

Given those alternatives, they chose the least worst alternative, and I think my view is with respect to Burma, that we can see over time, as we have begun to see with respect to the Security Council and the situation in Burma, an evolution towards a resolution, probably in the first instance that's not going to be a Chapter 7 resolution. It may be that there has to be a preliminary step before that of a presidential statement, but the point is that China, as I said, has a bigger fish to fry, and I think that the United States is in a position because of how the junta was acting, because of the change in ASEAN's view on Burma to become much more aggressive with respect to it, and their having said that they'll follow what ASEAN has to say about the situation in Burma because ASEAN is right on top of the situation also.

All of these factors together mean that China can be maneuvered I think to some extent with respect to the situation in Burma, and I think in respects, in many ways, quite different than the situation in Sudan, given their particular relationship.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. I'm going to break with our usual procedure. We have to free Mr. Genser to head off on his vacation in ten minutes. If any of my colleagues have a question specific to Burma or to him? Chairman Wortzel.

CHAIRMAN WORTZEL: What do we know about the health of the Karen National Liberation Army. These are the former Chindits that fought for the British. They are primarily Christians that for a number of years got all of their financial support from Christian evangelicals here in the United States. How is the KLNA's ability to raise funds? Are the Thais still providing passive sanctuary for them, and do they still think it's a good idea to blow up the gas pipeline between Thailand and Burma?

DR. GENSER: This is a little beyond the realm of my expertise. I am generally familiar with exactly what you're talking about, so let me

just speak to within the realm of what I know.

The situation in eastern Karen State right now is very desperate. Again, talking, as the Vice Chairwoman said, about as I was just talking to her about, the junta not making it easy for itself, in the last several months, the junta launched a new offensive in Karen State displacing another 12,000 people internally.

The Karen National Liberation Army has been at the forefront of trying to fight what has been an onslaught of literally multiple battalions of Burmese troops coming in and burning villages to the ground and have done so admirably under the most difficult of circumstances, but you're talking about hundreds of people who are armed. You may be up to thousands, but very, very small numbers relative to the size of the Burmese junta and relative to the overwhelming force that's being brought against primarily civilian populations.

The junta uses the Karen National Liberation Army as the excuse for why they basically make all of Karen State a free-fire zone against civilians, and they have struggled, as I said, admirably against these ongoing military incursions, but continue to face very, very tough times.

They have very little ability, as I understand it, to really raise funds. Not surprisingly, they would be blocked from raising funds in the United States because we wouldn't approve of financing armed activities and with the Patriot Act and expansion of definitions of what is considered a terrorist. Even a person in Burma, we have this problem with refugees coming from Burma now, even a person who for example allowed a person from the Karen National Liberation Army to stay in their home one night, that person could be considered aiding and abetting an armed insurgent and could prospectively be barred from entry to the United States on that basis.

So they're really I think desperate for support. I think ultimately what we need to see in Burma is national reconciliation. There's not going to be a victory I think on the ground on any side by ongoing military conflict.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes, just a quick follow-up question, which is a theme of the day, which is the difference between presence, activism and influence. If China wanted to, besides sort of standing aside and letting U.N. resolutions go forward, if China wanted to exert some real influence in Burma to get the junta to change its ways, could it? Does it have that kind of influence in Burma?

DR. GENSER: I don't know that China knows the answer to that question, both because they don't want to see change, but also because I think they have been surprised by a number of the developments that I've described today. I believe they are in a position more so than any other country in the world to have influence on Burma. I think that that's very

clear given the massive investment.

I was in Burma recently and happened to just be on a toll road between Mandalay and Pyin U Lwin, and it was a toll road built by Chinese dollars and there's a nice sign saying thank you to the Chinese government for having built it, and the Chinese are collecting all the tolls for themselves, having built this toll road. That's just one illustration of one person on the ground.

But they are entering the country particularly up towards Mandalay in droves in terms of just one-on-one business center actions, let alone these massive deals. I believe that based on that, they do have a substantial ability to exert influence if they were to choose to do so. However, how far that would go given the rationality or lack thereof of General Than Shwe does remain an open question because there isn't necessarily a rhyme or reason to how a person who frankly has a sixth grade education and has lived his entire life inside the country is going to make decisions.

So I don't really have a precise answer for you. I think the best hope would be China to be able to exert influence, but the Chinese have tried to exert influence on Burma even in terms of just reducing the outflow of drugs into Yunnan Province and they have been unsuccessful at doing that, and there are lot of other examples that I could point to as well, and so they do have influence more than anyone else, but I'm not so sure if they wanted to, they're not going to be willing to push for democratization, but even if they wanted to go beyond that, to just push for them doing some smart things like policing Aung San Suu Kyi. If China asked, I'm not sure that the junta would say yes because I think that they see their entire existence being threatened by her and by her being released, it would be a serious problem for them because of her popularity still among the Burmese people.

I'm not so sure even if the Chinese were to ask, even with all their influence, even with all their investment, that the junta would necessarily say yes.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much, Mr. Genser. We'll spring you with five minutes to spare. Thank you for your testimony and thank you for your work.

DR. GENSER: Thank you very much, and I apologize for having to step out.

COMMISSION VICE CHAIR BARTHOLOMEW: Enjoy your vacation.

DR. GENSER: Thank you very much for having me. Thanks so much.

COMMISSION VICE CHAIR BARTHOLOMEW Thanks.  
Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you very much, Madam



Chairman. I have a question on Sudan for Mr. Reeves. Just to clarify for the record, I'd like to get your view of the extent of the dependence of the Sudanese regime on the Chinese. Is it such that Sudanese governmental behavior is to a large extent contingent upon Chinese support and that if China withdrew its support for that regime, how would the political situation actually change in Sudan? DR. REEVES: It's an extraordinary hypothetical because there is no imaginable way in which China is going to withdraw or cease to support Khartoum. But certainly we would look elsewhere. We have to look at the fact that Russia also has threatened to veto any U.N. authorization of a peace support operation. Sudan gets reflexive support from the Arab League, the Arab League, which is little more than an extension of Cairo's foreign policy as far as I can make out, and Cairo really does wish to see the current regime remain.

The Organization of Islamic Conference also can be counted on for almost reflexive support for the National Islamic Front, now National Congress party regime.

But when push comes to shove, if the issue before the Security Council is whether there will be a meaningful force to protect civilians and humanitarians in Darfur, humanitarians upon whom quite literally millions of people depend, the support if Khartoum resists at that last moment is certainly most likely to come from China. I'm not sure how fully that answers your question because there other forms of diplomatic support, but in the most extreme situation, in which Khartoum is most desperately reaching out for protection, and there were a point that China says the heat is not worth bearing, that Khartoum will accept some sort of U.N. force.

But I think what China is doing and will continue to do is give Khartoum the political leeway so that it can beat down any U.N. resolution so that it's under Chapter 6, not Chapter 7, and that the rules of engagement are determined not by the U.N. Department of Peacekeeping Operations but by Khartoum itself. That would be the kind of victory that the Chinese would be most enabling of.

COMMISSIONER D'AMATO: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Houston.

COMMISSIONER HOUSTON: Thank you. I have two questions, and I'd like to ask them separately if I may. I think that all the testimony, particularly this panel, is very important to us as far as tangential impacts of China's relationships with other countries and how it impacts our security here, and it's really perceiving the complexity of those relationships that are so important in finding trends that we need to get out in front of instead of having them chase us.

Dr. Reeves, I read something on the Internet the other day. The jihadis now have their own online magazine. It's kind of a policy digest for terrorists, I guess you'd call it, and it's called "Echo of Jihad," and

there was an article in there written by an al-Qaeda operative, and the title of it was roughly translated--my Arabic is terrible--"Africa: Al-Qaeda's New Frontier."

It went on to talk about how the poverty and the corruption in Africa makes it very easy for al-Qaeda to turn to Africa for its new recruits, and it mentioned in the article two things that you mentioned. One is infrastructure building, and the other one is military operations. So I realized that your expertise is certainly Sudan, but if you could just broaden it for us just for a moment, would it be your guess or your estimation that China would pursue in the rest of Africa sort of the similar policy that they have in Sudan and other places where they are building infrastructure and they are doing arms trading?

And when you marry that with this notion that al-Qaeda is going to turn south for its next recruits into the Sufi community as well, would you see China actively involving itself in that kind of strategy in other African nations or do you think it's just going to stay sort of in the places where it is now?

DR. REEVES: Those are two very important and interrelated questions. I think all the evidence to date suggests that China's behavior in Sudan will be replicated elsewhere in Africa and indeed has already been replicated in Africa. China to date has demonstrated absolutely no concern whatsoever for human rights anywhere it operates, none.

It has shown no willingness to criticize either corruption, abusiveness, tyranny, anywhere it operates. China does realize that the United States is deeply concerned about international terrorism and would adjust its policies accordingly.

But if we look at Sudan in particular, which by the way, of course, is the birthplace of al-Qaeda. Al-Qaeda came to fruition in the years '91 to '96 when Osama bin-Laden resided under NIF, National Islamic Front, sponsorship in Khartoum and the environs. China is going to be very wary, given its own domestic concerns about possibilities of terrorism, of being seen to be complicit with terrorist threats.

For example, there have been threats including from al-Qaeda saying that if there is a deployment of U.N. forces to Darfur, it will be the new Iraq, some version of the line that I saw somewhere--if you liked Iraq, you'll love Darfur-- if there's an intervention.

I don't believe that's true for a variety of reasons. First of all, everybody in Darfur is Muslim and most of the Muslims in Darfur are desperate for Western and quite specifically American intervention. But leaving that aside, I do think China would be especially sensitive to being perceived as complicit in activities that in any way support al-Qaeda or international terrorism.

That does not in any way diminish their willingness to turn a blind eye to the grossest of human rights abuses, tyranny, corruption, wherever they work.

COMMISSIONER HOUSTON: Thank you very much. And Dr. Ratliff, you are also an expert on Cuba, and what I'm wondering about is the triangular relationship between Cuba, Venezuela and China. Cuba has recently decided to drill for oil off its northern shelf which is quite arguably the same puddle of oil that we could be drilling off as well, as oil puddles don't really worry about national boundaries too much.

So that money, the infrastructure and the cash to get this done obviously isn't coming from Cuba and it is coming from Sinopec. So what that means is that not only will the oil go to China, but the money will be coming back to Cuba, and when you combine that with the Venezuela oil situation, it's the other exact same other side of the triangle. You've got oil going from Venezuela to China, and then you have money coming back to Venezuela, and of course Hugo Chavez is the best friend of Castro--I guess we should say Castros--and the greatest support for that regime in the entire area there.

So should we be concerned about that oil and money flow as far as Cuba goes? Would you ever imagine any direct China intervention there or do you see it just as an economic relationship?

DR. RATLIFF: Well, I don't anticipate any--you mean military? That kind of an intervention?

COMMISSIONER HOUSTON: Just using that money to prop up--

DR. RATLIFF: Trying to guide the direction of the politics of something?

COMMISSIONER HOUSTON: --a Communist regime in Cuba that we are hoping would fall?

DR. RATLIFF: China has a stake in Fidel Castro, but China really would rather I think see Cuba reform more or less the way China has reformed its economy.

It doesn't really want to carry along a Cuban basket case forever and ever. And its investments there and so forth are helping to do that to be sure, as is Hugo Chavez' support for Castro.

If it were not for Chavez and China, in the last few years, Cuba would have been much more miserable place than it is, and it's already miserable enough. But it would have been much worse, so the Chinese are playing a role there. Are they going to step in and uphold, say, a Fidel type government? This gets into the master debate of what's happening in Cuba as we speak about whether it's going to go into the direction that Raul Castro has on occasions said he would like to go on reforming in a Chinese way. That is to say maintaining an authoritarian political structure, but making significant market-oriented economic changes, which I frankly think if Raul can consolidate enough support, he will do. He may not be able to consolidate the support.

But I think the Chinese would like to see that happen. They like Fidel because Fidel has been very loyal to them in many ways. At the time of Tiananmen, the Chinese Foreign Minister was traveling in Latin

America. He had meetings lined up in several countries. Tiananmen occurred and all the Latin American countries closed their doors except of course Cuba, and so he went to Cuba and Fidel briefed him, because the minister had been out of touch.

And Cuba was the first country to come out and support China on Tiananmen. Very shortly after that Cuba did the same thing to General Ochoa, its main military general, and executed him on trumped up drug charges and the Chinese supported that.

So they do support each other and there is this feeling, but the Chinese, I think, would rather see a Raulista government that reformed and began to make economically intelligent decisions so that country could begin to support itself better. That doesn't mean the Chinese wouldn't continue to become involved and invest there. They certainly would.

But I think they would like to see a change. So your question might apply: would they put money toward supporting that kind of a change? Would they put pressure toward that kind of a change? I think they're more likely to put pressure to that than they would be to keep a Fidelista type of government because Fidel is such a basket case.

I think we do need to watch what China is investing in oil in the Cuba area particularly so long as we have the kind of relationship that we do with Cuba. This might even change also in the years ahead, but I think we should watch what China is doing. They're investing in various aspects of the oil drilling off of Cuba and that could turn out to be significant.

COMMISSIONER HOUSTON: Thank you very much.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Madam Chairman. Let me ask you this. Dr. Cynthia Watson was here. She's a Professor of Strategy at the National War College. I want to see if you agree with this. She said I do not believe China currently, and then she emboldened "currently," poses a significant strategic threat to the United States and Latin America.

Do you agree with that?

DR. RATLIFF: Yes, I do.

COMMISSIONER MULLOY: She also said most important to the Chinese is the relationship with the United States which they would not jeopardize through strengthening their ties to regional governments at the expense of ties to Washington.

Do you agree with that?

DR. RATLIFF: Basically I do, and I would give as an example of that, Hugo Chavez, I mentioned very passing in my oral remarks and there is more detail in my written remarks.

Hugo Chavez has tried very hard to drag China into his fight with

the United States. He keeps saying if we don't repair his F-16s, he's going to give them to China or something like that or he's going to get Chinese weapons. Well, of course, he got Russian weapons instead, but he's been trying to do that, and the Chinese have just put the brake on this. They said thank you, Hugo, we don't want to get involved in this business.

I agree with her first comment; I agree with the second one as well.

COMMISSIONER MULLOY: Yes, on page ten of your prepared testimony you made that point about Hugo Chavez and that they're not going to go in that direction.

DR. RATLIFF: Yes.

COMMISSIONER MULLOY: They don't want to jeopardize their relationship with the United States.

DR. RATLIFF: The relationship with the United States is far more important than the one with Hugo Chavez.

COMMISSIONER MULLOY: What I want to get into is in your view what is so important about their relationship with the United States that they don't want to offend us?

DR. RATLIFF: I think China is very concerned about the United States. A year ago Secretary of Defense Rumsfeld made a comment that he doesn't understand why since the Chinese have no enemies they are insisting on spending all this money on developing their military. Of course, what they're spending is just an infinitesimal amount of what we're spending and we are already light-years ahead of them.

In my prepared testimony I cited a quotation from your 2005 Report to the Congress--that a lot of people in China are very concerned about the United States.

They are concerned about the United States because the United States, but particularly the Western world, has 400 years of history of landing in and ruling countries all over Asia. One year after Kosovo. I talked to a top advisor to the Chinese Foreign Ministry, and he said you Americans have forgotten about Kosovo, but the rest of us around the world are learning its lessons.

Among the lessons that he said people around the world are learning, and I saw this response in other countries in addition to China, is that the United States pays attention to international agreements when it suits its will to do so and creates an ad hoc committee otherwise, that the United States is willing, and this is the main thing that concerns China, to intervene in a sovereign country on issues that the sovereign country, and generally the world, regard as the domestic affairs of that country.

Also the United States has military establishments on three sides of China. We control the seas. 80 percent of their oil comes in by sea and much of it comes through the Strait of Malacca, which we also control. So they are very worried about us and they don't want to make relations

worse.

COMMISSIONER MULLOY: Let me ask you a leading question then. Do you think some of their desire not to offend the United States is because they're getting a lot of wealth out of this country to build their economy, and they're getting a lot of investment, and they're getting a lot of technology, and they're getting a lot of R&D? Do you think that plays a role in their thinking? We don't want to offend this group because we're doing pretty well by them right now?

DR. RATLIFF: Of course that's also important. I'm just talking one side of it, why the Chinese are concerned about us. What they get from us in trade is an important part of it as well. Of course they also own most of our debt so they're helping to sustain our fiscal policies. So I mean it's a great big complicated stew of factors.

COMMISSIONER MULLOY: Well, it's GMAC financing. In other words, they're providing us financing to continue to buy their goods.

DR. RATLIFF: That is an important part of it. Absolutely.

COMMISSIONER MULLOY: Dr. Reeves, you tell us that they don't seem to be afraid of offending us in Africa because we don't want them doing what they're doing in Darfur, but they're going to do it anyway. Why is there a difference between how they think about us in Latin America where they don't want to risk offending us and how they think about us in Africa where they will risk offending us?

DR. REEVES: I'm not sure there's an entirely clear answer. Part of it is the difference in development in Latin America as opposed to Africa. If you look at Sudan, excluding the Nile River Valley, take southern Sudan, for example, which may if it ever has a self-determination referendum become an independent country. If it does, it will that day become the least developed country in the world without a close rival. Part of China's attitude towards Africa and Africans is a function of the chaotic nature of governance in so many African countries including Sudan. China, of course, is not in Darfur. They're simply enabling the Darfur genocide to proceed both by virtue of weapons transfers and political and diplomatic protection.

But I think the deeper answer to your question really has to do with the U.S. relationship to South America as opposed to the U.S. relationship to Africa.

COMMISSIONER MULLOY: So you think that historical Monroe Doctrine type thing carries weight?

DR. REEVES: Exactly. And again what troubles me most about U.S. policy towards Sudan is that it seems fitful and inconsistent. The only special envoy appointed to date by President Bush was John Danforth who at least presided over the Comprehensive Peace Agreement, one of the really important diplomatic achievements of the last decade in Africa.

At the same time that was being negotiated, though, Darfur was aflame and nothing was being said. And the administration seems

paralyzed in responding to Darfur. There have been other points of engagement. Tony Lake was deeply involved in negotiating the peace agreement that may break down, but between Eritrea and Ethiopia. There are times when the United States has played a tremendously important role, but it has not been consistent and it has not been sustained.

I think U.S. diplomatic relations and interests, political interests, in South America and Central America and Mexico have been much more consistent over the years.

DR. RATLIFF: May I?

COMMISSION VICE CHAIR BARTHOLOMEW: Please go ahead. We have time.

DR. RATLIFF: Speaking of a fitful policy, one of the real reasons the Chinese have made so much relative progress in Latin America is because of our fitful interest in Latin America. No time in the decades that I've been following Latin America have I known U.S. relations across a broad spectrum to be so bad as they are today.

The president said when he was running for office this was sort of the era of U.S.-Latin American relations. It has been the era of non-U.S.-Latin American relations, and the relations down there are very bad. Hu Jintao spent more time in Latin America in November of 2004, and he went back later, than President Bush has during his entire presidency, and when Hu Jintao went around, he glad-handed and he broad-smiled all of the people that he met in the various countries and he got really a good press.

China's relations in parts of the region have declined since then because some things he said didn't actually happen, but by and large he got a very good press. President Bush went down and fought with the security officials in Chile and stopped for a couple of hours to talk drug war in Colombia.

President Bush was in and out just like that and people down there noticed. I went into some of these details in my paper. This is a period when there are lots of issues we should be dealing with, but fitful is the nicest thing you can say about our policy toward Latin America. It's almost nonexistent.

COMMISSIONER MULLOY: Thank you very much.

DR. RATLIFF: Yes.

COMMISSION VICE CHAIR BARTHOLOMEW: Commissioner Wortzel.

CHAIRMAN WORTZEL: Dr. Reeves, I got that most recent Amnesty International report on China's arms sales in Sudan. Amnesty did a great job on it, and I notice that you refer to it pretty heavily in your testimony.

A practical matter captured me when I read that report, and that is that of all the arms control regimes that one could possibly hope to put teeth to and get compliance with, for myself probably weapons of mass

destruction proliferation, missile proliferation, nuclear, chemical, and biological proliferation, would have a higher priority the conventional weapons covered in the Amnesty report. Therefore, if I was a government official or an executive branch official, I would be inclined to focus on those and not conventional arms transfers.

In fact, you cite the Reuters article that China is not directly contravening the U.N. resolution. China is providing the conventional arms to the constituted government. So the dilemma is if you're going to spend diplomatic and political capital, where do you spend it if you're in the executive branch and the State Department? Where do you put your pressure, on conventional arms or on weapons of mass destruction?

On page three of your testimony, you have the statement about 200 Chinese military trucks fitted with U.S. Cummins diesel engines. Are there specific provisions that could be put into legislation that would really take companies that trade with China to task. Have there been attempts by human rights organizations to address these issues through Congress.

One other area that I wanted to ask you about is reports that there are armed Chinese troops in Sudan. I have never been able to get any agency of the U.S. government to talk about constituted units of the People's Liberation Army.

Are you aware of units of the PLA that have been simply pulled out of uniform and sent to Sudan with civilian clothing, but their equipment and weapons, in units? Or are these deactivated soldiers who came out of the military and are being hired by state companies in China to protect these oil pipelines?

DR. REEVES: The latter is the case. And increasingly I receive reports that the Comprehensive Peace Agreement of January 2005 called for the disarmament of all forces not part of the Sudan People's Liberation Army or the regular military force, Sudan Armed Forces of Khartoum and this is not being implemented.

These militia forces continue to exist and are perhaps the most dangerous threat to peace in southern Sudan. Some of these militia elements are clearly now employed by the Chinese as a source of security. Earlier I think what you saw much more frequently was the use of former Chinese military personnel employed by China National Petroleum Corporation and subsequently in eastern--we're talking about two oil production areas, Western Upper Nile and eastern upper Nile, and it's Eastern Upper Nile which is much less reported.

This is where Sinopec is operating. This is where I think we're going to see ongoing militia activities and these militia activities are increasingly highlighted by the southern leadership. I met with Salva Kiir when he was in Washington a couple of weeks ago and the delegation, and they're extremely concerned by noncompliance with the various terms of the Comprehensive Peace Agreement, and they put front and center the



failure of Khartoum to disarm these militias, Khartoum's continuing support and payment of them. Khartoum will continue to pay them in ways that provide a huge incentive for them to stay outside the CPA.

The SPLA can barely pay its own soldiers, let alone bring others into the SPLA when sometimes the SPLA doesn't have enough food, literally does not have enough food for its soldiers.

I want to get back to the first issue you raised. Where would we put our political and diplomatic capital? I'm all in favor of the regimes that will control both weapons of mass destruction but also the much more lethal and destructive small arms trade that abounds in Africa and elsewhere and claims many, many more lives than have ever been lost to weapons of mass destruction.

If you're asking what the executive branch of the United States should do, it should commit to the force in Darfur with all necessary resources that will stop the genocide. Currently we have almost four million people the U.N. defines as conflict-affected in Darfur and eastern Chad.

Just today, Doctors Without Borders, the most intrepid of all the humanitarian organizations, the one that will be last to leave, issued a desperate plea saying, as Jan England had of U.N. aid operations, as other NGOs have said, security is falling apart. We cannot operate in this kind of insecurity. If those NGOs are forced to pull out, if they're forced to suspend operations, after three-and-a-half years of genocidal conflict, these people have nothing with which to survive, nothing.

Jan England, when there were a million fewer conflict-affected people in December 2004, said if there's full-scale humanitarian withdrawal, we could see casualties in the range of 100,000 a month, up to 100,000 people a month.

We're now at the very middle of the rainy season. Half million people by my own calculations have already died as a result of violence, malnutrition and disease. This genocide simply must be stopped. It must trump, I think, with respect to Sudan any of our other concerns at least in the near term, and that's where certainly with respect to Sudan, executive branch diplomatic capital should be expended.

HEARING COCHAIR BLUMENTHAL: Thanks to our very competent staff member, Marta McLellan, I have two questions based on two articles I have before me. The first for Dr. Ratliff, both you and Cynthia Watson earlier today said that Venezuela and other Latin American countries, rather China's relationships with these countries should not be considered a threat to the United States.

Apparently the Pacific Command sees it differently. I have before me an article in Defense News that talked about an exercise in which Venezuela, Iran and China got together in a conflict with the United States. The details, I suppose, of this exercise and war game leaked to Defense News, but essentially you had China using Iran to distract the

United States inside the Gulf, the Persian Gulf, while you had Venezuela sending its weaponry, I believe, basically naval assets into the Caribbean to terrorize U.S. and Mexican oil platforms and international shipping.

Based on your testimony, which says while the Chinese have reason to fear the United States, it would seem to me then that based on what your testimony is, Venezuela provides such a juicy target for the Chinese to develop over the near term into a proxy of this kind here in our own hemisphere, pretty well armed. Do you think the Pacific Command is being fanciful in its projections of what could happen in the future between China, Venezuela and put aside Iran?

DR. RATLIFF: I don't know anything about the event that you've described. Please give me the citation. I'd like to read it.

HEARING COCHAIR BLUMENTHAL: Defense News, May 29, 2006, our own Commissioner Donnelly was quoted in it actually.

DR. RATLIFF: Thank you. No, I am not familiar with that at all. But I think I can answer the question. I just cannot imagine such a threat at present, the Chinese at least are too prudent, though Pacific command may want to have contingency plans for all sorts of eventualities. I do not believe that China is willing to try to set up something like that with Venezuela in the backyard of the United States. I just think they aren't going to do it because they have too many other things that are too much more important, they are not going to want to provoke the United States like that. That is a super provocation.

Whatever they may do, I think, in other parts of the world, at least in the foreseeable future, I do not think that they're going to line up with Venezuela to pose any kind of an obvious threat to us. HEARING COCHAIR BLUMENTHAL: So do you think our military is being overly paranoid about this relationship?

DR. RATLIFF: I'm not familiar with that incident. That is not an assuring operation. That's the reason I immediately asked for the citation because I want to look into it. But I have talked to a lot of people in the military about this in the course of preparing these comments, and it's not that they are not watching. They are definitely watching and they should be I obviously didn't talk to the people who were involved in writing up this Pacific Command game and whoever they're working with, but I have not found people in the military panicked about what's happening or even thinking about panicking about what's happening in Latin America with respect to China and Venezuela.

HEARING COCHAIR BLUMENTHAL: Okay. Thank you.

Dr. Reeves, I have another article in front of me called "China, Burma, and Sudan: Convincing Argument," in the New Republic, May 11, 2006, which basically says that China is slowing being--and we heard a little bit of this from Mr. Genser--China is slowly being convinced that Burma is so unstable that they actually maybe won't be helpful on the issue, but because it's starting to harm their own interests in Burma, they

may perhaps stand aside, move with us a couple of degrees on the U.N. resolution, and this article argues that the same might happen in the Sudan, that China might be convinced that the Sudan is so violent, so harmful to their own oil interests, that perhaps they would stand aside.

On the U.N. resolution, the first question I have for you is do you think that's a possibility? And the second question is if it's not a possibility, where do we go from here if the Chinese are obviously a member of the Permanent Five, if we can't get them to go along with a Chapter 7 resolution, as you recommended, what can we do?

DR. REEVES: I think the answer to the question is let's look at the past three and a half years and how little has been done, and if China is prepared at this late date to act in such obstructionist fashion as it has demonstrated, it's not at all clear to me that things will change in the foreseeable future.

Perhaps when hundreds of thousands of additional dead bodies mount up, they may eventually relent, maybe. They certainly do not want the National Islamic Front regime to fall. The oil contracts they have signed, they signed with the National Islamic Front, again renamed the National Congress Party, and their validity is in many ways dependent upon the continuity of governance in Khartoum.

But the National Islamic Front, which came to power by military coups in June of 1989, has proved a ruthlessly survivalist regime, and there's no reason to believe they will not survive and it's very, very clear, including statements today by Agricultural Minister Khalifa, who declared unambiguously that there would be no assent to a U.N. operation, that the regime has dug its heels in a long way, and China certainly has the ability to give them a strong nudge. In fact, China, of course, could move them powerfully if they wanted, but what's the incentive for China?

I think that is the real question here. What is the incentive? Only we can really create that incentive.

HEARING COCHAIR BLUMENTHAL: How can we do that?

DR. REEVES: We can make it clear that when we're stacking up issues and we put North Korea and Iran and global terrorism and trade and maybe 15th or 16th we put Darfur, if we start to say actually we're going to be looking at Darfur through the lens of not only our interests in regional stability but in terms of our obligations under the 1948 U.N. Convention obliging us to prevent genocide, and we expect you to behave responsibly and start taking China publicly to task, which is something the U.S. has not done at the United Nations.

There has been no public taking China to task. There's been no public excoriation. There's been no declaration that "this matters to us; it had better matter to you or there will be consequences." To date, there is nothing from the U.S. pushing back on Chinese obstructionism nor, it must be said, are the Europeans. If anything, the Europeans are even lazier and more indifferent and silent.

HEARING COCHAIR BLUMENTHAL: That's truly shocking, but if we do not get the Chapter 7 resolution, are you an advocate, are you in favor of U.S. unilateral action, U.S. action through a coalition of the willing, U.S.-NATO action?

DR. REEVES: Yes. We are signatories to the 1948 Convention as are all the European nations of NATO. We have per Article I an obligation to prevent genocide. We have declared it is occurring. Colin Powell in his Senate testimony of September 2004 said that having determined its genocide, nothing follows from this determination. I regard that as perverse abrogation of our obligations.

HEARING COCHAIR BLUMENTHAL: One last follow-up question. How do you see the Chinese reacting should we take such action? Would they step aside in terms of their interest in the Sudan?

DR. REEVES: They and Khartoum are right now working very hard to calibrate the international response to Darfur, to determine how serious we really are. Until there is evidence of seriousness, both Khartoum and Beijing will hold to their present course of action.

If it becomes too consequential, since there are no natural resources, there is only the threat to Khartoum of political disintegration, which is, needless to say, a very considerable threat, and thus a threat that Beijing takes seriously, but unless there is a clear perception that there are consequences, that this does have geopolitical significance, we're going to see the status quo maintained.

COMMISSION VICE CHAIR BARTHOLOMEW: Quick question.

COMMISSIONER MULLOY: Dr. Reeves, I was with you all the way until you said that we would take unilateral or coalition, and you based that on the fact that we have this Geneva Convention on prevention of genocide. But we also have a U.N. Charter which was a treaty, which also binds us, and there is an Article 125 in that Charter that says that has primacy over all your other treaties. One of your agreements in there is that you don't take unilateral action, you go through the Security Council when you're going to do things like Chapter--you got through Chapter 7. I was with you up until you said go there.

DR. REEVES: In fact, legal scholars disagree as I have come to learn about what is entailed by virtue of our being a contracting signatory to the 1948 Convention.

Some take a minimalist view, the one that you've just articulated. Others say that, in fact, the 1948 Convention trumps Article 125, that the legal and moral obligations are so great in the face of massive genocidal destruction that we act.

It's also important to remember that the U.N. Summit Document of September 2005 explicitly stipulates and all nations, every nation participating in the U.N. Summit, declared that when civilians in a country are subject to genocide, ethnic cleansing, crimes against humanity, then it is the obligation of the international community to

intervene if a government is either unable to protect those civilians or is in fact responsible for those crimes against humanity, ethnic cleansing, or genocide.

Now, we have here a series of U.N. documents that can't be brought into anything like perfect reconciliation. That's I think the basis for some legal scholars arguing that when you have conflicting U.N. terms and points of reference, that in the case of genocide, you would have an obligation both moral and legal to intervene.

Let's be very clear about the absence of a response. Let us say that a Chapter 7 or a meaningful peace support operation does not make it out of the Security Council, are we really prepared to watch as hundreds of thousands of human beings die over the coming months and years? That's the question that has to be answered by everybody who says it has to be Chapter 7.

I personally both on the basis of my own more expansive reading of the '48 Convention and also a sense of moral obligation believe that if the United Nations will not stop massive genocidal destruction, it is incumbent upon those nations with the power to do so to act.

COMMISSIONER MULLOY: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. Thank you very much to both of our panelists for your testimony and also for your leadership on these issues. We appreciate it. I also want to really acknowledge the work of Marta McLellan on the Commission staff. This is the first hearing that she's put together. It's been extraordinarily well done so thank you very much.

We're finished for today. We'll be back here at 8:30 tomorrow morning to take a look at China's energy diplomacy. Thank you.

[Whereupon, at 4:53 p.m., the hearing was recessed, to reconvene at 8:38 a.m., Friday, August 4, 2006.]

**CHINA'S ROLE IN THE WORLD:  
IS CHINA A RESPONSIBLE STAKEHOLDER?**

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**FRIDAY, AUGUST 4, 2006**

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

*Washington, D.C.*

The Commission met in Room 385 Russell Senate Office Building, Washington, D.C. at 8:38 a.m., Chairman Larry M. Wortzel and Vice Chair Carolyn Bartholomew and Commissioners Daniel A. Blumenthal and Michael R. Wessel (Hearing Cochairs), presiding.

**PANEL II: ADMINISTRATION PERSPECTIVES**

**OPENING STATEMENT OF COMMISSIONER MICHAEL R.  
WESSEL, HEARING COCHAIR**

HEARING COCHAIR WESSEL: If we can get started, Mr. Chairman. If acceptable, rather than reading opening statements, we will have them inserted into the record this morning. We are pleased to have this morning the Principal Deputy Assistant Secretary of Energy in the Office of Policy and International Affairs at DOE, Katharine Fredriksen. Thank you for being here this morning.

Prior to joining the agency in June, Ms. Fredriksen was the principal and founder of her own consulting firm specializing in energy and environment issues.

Ms. Fredriksen has been asked to address the administration's policy perspectives and concerns about the impact of China's development on that country's energy demands, China's policy approaches for securing an adequate energy supply, opportunities for U.S.-China cooperation to improve energy efficiency, and the implications, both globally and for the United States, of China's oil acquisition strategy.

We're grateful that you could join us, and offer testimony on behalf of the administration and look forward to your remarks. Our normal process is to have our witnesses' written testimony inserted in the record,

to have oral testimony of approximately seven minutes, and then go for rounds of questions, and we look forward to your testimony.  
[The statement follows:]

**Prepared statement of Commissioner Michael R. Wessel  
Hearing Cochair**

Thank you, Commissioner Blumenthal, and thanks also to the Chairman and Vice Chairman for their remarks as well.

Today's session will focus on China's interest in, and impact on, world energy markets. It is clear that China's rising thirst for energy resources and, indeed, natural resources of all kinds, is a key driver behind its economic, foreign policy and military posture.

There are many challenges on the international stage at this point and the driving factors behind these conflicts and tensions are diverse. But, it is important to recognize that competition for energy is, and increasingly will be, a potential point of conflict in the future.

China has already chosen a different path in terms of energy and resource acquisition than that of the United States and other major consuming nations. Despite China's desire to be treated as a market economy in many ways – a desire it has, in fact, made clear to the U.S. and other nations – in the energy arena, it is pursuing a different course. China wants to own the energy resources itself and maximize the security of its energy supplies and minimize its participation in world energy markets. That's an understandable approach. But, what impact does it have on other nations?

Last July, we saw China National Offshore Oil Corporation — or CNOOC — attempt to purchase the U.S. oil company Unocal, a move that, if successful, would have made China the owner and controller of Unocal's reserves at the wellhead. This year we have seen China continuing to pursue wellhead acquisitions in other countries. From June 2005 to June 2006, China signed thirteen agreements in nine countries for investments in upstream reserves. These thirteen acquisitions, totaling \$11.97 billion in one year alone, represent an assertive trend aimed at securing petroleum reserves for China's exclusive use.

What does this mean, in reality? First, it means that China has embraced a number of regimes whose interests are adverse to our own: Iran and Sudan to name but two. China has supplied weaponry, strengthened ties to these nations and has protected them from world pressure in venues like the United Nations. In return, China has been given preferential access to their energy reserves. We can expect that China will engage in similar efforts elsewhere around the globe.

Second, it means that as world energy demand continues to rise but reserve additions do not rise at the same rate, China's effort to procure and restrict supplies only for itself will put increasing pressure on world markets and price. Energy may be fungible. But, rising demand coupled with inadequate reserve additions means more competition for fewer resources among other nations who do act as free market purchases. Certainly, the conflict in the Middle East and political uncertainty elsewhere has had an impact on the energy markets and price speculation. But, I do not believe that it is the total answer. China is having an impact on world energy prices.

China alone is not responsible for the high price of oil. Our own energy policies are in need of dramatic reform. But, China does play an increasingly important role in world energy markets and that is what we are here today to discuss.

And, as we seek to redefine our own approaches to energy, we need to do so cooperatively with other nations. On this end, China's "go-it-alone" strategy will only compound the world's problems and increase tensions.

We also remain concerned about the country's inefficient consumption of energy and the environmental ramifications of that use. China's energy policy-making body, the National Development and Reform Commission, reported in 2005 that China's energy efficiency falls 10 percentage points below the average of developed nations, indicating a significant waste of resources. Inefficient energy use forces China's demand higher than it otherwise would be, and will complicate the task of reducing the growth in that demand. This will continue to drive China's acquisition of resources.

Petroleum is not the only pressing energy issue involving China. As the New York Times reported in June, China's extensive utilization of coal, the burning of which produces sulfur dioxide, contributes to approximately 400,000 premature deaths per year and poisons the water supply with acid rain. Not only does this environmental threat pose problems for China's health and development, but China's emissions carried by wind and rain also create crossboundary effects felt in South Korea, Japan, and as far away as the United States. The United States has a significant interest in China's progress toward more efficient and environmentally benign energy consumption.

The U.S.-China Commission sees this situation as an opportunity for international cooperation and technological exchange to improve both the efficient use of energy as well as the advancement of environmental controls. Specifically, the Commission advocated in its 2005 Annual Report "...the initiation of new cooperative efforts with China to (1) increase the efficiency of its energy use...(2) shift some reliance on oil to coal (using advance clean coal technology) and natural gas; and (3) explore and pursue the economic, technical, and logistical feasibility of using renewable energy sources..." It is my understanding the Department of Energy has sponsored exchanges at various governmental levels, including the U.S.-China Energy Policy Dialogue and the U.S.-China Oil and Gas Industry Forum. I hope witnesses today will offer suggestions on what can we do to improve the opportunities for cooperation—taking things beyond discussion to practical implementation.

**STATEMENT OF KATHARINE A. FREDRIKSEN  
PRINCIPAL DEPUTY ASSISTANT SECRETARY, OFFICE OF  
POLICY AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF  
ENERGY, WASHINGTON, DC**

MS. FREDRIKSEN: Good morning, Mr. Chairman, Madam Vice Chairman, and members of the Commission. I am very pleased to appear before you this morning to discuss the administration's policies and perspectives on energy security issues and the cooperative efforts we have underway with China and the U.S. Department of Energy.

China, as you've probably heard in testimonies previous to mine, has become the world's second-largest energy consumer after the United States following two very rapid decades of growth in China. Since 1980, China's appetite for oil has jumped 250 percent, increasing its daily consumption of oil from 1.8 to 6.4 million barrels per day.

The most significant energy demand in China has come from the country's robust economic growth. China's economy has grown by about nine percent a year since 1978, fueled by free market forces, increased foreign investment, and exports.

This rise in consumption has led to an increased dependency on oil imports. In 1993, China became a net importer of petroleum products. By



2004, approximately 43 percent of its oil was imported, and by 2030, we estimate that China's oil consumption will account for approximately 13 percent of the world's oil demand.

In order to reduce demand and increase the supply of energy available domestically, China has begun adopting specific policies that include increasing both the domestic production of traditional energy resources and improving domestic infrastructure. They are also taking an aggressive stance on energy efficiency and increasing the use of renewables.

China's establishment of strategic petroleum reserves has been one of the most significant developments in the domestic energy policy arena. China is building an SPR at four sites on the coastal area, and they have expressed the intention to build stockpiles equivalent to 90-days of imports, the minimum that is required by the IEA members, or International Energy Agency members, even though China is not a member.

China's domestic energy strategies also emphasize improvement in energy efficiency. The Chinese government has launched aggressive energy initiatives that call for a 20 percent reduction of energy consumption per unit of GDP by 2010.

China has been seeking to enhance its own energy security by diversifying its energy supply through imports and by acquiring overseas assets. As recently as 1996, China imported 70 percent of its oil from Oman, Indonesia and Yemen. By 2003, they had expanded their import sources to include Saudi Arabia, Iran, Angola, Oman, Yemen and the Sudan.

In recent years, China has significantly increased the number and geographic distribution of energy assets and investments. Chinese national oil companies have invested in oil ventures in over 20 countries with bids for oil field development contracts, pipeline contracts and refinery projects.

But China's energy investments are limited in sheer terms of value and volumes. Between the 1990s and early 2005, China's overseas investment in oil and gas averaged less than \$600 million a year. The total equity oil secured mainly by Chinese oil companies is around 400,000 barrels of oil per day. This means that the total equity of oil that China is securing is equivalent to about five percent of its current oil production.

This also amounts to about a half of a percent of global oil production. Judged by this perspective, the impact of China overseas petroleum investments on the global market is limited.

DOE has forged a strong relationship with China through various bilateral mechanisms. One such mechanism is the U.S.-China Energy Policy Dialogue. Signed in 2004, the dialogue was designed to facilitate policy-level discussions on a range of energy issues, including energy

policymaking, supply security, power sector reform, energy efficiency, renewable energy and energy technology options.

Our goal through this dialogue includes assessing the impacts of China's energy policies on U.S. energy security, offering best practices to help the Chinese policymakers promote energy sector reforms, mitigating climate change effects, assessing trade and investment opportunities in each other's energy markets, and encouraging market-based principles.

The first dialogue was held at DOE Headquarters on June 30, 2005. Key topics included supply security, energy market forecasts, energy efficiency and renewable energy technologies. While commending China's efforts to build their first state-owned SPR, we have constantly reiterated that the SPR needs to be used to address supply disruption, not to affect global petroleum markets.

The next dialogue is scheduled to be held in China this September and we are focusing on energy efficiency as a key theme.

Another bilateral forum where we have been promoting greater appreciation of the global energy market with respect for market principles is the U.S.-China Oil and Gas Industry Forum.

Launched in 1998, the forum serves to facilitate opportunities for government and industry leaders from both countries to have open and frank discussions about our respective needs in the oil and gas sector.

The forum also serves to expose the Chinese to Western business customs as well as to open the Chinese market to U.S. investment. The U.S. industry is already the largest investor in China's petroleum sector and continues to see greater investment opportunities there.

At the last forum meeting in New Orleans in June of 2005, the U.S. stressed the importance of transparency in reporting oil supply, demands, and pricing information, so as to provide potential investors with accurate and reliable information for their use in decision-making.

The seventh forum will be held next month in China. In the area of science and technology, DOE and China have been cooperating in the fields of energy, physics, fusion, fossil energy, energy efficiency, renewable energy, energy information exchange, the peaceful use of nuclear technology and clean energy development for the 2008 Summer Olympics in Beijing.

DOE's work with China has resulted in solid successes. For instance, in March 2005, China's Congress passed legislation calling for the government to adopt an array of policies that encouraged the development and use of wind, solar, geothermal, and small-scale hydroelectric plants.

DOE's National Laboratories were instrumental in helping draft what some call "the Green Power law." DOE also engages China through multilateral energy organizations as well. Although China is not a member of the IEA, key Chinese officials have been invited to IEA ministerial meetings in recent years. DOE has been a key participant in

workshops held in China by the IEA to assess the Chinese government in reforming and opening the gas sector and in creating a national SPR.

China is becoming an active member in the Asia-Pacific Economic Cooperation's Energy Working Group. They are also a key participant in U.S.-led international science and technology initiatives such as the International Partnership in the Hydrogen Economy and the Carbon Sequestration Leadership Forum.

HEARING COCHAIR WESSEL: If you can begin to sum up, please.

MS. FREDRIKSEN: Actually, leading to a conclusion now.

HEARING COCHAIR WESSEL: Perfect timing.

MS. FREDRIKSEN: The U.S. and China face similar energy challenges. While there are many notable differences in our approaches, cooperation between our two countries will continue to promote greater energy security here in the U.S.

Our energy security is inextricably linked to the energy security of producing and consuming nations including China. The U.S. has an important role to play in encouraging China to adopt responsible energy policies and strategies that place China in full accord with international forums.

We are committed to continuing our efforts to encourage China to become a prosperous nation, but also a responsible stakeholder in the international system.

Thank you. And I welcome any comments.  
[The statement follows:]<sup>4</sup>

### **Panel VII: Discussion Questions and Answers**

HEARING COCHAIR WESSEL: Thank you. Your entire statement will be inserted in the record. Chairman Wortzel.

CHAIRMAN WORTZEL: Thank you very much for testifying today. In looking through your written testimony, I have a few questions about coal and coal liquefaction. My understanding was China has the largest coal deposits in the world. Therefore, I was surprised about the rail infrastructure problems that are causing shortages there. I also recall from some of the materials I got from inside the Commission that there is a several billion dollar investment by Chinese companies to purchase West Virginia coal. This surprised me since China has the world's largest coal deposits.

So what does West Virginia coal offer to China that China doesn't have?

HEARING COCHAIR WESSEL: It's much better.

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<sup>4</sup> [Click here to read the prepared statement of Katherine A. Fredriksen](#)

CHAIRMAN WORTZEL: Second, are we going to see an attempt to purchase a West Virginia coal field by the Chinese? Are we going to face another CNOOC-like problem?

On coal liquefaction, I don't know if the Department of Energy works with Commerce on business promotion and opportunities for U.S. business. I'd be interested in knowing if that happens. What opportunities are there for American businesses in the coal liquefaction area in China?

Finally, because in DOE you've made such a contribution to the Chinese nuclear program, do we still have any Chinese nuclear scientists working at DOE's labs?

MS. FREDRIKSEN: I will try to remember all your questions and answer them. Let's see. China will use all of their domestic coal reserves, just as the U.S. will always use all of ours and look for more. We are working with China. As you know, they are a member of the Asia-Pacific Partnership, which was launched not quite a year ago, and we do have exchanges and forums working on coal liquefaction, working on IGCC technology, and they are definitely looking at coal liquefaction as a way to help offset their need for oil imports.

So that is an ongoing work that we have under the APP and we are sending lots of technology experts from DOE there to work with them.

On your question about employment at the labs, I don't know the answer to that, and I'd have to get back to you.

[Ms. Fredriksen's response for the record follows:]

Yes, the United States has Chinese foreign nationals working in the Department of Energy laboratories. According to DOE's Office of Science, there are Chinese foreign nationals who had "assignments" (greater than 30 day stays) at the ten (10) Office of Science Laboratories during the first half of calendar 2006 (Ames Laboratory, Argonne National Laboratory, Brookhaven National Laboratory, Fermi National Accelerator Laboratory, Lawrence Berkeley National Laboratory, Oak Ridge National Laboratory, Pacific Northwest National Laboratory, Princeton Plasma Physics Laboratory, Stanford Linear Accelerator Laboratory, and the Thomas Jefferson National Accelerator Facility). These scientists, some of whom are full-time employees, and many of whom are working on short-term assignments, are engaged in basic research on high energy physics, nuclear physics and fusion energy sciences. Also, according to DOE/National Nuclear Security Administration, there are Chinese foreign national assignees at DOE national laboratories during the first half of calendar 2006 (i.e., Lawrence Livermore National Laboratory, Los Alamos National Laboratory, Sandia National Laboratory).

CHAIRMAN WORTZEL: How about business promotion with Commerce; do you all have any effort to help U.S. business get into this coal liquefaction industry in China?

MS. FREDRIKSEN: Specifically through the Asia-Pacific Partnership, it is an industry-government joint effort, and so those folks are at the table as well, and that is a direct promotion of our ability to have U.S. investment in countries like China and India.

CHAIRMAN WORTZEL: Could you, for the record, come back

with a short note to us on the Chinese coal contracts in the United States?

MS. FREDRIKSEN: Yes.

CHAIRMAN WORTZEL: Thank you very much.

[Ms. Fredriksen's response for the record follows:]

The West Virginia coal that China is interested in is the low volatility (usually 20~25%) coking coal with low sulfur (<0.8%) and low ash, and which is primarily used to manufacture metallurgical coke. In the United States, this type of coal is only produced in southern West Virginia. As the reserve of this type of coal is very limited worldwide (only produced in several countries), its price is much higher than normal coal.

China had been a major export country for this coal, but in recent years, the high growth of Chinese coke and steel industry resulted in the short supply of the coal. Due to China's shipping, production, and quality problems, some coking plants, specifically some large steel companies in southern and southeastern China, began to import this coal from abroad.

According to data from the Energy Information Administration, no coal was exported from the U.S. to China prior to 2005. Since then, it is EIA's understanding that approximately 1,000 short tons of eastern coals, possibly from West Virginia, were exported to China through the deep water port in Hampton Roads, Virginia.

DOE is aware that 13 West Virginia companies exhibited their products in the China Coal and Mining Expo in Beijing in 2005. China hosted the International Technology Exchange and Equipment Exhibition on Coal and Mining.

It is possible that Chinese companies purchased some U.S. made equipment and may be using the coal purchased to baseline test the equipment with U.S. coal. Alternatively, it is possible that prospective U.S. purchasers of coal utilization equipment manufactured in China (e.g., industrial gasifiers) may be testing that equipment in China with U.S. coal. These conclusions are speculative. At this time, we have no "hard" information on current Chinese contracts for coal with U.S. coal suppliers.

HEARING COCHAIR WESSEL: I appreciate your being here this morning. In your testimony, you identify that between the 1990s and early 2005, China's cumulative overseas investment in oil and gas supply was \$7 billion, and unfortunately that, as you probably know, has accelerated dramatically, since between June 2005 and June 2006, the value of those acquisitions was 11.97 billion.

So we've seen in one short year, investment more than surpassed what happened over the last decade--with Syria, an investment of \$586 million; Angola, 982--Angola, again, \$1.1 billion. We see a substantial coming-out strategy, if you will, for China to try and expand its involvement in overseas energy markets.

Last year during the CNOOC incident, I believe it was Chairman Pombo asked for a response from the department with other agencies participating on what all this means, which we've looked through. But one of the key issues is what are we seeing in terms of both fungibility of energy, which I think we all understand, but also China's differing energy acquisition strategies and what does that mean long term? If there are

tremendous reserve additions, the question of who purchases what and whether it gets taken off the market, of course, has less impact.

What is DOE's view of where we are in terms of reserve additions? Prices have skyrocketed. And what is the impact of China's acquisition strategies, where they want to own upstream assets rather than participate in world energy markets, the way the rest of most of the industrial world does by buying on the spot market or as long a contract as you can get but at market prices?

MS. FREDRIKSEN: Oil is a fungible market, as you know, and we participate in buying that on the world market--we actually haven't seen a threat per se from China's approach. They have a very different approach obviously. They typically will go into countries that have a higher geopolitical risk than a lot of private sector companies are willing to take on and invest, and so for every drop of oil that they now are mining out of the ground in those countries, it's oil they're not taking off the international market.

Those are new resources, and so for us, we believe the market will adjust to handle that, and they're not actually removing any oil from the world market. They're developing new sources. So actually we could see that as a positive.

HEARING COCHAIR WESSEL: That assumes that a Sudanese oil or Nigerian or wherever, Angolan oil, is not going on the market in some other way; correct?

MS. FREDRIKSEN: Typically, it hasn't been in the past so they are, in effect, opening up new opportunities.

HEARING COCHAIR WESSEL: Okay. But what your testimony talks about--their demand increases dramatically, reserve additions, as I understand it, have not increased at the same pace. So if we have 100 as the measure and they take 20 off of the market, it leaves 80 for the rest of us as our demand increases but reserve additions don't go at the same pace. The industrialized world is competing for a smaller and smaller pie over time; is that not right?

MS. FREDRIKSEN: You could probably categorize the U.S. as being the 800 pound gorilla and China being the 700 pound gorilla and getting bigger everyday. It behooves us to work cooperatively which is why we've established all of these dialogues and bilaterals and multilateral working relationships with them to increase their efficiency in their country, but it also makes it incumbent upon us to become better users of energy ourselves.

So we've seen a broader investment in diverse energy supply in this country. Things that previously weren't viable have now become very viable in this country in the realm of renewable energy. Nuclear is back on the table as a viable option in this country. So it's making us look internally and sharpen up our activities, but that is why we are working very cooperatively with them because we do see the fact that the two big

players in the world market have got to be better users and better consumers.

HEARING COCHAIR WESSEL: Certainly we agree, and the Commission last year recommended a number of steps that should be taken, many of which you are already engaged in, for greater cooperation. But the threshold question you raised just a moment ago, is how one views world energy supplies and how those acquisition strategies interact with it? If reserve additions don't keep pace with demand, and certain players want to restrict a part of the pie for themselves, it means that rising demand starts bumping up against finite supplies and the rest of us are going to have to compete more aggressively against each other, where China will have a stable secure supply for themselves. Am I reading this wrong?

Understanding we have to deal with efficiency and everything else to try and address the trajectory of growth, but that's going to take some time. Prices of gas here are already over \$3, as you well know. We are facing an energy problem here and China's strategy seems to be enhancing the problems that we're all facing.

MS. FREDRIKSEN: We are working with them to develop their domestic resources as well. They have untapped resources, domestically, not far off of their shore as well. So we are working with them in trying to get U.S. investment there to help them, technology investment there to help them, so that they become a less dependent, as is our goal in America, to become less dependent than we have been.

HEARING COCHAIR WESSEL: Thank you. Commissioner Donnelly.

COMMISSIONER DONNELLY: Thank you, Mr. Chairman. My question actually follows on to the last one to try to tease out some of the political implications of Chinese acquisition strategy and, again, to refer to the infamous CNOOC experience, it seemed to me that some of the aspects that were less part of the public debate on that were things that were a little more worrisome in the following two ways:

It wasn't a market question so much as a question of whether the acquisition would have given China a significant or disproportionate impact over Indonesia where the really most valuable Unocal assets were located?

Secondly, whether the other consumers of those products, particularly Taiwan, Japan, and South Korea, wouldn't likewise feel some nervousness by having their supply assets as it were connected to China?

So I'm sure the international energy markets can accommodate the Chinese strategy. The question is, is whether sort of second tier effects, either from China establishing a disproportionate influence over particular supplier nations, or conversely, that the supplying company can resist that influence. Do we have a good understanding of how China's acquisitions overlay the supplies that are received elsewhere in East Asia?

In other words, is it possible that, again, a disproportionate Chinese presence in locations where, particularly our democratic allies in the regions get their supplies isn't something that we ought to pay attention to and give some weight to?

And then I had a second question. I wish you'd elaborate a bit on China's nuclear plans to the degree do we have a good understanding of them? Do we understand what the design of the plants is going to be like? Are they going to be locally Chinese-designed plants? So, again, any more information about what is clearly a pretty ambitious effort would be most welcome.

MS. FREDRIKSEN: Let me just look really quick. I do have a little bit more expanded paper on the nuclear, if you'll give me just a moment.

On your question about influences over the supply nations, if I go back to our belief in the market system and the producing nations that are in agreement and working either through OPEC or non-OPEC arrangements and how that market is bought and sold into and out of. I can't off the top of my head, and I'll apologize, give you probably an answer you're going to look for on that, but I can get back to you.

COMMISSIONER DONNELLY: If you could give us something in the record. I have tried to look for the kind of information in my own research and had a hard time. I'm more interested in two things: whether, in the case of Sudan, for example, I'm less interested in how China's energy comes from Sudan, but how much of Sudan's output goes to China.

MS. FREDRIKSEN: Right.

COMMISSIONER DONNELLY: And conversely, in places like Indonesia and the other sources of supply for Japan, Taiwan, et cetera, what the Chinese presence in those countries. So just to try to make the question as clear as I possibly can.

MS. FREDRIKSEN: I'll be happy to respond to that and get you a more full answer.

COMMISSIONER DONNELLY: I appreciate that.

[Ms. Fredriksen's response for the record follows:]

We have not been able to demonstrate that China has a disproportionate influence over supplier nations. As DOE's response to Section 1837 of the Energy Policy Act of 2005 states, documentation on the role of the Chinese government in commercial energy dealings with foreign entities is scarce and, even if available, inconclusive. The extent and precise nature of the role the government plays in overseas asset acquisition remains a question.

China's presence in oil producing nations does not threaten U.S. energy supply, as oil is a fungible commodity. The U.S. buys oil on the world market, not from specific countries. If a company, be it state-owned or private, chooses to take on the political and economic risks associated with an investment, their subsequent contribution to the world market benefits all consuming nations. From an energy security perspective, any investment and additional production benefits the U.S. and our allies, particularly in the current tight market. In certain countries, specifically Sudan, China is the top export destination (in 2005



approximately 40 percent of Sudan's oil exports went to China).

MS. FREDRIKSEN: On the nuclear, we do have statistics on that. China is in the final stage of building a pressurized water reactor. Westinghouse is currently the only U.S. contestant, and we've been encouraging the Chinese government to fully and fairly consider Westinghouse's Consortium AP1000 technology.

We've also had other American vendors that are working with them on building boiling water reactors, GE predominantly in that arena. They are actively moving forward on 30 additional nuclear reactors by 2020. It's a rather aggressive movement there on nuclear.

COMMISSIONER DONNELLY: And in these contracts, is there a big technology transfer component, or have the negotiations gotten that far? Who else is in? I assume the French and Germans are?

MS. FREDRIKSEN: I don't know the answer to that. I can get it for you. I do know that our American companies are the leading bidders for the technology transfer right now, and so I think they're placed very well in the pack.

COMMISSIONER DONNELLY: Thank you.

[Ms. Fredriksen's response for the record follows:]

Westinghouse has submitted a formal bid and is currently engaged in negotiations with China for the sale of the nuclear steam supply system for up to four (4) AP1000 reactors. Both Westinghouse and General Electric have received Secretarial Authorization from the Department of Energy, in accordance with Section 57(b) of the Atomic Energy Act, to market and sell its full-range of nuclear services to China. There is a significant technology transfer component with China and its burgeoning civilian nuclear power program. This technology is the latest generation of advanced light water nuclear reactors to receive design approval from the NRC. The USG has officially advocated on Westinghouse's behalf with the Chinese Government. Other international companies competing with Westinghouse for the Chinese bid are France's Areva and Russia's Atomstroy Export.

HEARING COCHAIR WESSEL: Commissioner Reinsch?

COMMISSIONER REINSCH: Just on that last point, it would be nice to have a little more information on it, although I would say, recalling something on this subject, I don't think there's any technology in question that they don't already have. It may be latest generation, but it's not exactly of military relevance or anything.

We all seem to have the same question, so for the second time, Mr. Wessel has preempted what I was going to talk about. But let me try to get at it a slightly different way because otherwise I have to do five minutes on the beauties of West Virginia coal, and I don't think anyone wants to hear that.

COMMISSION VICE CHAIR BARTHOLOMEW: Or just not speak.

COMMISSIONER REINSCH: Well, that would be a possibility, too. But I don't want to set a precedent here that might be difficult for

others to meet. Think about this. I'm thinking about the market effect of a large new entrant with rapid growth, and throw India into the mix as well, another large entrant, whose energy needs are rapidly growing, who also will be rapidly expanding through imports, at least as far as I can tell, as well as through whatever they can do to expand their domestic production.

It seems to me, as Mike was suggesting, this has to have some kind of disruptive effect on the market, at least in terms of price. I don't see supply growing fast enough to meet vastly increased demand, not next year, but five or ten years from now. Does the department not see it that way?

MS. FREDRIKSEN: Oh, no, we do have a healthy respect for the tight supply and increasing demand. Again, I go back to why we are looking domestically to doing enhanced oil recovery in this country, which is looking at optimizing that, looking at renewables in a much more robust way, looking at our efficiency of our transportation sector. Those are all things that we are trying to do to adjust to the market.

The market will dictate that. It will balance at a level where you may see immediate, some immediate, more up-front rise, but it will come back down and level off as everyone responds to that.

So, yes, we do have a respect for it. That is why we are aggressively working on the Advanced Energy Initiative, the American Competitiveness Initiative, trying to look at the role that we play as consumers in that market.

COMMISSIONER REINSCH: I think what we're all suggesting in a way is that as the crunch gets more significant, you may see odd market behavior in some ways that we hadn't projected, and efforts by other countries to lock up sources of supply will encourage hoarding, for example, and favoritism in allocation between customers.

In other words, the market may not work in the way that you expect that it's going to work. And I think that's what we're trying to get at. Maybe it's not what we're trying to get at. But--

COMMISSIONER DONNELLY: I'm happy to hear that you're trying to get at.

COMMISSIONER REINSCH: Something to think about. Another question. Why haven't they joined the IEA?

MS. FREDRIKSEN: I believe you first have to be a member of the OECD.

COMMISSIONER REINSCH: Aah. Okay. Well, that answers that. Let's assume for the moment that they do that and then join, what does that do for us if they join?

MS. FREDRIKSEN: The most immediate is the availability of the strategic petroleum reserve so that if there is a world market disruption, the participating countries in the IEA are compelled to release reserves to help balance out the market supply disruption.

COMMISSIONER REINSCH: I see.

MS. FREDRIKSEN: So they would actually be one of those members that would be required to have releases from their SPR on the immediate.

COMMISSIONER REINSCH: Okay. Switching subjects, have you or anybody in the department done any thinking about the impact on the environment of the significant increase in energy consumption, particularly in the transportation sector, in China?

MS. FREDRIKSEN: Yes, we have. We have been working with them. They've got some of the most aggressive tailpipe emission standards out there. They have issues on enforcement. So that is one area where we are trying to work with them on.

Another one, we're working with them because Beijing got the Olympics because they agreed to clean up the air in Beijing. We're trying to make sure that the approximately 500 megawatts of power that they are adding on a weekly basis is in clean coal technology, and also looking at some of the older power plants and upgrading them, putting on pollution control technology to get to those things that are the cause of concern. We've seen China begin to move the power plants outside of the big cities in order to reduce the levels of pollution because they do have increasing transportation sector issues to address.

COMMISSIONER REINSCH: Thank you.

HEARING COCHAIR WESSEL: Commissioner Houston.

COMMISSIONER HOUSTON: Bill, you stole my question.

COMMISSIONER REINSCH: We're even.

COMMISSIONER HOUSTON: Yes. It was interesting that you mentioned the Beijing Olympics. We were just there and we all mentioned that you could actually see the air when you walked around Beijing, so how they're going to clean it up between now and 2008, boy, I tell you what, we need to get a-hold of that technology if they can do it.

I have two questions. One has to do with IPR, intellectual property rights. One of our main concerns as a Commission this year has really been to focus on IPR violations by the Chinese, and I wondered if you could tell us any manners in which DOE is either monitoring or advising the Chinese on any IPR violations that might come up as regards this technology transfer that you're talking about?

And two, as far as the environmental degradation goes, when you say that DOE is working with the Chinese, we're very aware that there are a lot of rules and no enforcement--can you give us some specifics on exactly what DOE or the administration is trying to do as far as the working with statement about environmental degradation?

MS. FREDRIKSEN: On your first question about the intellectual property rights, I'll need to get back to you on that. I don't know the answer.

COMMISSIONER HOUSTON: Thank you.

[Ms. Fredriksen's response for the record follows:]

DOE has been cooperating with Beijing on clean energy efforts for the upcoming Olympic Games. DOE, the Chinese Ministry of Science and Technology, and the Beijing Municipal People's Government signed a Protocol for Cooperation in Clean Energy Technologies for the 2008 Summer Olympic Games in Beijing on January 12, 2004. The Intellectual Property Right (IPR) provision, stated in the Article 8 of the Protocol, has specific language that protects IPR. The allocation of rights to intellectual property and the use of business-confidential information obtained in the course cooperative activities are governed by Annex I to the 1979 Science and Technology Agreement between the U.S. and China. Annex I is a standardized USG document in dealing with intellectual property issues for all international agreements.

MS. FREDRIKSEN: On the issue of the air pollution controls, our Fossil Energy Office within the department is aggressively working with them on not only new technology like IGCC, and we're also very much encouraging China to come on board fully in our FutureGen, commercial-sized demonstration project. Right now China has I believe one of its coal companies participating. We'd actually like to see the full Chinese government participate in FutureGen, as are our other country partners.

But we are working on clean coal technology with them. We have a vested interest in seeing this aggressive addition of power, predominantly coal-fired power, coming on line to be in new technology, not the old pulverized coal technology. So that is one area where we are working with them, and as they are trying to move, shut down power plants and move them outside of the big cities, when they rebuild them, because they are, that's where we're really concentrating on the technology.

COMMISSIONER HOUSTON: Okay. Thank you.

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Thank you. I had a question. There's a lot of confusion I think both here and in China--in some ways it matters more in China than it does here--but among people who aren't energy experts about the difference between security and just supply. So you get into it in your testimony a little bit where you talk about the Chinese concerns about chokepoints and the building of pipelines, and from my talks with the Chinese, their definition of security means actually getting the oil back or the petroleum back from wherever they're buying it.

Is that your understanding?

MS. FREDRIKSEN: Yes.

HEARING COCHAIR BLUMENTHAL: And is the American position that the difference between security and--because you used the words "energy security" quite a bit--is that actually securing the supply or is that just the access, the general access to a large supply?

MS. FREDRIKSEN: U.S. definition--

HEARING COCHAIR BLUMENTHAL: What's our definition?

MS. FREDRIKSEN: The U.S. definition is a diversification of

supply sources. So whether it is making sure that we are balancing our imports appropriately, whether we are looking at our renewable portfolio and trying to enhance that, the nuclear portfolio as well, so that we're drawing it from multiple sources and not having all of our eggs in one basket, so to speak. That's our definition of security.

HEARING COCHAIR BLUMENTHAL: But you agree the Chinese definition may be different?

MS. FREDRIKSEN: Again, we've seen, I think as Commissioner Wessel pointed out, they have entered into a lot of bilateral contractual relationships with countries that traditionally haven't had a lot of private sector investment, so we still see that as a positive of bringing more oil molecules to the surface and not taking away from the world market.

They are working on building the pipeline to try to bring more products to them. Again, I think it is an area of concern and we are trying to work with them on that.

HEARING COCHAIR BLUMENTHAL: I guess yesterday we had a hearing on the company that China keeps their friends around the world, and there was a pattern of oil and energy-rich pariah nations. You mentioned some of them--Sudan, Iran, increasingly Venezuela, and Angola. And I guess, again, not being an expert on this, I guess our security--I would venture a guess that our security is harmed by those relationships in the sense, our energy security, in a sense that the price volatility, the more geopolitical instability there is, the more violence there is, say, in Sudan, the more unable we are to come to a resolution in Iran, the more prices of oil go up.

Is that correct? The pricing, this isn't a pure free market.

MS. FREDRIKSEN: I think oil from Sudan or some of the other countries was not readily being sold into the market before China started trying to secure those. Iran, of course, does sell into the market.

HEARING COCHAIR BLUMENTHAL: But I guess my question is, if there's instability in Iran or instability of China's being less than helpful in solving the Iranian nuclear question, the price of oil for everybody goes up; would that be correct?

MS. FREDRIKSEN: Yes, in the short term.

HEARING COCHAIR BLUMENTHAL: The pricing of oil is not just based on a free market notion of pricing.

MS. FREDRIKSEN: In the short term, yes, you'll see that until the market reallocates, and I think that's where we would stand and believe that the market will readjust to the initial volatility that might be seen by a supply disruption or from political causes like in Iran.

HEARING COCHAIR BLUMENTHAL: Do we ever get into discussions with them along these lines? You hear very much from the Chinese the following, and I hear this from the Japanese as well, that when you push them a little bit, they say America controls oil market and therefore we need to find ways to get around the market. You hear that

from Japan as well.

And our answer is the more you do that sort of thing, the more you go into these volatile places and create political or add to political instability or build pipelines in Central Asia, and we have to respond to it, the more the price, the sort of superstructure of energy goes up. Do we ever have those kinds of discussions with--and what I mean by superstructure is obviously, obviously the oil and the gas that we get from the Middle East, we're paying a lot, for example, to our military to secure those supplies.

Do we ever get into these kinds of discussions besides the free market kind of discussions with them?

MS. FREDRIKSEN: With China? I think it's why we have engaged in the forums that we have, to expose them to a much more Westernized approach versus a nationalistic approach. We have fundamentally different ways to go about it. We don't believe in owning the assets. They do. But I think as we begin these dialogues and they see that they will not be able--predictably they won't be able to secure all that they need from going out and acquiring it through contractual relationships, they will buy on the market and they will see that value of the market.

HEARING COCHAIR WESSEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman. Yesterday, Mr. Christensen from the State Department testified. On page five, he told us that China is improving its coordination with the International Energy Agency and working to put in place a strategic petroleum reserve.

You make the same point on page ten of your testimony. This Commission some years ago made a strong recommendation that we bring China into some affiliation with the IEA. So we're delighted that that's going on, and we made the recommendation that they put a strategic petroleum reserve in, so we're happy with that.

Commissioner Reinsch raises the point, why isn't China in the IEA? My understanding is that you have to be an OECD member and that further to be an OECD member, you have to be a democracy. So I don't think we can see them getting in the OECD unless those rules are changed.

MS. FREDRIKSEN: Right.

COMMISSIONER MULLOY: Is that your understanding?

MS. FREDRIKSEN: Yes.

COMMISSIONER MULLOY: Now, in the IEA--I used to attend the IEA meetings when I was a young man in the Antitrust Division of the Justice Department--because there is not only built-in strategic petroleum reserves, there's also a scheme by which consumer countries agree that they don't bid against each other in these shortage periods because then we drive up the price.

There's actually an oil allocation and sharing scheme as part of the

IEA. Now, if China is not in the IEA, and this is the point that Commissioner Wessel makes, and they are going out and locking in their share of global energy supply, it leaves the rest of us bidding against each other or sharing a smaller portion. Is that the understanding of what is really going on here; is that correct?

MS. FREDRIKSEN: If you're talking about on a day-to-day basis or in a disruption--

COMMISSIONER MULLOY: No, I'm talking about an energy shortage basis.

MS. FREDRIKSEN: Okay. It is our goal to encourage the continued building of China's own SPR.

COMMISSIONER MULLOY: No, no. No.

MS. FREDRIKSEN: And to help them understand how to use that SPR.

COMMISSIONER MULLOY: No, no. I understand that. But the point that we try to make, and this came up during the CNOOC thing, is that the Chinese are going out and they are getting shares of the total oil market. They're not putting their supplies into the total market. They're taking it home; aren't they?

So then, the larger share they get, it means the rest of us in a time of shortage would be bidding against each other for a smaller share while they have their share and take it home; is that a correct understanding of how this would work in a shortage situation?

MS. FREDRIKSEN: Not if they understand the value of the SPR, and that is why the IEA has been working to include the Chinese ministerial officials in the IEA meetings, so that that understanding exists, and there is hope that the IEA would be able to work with them in a time of a disruption to use some of their SPR reserves as they come on line.

They've only got one reserve built. They're trying to build the other four, I believe. And then filling them to the 90-day requirements that IEA has, but as a model.

COMMISSIONER MULLOY: Could you take this back? Because my understanding is the oil-sharing scheme is much more than just drawing on strategic petroleum reserves. It's actually allocating oil through some kind of formula that they have in the IEA, the available oil during an energy shortage. At least that's the way it used to be.

Could you have your people come back to us and explain what would happen if there was an energy shortage? And I think it triggers at seven percent--doesn't it--of global supply?

MS. FREDRIKSEN: I can't remember the exact number, percent, but, yes, we'll be happy to do that.

COMMISSIONER MULLOY: Is there some magic percentage that triggers the system? How it would work? And then my concern is as China locks up more of the global supply through its deals with these

other countries, it takes its own and can go home while the rest of us are still bidding for the available supply. So can you have your people explain that in something you could submit for the record?

MS. FREDRIKSEN: Be happy to.

COMMISSIONER MULLOY: Thank you very much. That would be very helpful.

[Ms. Fredriksen's response for the record:]

The United States is a member of the International Energy Agency (IEA), the organization established in 1974 to enable its members (all of whom are members of the Organization for Economic Cooperation and Development) to cooperate in responding to oil supply disruptions. The IEA has two sets of emergency oil supply disruption response measures. The 1974 Agreement on an International Energy Program, the charter of the IEA, incorporated an allocation system (Emergency Sharing System) to be triggered by a physical shortfall of 7% in IEA oil supplies. This system was typical of 1970's notions of government intervention in markets; it has never been used, and is now considered outdated/inefficient. The second response system is known as the Coordinated Emergency Response Measures, or CERM. CERM is flexible, market-oriented, with emphasis on stockdraw as a first response, and is intended to complement the market's own response to a problem by quickly adding supply to the market. The decision for activation of a CERM-type response would be by consensus of the IEA's 26 member countries, acting through the IEA Governing Board

The IEA's response policy is oriented toward reacting to a physical disruption in world oil supplies that has the potential of inflicting economic damage on its members. Upon occurrence of an event, any member may call for IEA action. The IEA can also be anticipatory. There is a contingency plan in place, agreed shortly after September 11, 2001, and modified in October 2002. This contingency plan was used to implement the IEA's September 2006 response to supply losses resulting from Hurricane Katrina. The Contingency Plan process has the IEA Executive Director making an "initial assessment" that a specific supply event may merit IEA action, to be followed by a period of consultation among IEA members, that leading to a decision by members on whether to initiate a response action (draw stocks, demand restraint, etc.). Under the IEA contingency plan, members' shares in an overall IEA response are divided according to their share in total IEA oil consumption. Under this arrangement, the U.S. would currently make up slightly less than half of an IEA response.

HEARING COCHAIR WESSEL: Commissioner Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you and welcome, Ms. Fredriksen. Thank you very much for appearing today, and I understand that you've just started in June--

MS. FREDRIKSEN: Yes.

COMMISSION VICE CHAIR BARTHOLOMEW: So thank you. Welcome to government service and thank you very much for the time that you're spending working in the government. As Kerri mentioned, we were in China recently, and once again, the pollution is just astonishing, breath-taking in more ways than one, and about the only good thing I could say that comes out of it is roses are thriving. Apparently roses thrive with acid rain.

But obviously, the energy consumption is an issue for a number of reasons, and one is the pollution which is going to reach our shores also, and it's already doing that.



But to what degree do the Chinese acknowledge global climate change and also what role does the U.S. government believe that China's energy consumption is contributing to global climate change?

MS. FREDRIKSEN: We've wrestled with this for a number of years, as you're well aware, and I think the energy efficiency focus that China has right now is going to realize the largest gains, and they've come to the table and to the Asia-Pacific Partnership with that mind, to increase their energy efficiency.

I think you will see the benefits of that will come through reduction in all air pollutants, but to date, we've not seen them want to engage on climate change specifically.

COMMISSION VICE CHAIR BARTHOLOMEW: Do we have any sense of what role their increasing energy consumption is playing in the bigger problem of global climate change?

MS. FREDRIKSEN: We certainly know that between China and India. You can't really discuss climate change in a global setting without the large players there, and the U.S. is only one of those, and so it becomes esoteric if you don't have China and India at the table. Until they're ready to do that, I think we won't see a global approach to dealing with climate change.

But we will see a lot of large gains in just the things that we are doing now and getting the technology there and getting it installed. Until they see the benefits of IGCC, for example, we're still struggling in this country to get it online and to get it prosperous where the private sector takes off on IGCC.

The Chinese are watching that as well. We've got to try to do as much as we can to advance those technologies domestically for them to pick them up. It becomes a cost issue. They can invest, but they don't have the same recognition or they do have the same recognition of the old pulverized coal plants, for example. They do have the recognition on the transportation side.

They have become a very prosperous and growing country, and they progressively want to get to the standards that the rest of the world enjoys, so they are now dealing with those problems that come with that, just as we've had to do in the past, and I think we are getting there cooperatively with them.

COMMISSION VICE CHAIR BARTHOLOMEW: And we obviously have some policy debates going on in this country about pollutants and what we should be doing about them. Do you find that as we are talking to the Chinese and encouraging them to deal with their pollution issue, that they are pushing back at us, saying, well, you guys aren't doing some of this; why should we be doing it?

MS. FREDRIKSEN: Not to my knowledge. I think they recognize the technology advances that we have, that they can take a-hold of and use. I think there's that education component that they respect. So to my

knowledge, they don't feel that way.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you.

HEARING COCHAIR WESSEL: With your leave, since we started just a couple minutes late, we had three commissioners who had asked for brief follow-ups, if that's okay with your schedule--Commissioners Wortzel, Donnelly and Blumenthal.

CHAIRMAN WORTZEL: I wanted to ask you if you're aware of the situation in the Tarim Basin in China? In the late 1980s there was a lot of international and domestic exploration there, and it's never been clear to me whether the government of China made a strategic decision to simply leave those fields untouched, as a long-term domestic strategic reserve, or whether there were serious problems with exploitation and extraction that were awaiting new technologies to facilitate exploiting any fields?

So I'd be interested in an update on that if you are able to provide it.

MS. FREDRIKSEN: I'd be able to provide it to you. I don't think I know off the top of my head. I apologize.

CHAIRMAN WORTZEL: Thank you.

[Ms. Fredriksen's response for the record follows:]

In July 2006, PetroChina announced that it would open nine blocks in the Tarim basin in northwestern China's Xinjiang Uygur Autonomous Region for foreign companies to explore. The nine blocks cover more than 42,000 square miles and according to CNPC hold an estimated 43.9 billion barrels of potential oil reserves. Despite the lure of large potential reserves, previous bidding rounds in the Tarim basin received a tepid response from foreign companies, because potential bidders thought that its remote location and difficult geological structures would make exploration and development difficult.

HEARING COCHAIR WESSEL: Commissioner Donnelly.

COMMISSIONER DONNELLY: Thanks. I know you're going to come away from this hearing with a feeling that we have no understanding of the international energy marketplace.

MS. FREDRIKSEN: Not at all.

COMMISSIONER DONNELLY: But I want to try one more time.

HEARING COCHAIR BLUMENTHAL: Which would be an accurate--

COMMISSIONER DONNELLY: Yes, right. I just want to reinforce that impression. To the degree that China is extracting new resources, bringing to the surface new resources, that is a good thing, I suppose, but those resources don't go directly into the marketplace, so to speak.

MS. FREDRIKSEN: Right.

COMMISSIONER DONNELLY: So if nothing else, it seems to me that if that pattern persists, there are opportunity costs to the marketplace. The ability of the marketplace to develop new resources is constrained because these resources which might have been developed under normal

market mechanisms in the course of time or whatever, as long as they stay in this non-market pot, are not available to meet the increasing energy demands of those nations, any of them, the Chinese, to the degree that they participate in the markets?

So is there no problem, at least a cloudy lining to this alternative non-market mechanism that extracts for developing energy resources?

MS. FREDRIKSEN: Again, I don't think that you don't understand markets so I don't want to come across that I thought that.

COMMISSIONER DONNELLY: It's true.

MS. FREDRIKSEN: They are building and extracting in previously closed-off areas because of the geopolitical risk that has deterred private sector investment from going into those areas, that China is able to take on that risk because of a different view fundamentally, a different approach than we have.

But again that oil that they extract if they do have it go back to China is not affecting what is on the availability of the world market now. That's actually adding to what--

COMMISSIONER DONNELLY: Right, but at some point the market might have said the risk/benefit analysis says it's okay to go develop those resources. And to the degree that they are, again, not available for development under normal market mechanisms, yes, fine, it doesn't affect the market now, but it certainly constrains the ability of the market to develop those resources in a market, under a market system, and a market fashion, if, to use a past phrase, taking home, or again not subject to normal pricing mechanisms the way the rest of the energy supplies are?

MS. FREDRIKSEN: From the U.S. perspective, it's why we have taken a very long look at where we can look at areas for exploration. As you know, we get the bulk of our oil from Canada, a very stable country, one that we have a lot of synergy with, and likely those reserves will continue in the future.

So I think it's in everyone's interests to look at their ability to bring more oil to the surface and you're seeing that in the former Soviet Union countries as well. Do we know how much Saudi Arabia has? Speculative. But the market is continuing to function. We're not going to change our model to go out and acquire assets like China does, but we will continue to buy off the market and believe it will adjust.

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Okay. I'm going to risk adding to the pool of ignorance. Is that fungible--ignorance?

MS. FREDRIKSEN: As long as it's not catching.

HEARING COCHAIR BLUMENTHAL: Right. Let's take the premise that you said there's this pool which is already on the market and then there is a pool that China is developing that isn't affecting that pool that's already on the market.

But I would question that, again, going back to this question of how petroleum is priced. In other words, and maybe this is just something you can't answer right now, but it would seem that extracting from Sudan is not the same as extracting from Canada, since it does add to the general geopolitical instability that I would contend I just see every time there's a Middle East conflict or something is not being resolved, you see the price of oil going up.

So I wonder, and perhaps you can do this in just a response for the record, it seems that China is actually contributing to the price volatility through the types of arrangements and types of relationships it gets into.

Or for being, let's say, obstructionist on solving certain geopolitical problems because all things being equal, the geopolitical problems in the Sudan and Iran, so on and so forth, would make the price of the market that we all participate in lower, and again it goes to this question of there are a lot of costs in petroleum coming back to our market that are probably not reflected in the marketplace.

I mentioned our military structure, but there are all sorts of diplomatic costs. So it seems to me that in that pool that you described that we're all part of, that's affected as well by Chinese behavior, and I wonder if, again, being obstructionist on solving some of these geopolitical crises, and I wonder if there is any way you can get back to us on some sort of way to quantify that sort of price volatility?

MS. FREDRIKSEN: I'll try to do that.

HEARING COCHAIR BLUMENTHAL: Thanks.

[Ms. Fredriksen's response for the record follows:]

We do not believe that China's efforts to obtain overseas oil production contribute significantly to oil market volatility. Oil market volatility typically results from uncertainty in the market, particularly as regards supply security. Global spare production capacity is currently relatively low, providing a narrow buffer against potential supply problems. Limited spare capacity exacerbates the market impacts (volatility) of geopolitical threats to supply, such as has recently occurred in Nigeria, with the nuclear situation in Iran, and the ongoing violence in Iraq. China will have to find the oil someplace, including in Iran and Sudan, to fuel its growing economy, either on the open market, through investing in overseas production, or through some combination of the two. China's efforts to develop overseas oil sources will, if successful, have the effect of expanding the global oil supply base. An expanded supply base typically would be expected to decrease relative market volatility.

HEARING COCHAIR WESSEL: With that, thank you. We appreciate your participation this morning and your generous devotion of time to us, and we will reconvene in about three or four minutes for the next panel. Thank you.

MS. FREDRIKSEN: Thank you.

[Whereupon, a short break was taken.]

## **PANEL VIII: CHINA'S ENERGY REQUIREMENTS AND POLICIES**

HEARING COCHAIR WESSEL: Thank you, Dr. Downs, for being here. Our second panel today will examine China's energy requirements and policies. We're pleased that Dr. Erica Downs from the Brookings Institution could join us today.

Dr. Downs specializes in Chinese energy issues. Prior to working at Brookings, Dr. Downs served as an energy analyst for the Central Intelligence Agency and at the RAND Corporation.

She has also taught at the Foreign Affairs College in Beijing. Dr. Downs has written numerous works detailing China's energy needs and its efforts to achieve energy security, and we are very pleased that you could be here today.

Your statement will be inserted into the record, and if you could speak for about seven minutes so that we can have a good round of questioning, we'd appreciate it.

Thank you.

### **STATEMENT OF DR. ERICA S. DOWNS CHINA ENERGY FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, D.C.**

DR. DOWNS: Let me begin by saying thank you to the chair and the other members of the Commission for the opportunity to participate in today's hearing. It's an honor to be here.

I'm going to confine my remarks today to oil. Oil is currently the only fuel which China imports in substantial quantities and consequently it is the fuel that has had the largest impact on China's international behavior in recent years.

My testimony today will briefly address several issues. First, I will discuss China's oil demand, domestic supply and imports. Second, I will examine some of the measures that China is taking to ensure its oil requirements are met. And third, I will discuss some of the implications of these measures for the United States.

In terms of China's oil balance, China is currently the world's second-largest consumer of oil behind the United States, and the world's third-largest importer of oil behind the United States and Japan.

According to the International Energy Agency, between 2000 and 2005, China accounted for about 27 percent of the growth in world oil demand. In 2005, China consumed 6.6 million barrels per day of oil, less than one-third of the amount consumed by the United States, and imported three million barrels per day of oil, less than a quarter of the amount imported by the United States.

China's oil demand and imports will continue to grow. The only question is by how much? Recent projections by Chinese and

international energy experts indicate that by 2020, China's oil demand will range from ten to 13.6 million barrels per day and China's domestic oil supply will range from 2.7 to four million barrels per day.

These projections indicate that by 2020, China will be importing six to 11 million barrels per day, constituting about 60 to 80 percent of China's total oil consumption.

Second, in terms of China's efforts to ensure its oil requirements are met, over the past decade, the steps that China has taken have emphasized supply expansion over demand moderation. The supply side bias is explained by a number of factors that have impeded demand side management in other countries.

These include the existence of bureaucratic champions for increasing supply but not for constraining demand; the limited financial resources devoted to demand side management measures such as energy conservation; and the fact that measures to slow oil demand growth tend to be more difficult to implement politically than measures to expand supply.

In terms of demand side management, the Chinese government has been reluctant to remove state-set caps on the prices of oil products to moderate demand because of concerns about the impacts of oil price volatility on the Chinese economy and on certain segments of society such as farmers.

The imposition of a fuel tax under discussion for more than a decade has been delayed in large part because of conflicts between central and local governments over revenue sharing. Beijing, however, has recently taken several steps to encourage consumers to buy more fuel-efficient cars, including the imposition of a first stage of fuel economy standards in July 2005 and a large-engine car tax in March 2006.

In terms of supply expansion, China is following in the footsteps of other major oil consumers in the measures that it is pursuing.

First, China has sought to diversify its oil suppliers and to limit China's dependence on the Persian Gulf which accounted for almost 50 percent of China's crude imports in 2005.

China also wants to reduce its dependence on the sea lines of communication through which about 90 percent of the country's oil imports travel because they are vulnerable to disruption on the high seas by various modern navies.

Russia and Kazakhstan are important to China's diversification plans, not only because these two countries are located outside of the Persian Gulf region, but also because their exports travel to China over land.

Second, China's oil companies are acquiring equity positions in exploration and production assets abroad. These investments are driven by multiple corporate and national motivations including growing reserves in profits and enhancing the country's energy security.

The companies' production to date has been concentrated in a few countries including Sudan, Kazakhstan and Indonesia, and in the hands of one company, the China National Petroleum Corporation, also known as CNPC.

In 2005, China's oil companies produced about 450,000 barrels per day of equity oil--that's the share of the oil that they produce abroad--accounting for about 15 percent of the country's total imports.

Third, the Chinese government is employing a variety of financial and political instruments to cultivate closer relationships with major oil exporters to facilitate trade and investment opportunities for China's oil companies.

These tools, the financial tools, include the provision of foreign aid and the construction of non-oil infrastructure. These financial tools have been used with some success in Africa where there is a tremendous need for infrastructure.

Finally, implications for the United States. Energy is undoubtedly playing an increasingly important role in Chinese foreign policy although where energy ranks as a priority in China's foreign policy varies by country.

China's energy interests like those of many other countries shape China's policies on non-energy issues. Beijing appears more willing to pursue policies to gain and maintain access to oil that run counter to U.S. interests when those interests are deemed not to be top U.S. foreign policy objectives.

For example, China has worked harder to protect its energy relationship with Sudan than with Iran. In the case of Sudan, Beijing actively undermined efforts by the United Nations Security Council to impose economic sanctions on Khartoum for the atrocities in Darfur. In the case of Iran, China has had to balance several competing interests including economic and energy interests and its relationship with the United States.

In February 2006, under substantial pressure from Washington, Beijing voted as a member of the Board of Governors of the International Atomic Energy Agency to report the Iran nuclear issue to the Security Council.

And finally, although the foreign investments of China's national oil companies pose diplomatic challenges for the United States, these investments also help to increase the global supply of oil which benefits all consumers.

Thank you for your time, and I'd be happy to answer your questions. [The statement follows:]

**Prepared Statement of Dr. Erica S. Downs  
China Energy Fellow, The Brookings Institution, Washington, D.C.**

Let me begin by saying thank you to the members of the Commission for the opportunity to testify. It is an

honor to participate in this hearing.

I have been asked to speak about China's energy requirements and policies. I am going to focus my remarks today to oil. Oil is currently the only fuel which China imports in substantial quantities and, consequently, it is the fuel that has had the largest impact on China's international behavior in recent years.

My testimony today will briefly address several issues:

- First, I will discuss China's energy demand, domestic supply and imports.
- Second, I will examine some of the measures China is taking to ensure its oil requirements are met.
- Third, I will address some of the implications of these measures for the United States.

### **China's Energy Demand, Domestic Supply and Imports**

China is the world's second largest consumer of primary energy behind the United States and the third largest producer of primary energy after the United States and Russia. China is able to meet more than 90% of its primary energy requirements with domestic supplies, largely because of the country's abundant coal reserves and coal-based economy. Coal accounts for more than two-thirds of China's primary energy consumption and production. China imports small quantities of coal to supply southern China, which is located far from the country's coal producing regions, and China began to import liquefied natural gas (LNG) in May 2006. However, natural gas imports probably will be negligible until after 2010 because of the lead-times for the construction of transnational pipelines and additional LNG receiving terminals. Oil is the only fuel that China imports in substantial quantities.

#### *China's Oil Balance*

China, which was self-sufficient in oil until 1993, is now the world's second largest oil consumer behind the United States and the world's third largest oil importer behind the United States and Japan. According to the International Energy Agency, between 2000 and 2005 China accounted for 27% percent of the growth in world oil demand. In 2005, China consumed 6.6 million barrels per day (b/d) of oil, about one-third of the US level of 20.8 million b/d, and imported 3.0 million b/d, about one-quarter of the US level of 13.5 million b/d, also according to the IEA.

China's oil demand and imports will continue to increase; the only question is by how much. Recent projections by Chinese and international energy experts indicate that by 2020 China's oil demand will range from 10 to 13.6 million b/d and China's domestic oil production will range from 2.7 to 4 million b/d. These estimates indicate that China's oil imports in 2020 will be 6 to 11 million b/d, accounting for 60 to 80% of total domestic consumption.

### **China's Efforts to Meet Its Oil Requirements**

Over the past decade, the measures that China has pursued to ensure its oil requirements are met have emphasized supply expansion over demand moderation. This supply-side bias is explained in part by factors that impede demand side management in other countries. These include the existence of bureaucratic champions for increasing supply and the absence of bureaucratic champions for constraining demand, the limited financial resources devoted to demand side management, and the fact that measures to slow demand growth tend to be more difficult to implement, politically, than measures to expand supply.

In terms of moderating demand, the Chinese government has been reluctant to remove state-set caps on oil product prices because of concerns about the impact of price volatility on the economy and on certain segments of society, such as farmers and taxi drivers. The imposition of a fuel tax, under discussion for more than a decade, has been delayed not only because of concerns about the burden it would impose on



the agricultural sector but also because of conflicts between central and local governments over revenue-sharing. Beijing, however, has taken steps to encourage consumers to buy fuel efficient cars, implementing fuel economy standards in July 2005 and a large engine car tax in March 2006.

In terms of expanding supply, China is following in the footsteps of other major oil consumers in its efforts to diversify its oil suppliers and oil import routes, acquire equity stakes in exploration and production assets abroad, and cultivate closer diplomatic relations with major oil exporters to help China's national oil companies (NOCs) secure trade and investment deals.

#### *Diversification of Oil Suppliers and Import Routes*

The Chinese government recognizes that the diversification of China's oil suppliers and import routes can enhance the security of the country's oil supply. In terms of oil suppliers, China has sought not only to expand the number of countries and regions from which it imports oil but also to limit its dependence on the Persian Gulf, which in 2005 provided China with almost half of its crude oil imports. However, Chinese and international energy experts expect that the country's reliance on the Persian Gulf will increase because of the region's large oil reserves. In terms of import routes, China wants to reduce its dependence on the sea lines of communication through which almost 90% of the country's crude oil imports travel because of their vulnerability to disruption on the high seas by various modern navies.

The construction of oil pipelines from Kazakhstan and Russia to China plays an important role in China's diversification plans not only because these two countries are located outside of the Persian Gulf region, but also because their exports to China are delivered overland. The easternmost leg of a multi-phase 400,000 b/d pipeline from western Kazakhstan to western China began operation in 2006. The fate of a proposed 600,000-b/d pipeline from Eastern Siberia to northeastern China, under discussion for more than a decade, is in the hands of Moscow. If both of the pipelines are built and operated at design capacity, the combined throughput of 1 million b/d would constitute 9 to 17% of the 6-11 million b/d China is projected to import in 2020.

#### *Foreign Oil Investment*

China's growing domestic oil deficit has propelled China's national oil companies (NOCs) to search for oil abroad. The NOCs select projects according to their respective capabilities and corporate objectives, not necessarily because of a state-directed set of national policy priorities. China's NOCs produced about 450,000 b/d of equity oil -- the companies' share of the oil they produce -- abroad in 2005, constituting 15% of total imports. Although the NOCs have invested in many countries, most of their production is concentrated in a few countries and under the control of one company, China National Petroleum Corporation.

- Sudan, Kazakhstan and Indonesia accounted for 79% of the overseas equity oil production of China's oil companies of 372,370 b/d in 2004.
- CNPC accounted for 89% of the foreign equity oil production of China's oil companies in 2004.

However, recent investments in Angola by China National Petrochemical Corporation (Sinopec) and in Nigeria by China National Offshore Oil Corporation Ltd. (CNOOC Ltd.) should make these countries substantial sources of foreign equity production.

The idea that the acquisition of oil assets abroad can enhance China's energy security is rooted in the assumption that oil obtained through foreign investment is more secure and less expensive than that purchased on the international market. Proponents of this idea are skeptical of the assumption held by Western oil industry analysts that oil will always be available, albeit at a fluctuating price, on the world market. These proponents recommend the acquisition of equity oil so that if China ever finds itself in a

situation where it has money but is unable to buy the oil it needs on the world market, then China's NOCs can send their foreign equity production to China. Some proponents also maintain that barrels of oil produced by Chinese companies abroad are insulated from fluctuations in world oil prices and can provide Chinese consumers with oil cheaper than that available on the international market.

The Chinese public debate on energy security indicates that participants have begun to question the relationship between the foreign acquisitions of China's national oil companies and China's energy security. While in the past there appeared to be virtually universal support for the acquisition of equity oil to meet China's oil requirements, dissenting voices have begun to emerge. Some Chinese analysts are now arguing that overseas oil investment is not a panacea, noting that the foreign equity oil of China's NOCs only constitutes a fraction of the country's oil imports and will do little to help China deal with a supply disruption and its consequences.

### *Oil Diplomacy*

The Chinese government is cultivating closer diplomatic relations with the governments of oil producing states to facilitate trade and investment opportunities for China's NOCs. Both the Chinese government and the NOCs maintain that developing such relationships are necessary not only because the governments of many oil producing states have considerable influence over which foreign companies are allowed to invest but also because other national and international oil companies receive varying degrees of home government support. Consequently, the Chinese government, like other major oil importing countries, has wielded a variety of financial and political tools to help China's NOCs secure deals.

Financially, the Chinese government has provided oil producing states with a variety of financial incentives to offer investment opportunities to China's oil companies, including the construction of basic infrastructure by Chinese firms and the provision of foreign aid. Many of the acquisitions made by China's national oil companies are linked to investments in non-oil infrastructure by other Chinese firms. This is especially true in Africa, where there is a tremendous need for basic infrastructure and certain oil producers, notably Nigeria and Angola, have indicated that they will give preferences to foreign oil companies that can offer attractive economic packages.

Politically, the Chinese government has supported China's oil companies with summit meetings between Chinese leaders and their counterparts in oil producing states, which provide Chinese leaders with the opportunity to lobby on behalf of the oil companies for projects and for the oil companies to sign previously negotiated agreements. China leaders have been directly involved in the negotiations for some projects, and, in at least one case, have used China's seat on the United Nations Security Council (UNSC) to deflect international diplomatic pressure on a country in which a Chinese oil company has substantial investments.

### **Implications for the United States**

Energy is undoubtedly playing an increasingly important role in Chinese foreign policy, although where energy ranks as a priority in China's foreign policy varies by country. China's energy interests, like those of many other countries, including the United States, shape China's policies on non-energy issues. Beijing is probably more willing to pursue foreign policies to gain and maintain access to oil that run afoul of US interests when those interests are not top US foreign policy objectives.

China's energy requirements and efforts to satisfy those requirements have generated friction with the United States. Sudan and Iran the most high profile cases and are often grouped together by analysts as examples of how China's energy interests are shaping China's international behavior in ways inimical to US interests. However, there are differences between China's energy ties with these two countries and the extent to which China's energy interests have impacted Chinese foreign policy toward these countries on other issues.

China's energy relationships with Sudan and Iran differ, with investment playing a substantially larger role in the case of Sudan and trade dominating in the case of Iran.

Sudan is the largest source of foreign oil production of China's NOCs and was China's seventh largest supplier of crude oil in 2005, providing China with 133,000 b/d, about 5% of China's crude imports. Iran was China's third largest supplier of crude oil in 2005, supplying China with 287,000 b/d, about 11% of China's crude imports. The investments of China's NOCs in oil and natural gas exploration and development projects in Iran are extremely modest to date, but Sinopec and CNPC are interested in making substantially larger investments. In the future, Iran is likely to play a more important role in meeting China's energy requirements because of its large resource base; Iran holds the world's second largest proved reserves of oil and natural gas.

China has devoted more effort to protecting its energy relationship with Sudan than with Iran. In the case of Sudan, Beijing weakened the language of at least one UNSC resolution which included an automatic trigger for sanctions if Khartoum failed to stop the atrocities in Darfur. The two main drivers of China's behavior were energy and the Chinese government's longstanding opposition to the use of sanctions, especially to punish violations of human rights.

In the case of Iran, China has to balance several competing interests, including energy and other economic interests and its relationship with the United States. In February 2006, under substantial pressure from Washington, Beijing voted as a member of the board of governors of the International Atomic Energy Agency to report the Iran nuclear issue to the UNSC, a step that might lead to the imposition of economic sanctions and jeopardize China's energy trade with and investment in Iran.

Although the foreign investments of China's NOCs have posed some diplomatic challenges for the United States, these investments are also helping to increase the global supply of oil, which benefits all consumers, including the United States.

### **Panel VIII: Discussion, Questions and Answers**

HEARING COCHAIR WESSEL: Thank you and perfect timing. Help us, if you can, and the point was made by one of the commissioners a couple of minutes ago, that we are not experts on the world oil market, so we're looking for a little education here, and your last point was that the places that China is advancing its energy security goals may be bringing new supply to market.

But it appears from looking out on the horizon that China's dramatically increasing energy demand, and I believe you said they now accounted for 27 percent of the growth, that reserve additions, even in the areas that they are now going to Sudan, et cetera, will not keep pace with world energy demand over time. And that their non-market acquisition strategy to buy the assets at the wellhead is at some point going to run against free market entities that are buying on the open markets, that the U.S. and other Western nations will have to compete for a smaller and smaller part of the pie.

Is that an accurate read as we look at this, understanding that we want to increase efficiency, we want to try drilling and all the various things you can do to bring new product to market, but reserve additions are not keeping pace at this point with the supply demands that we see? Is that an accurate read?

DR. DOWNS: I suspect that some of the participants in the following panel may have some thoughts on this question as well. In terms of putting the investments of China's national oil companies in a broader context, if you look at the world oil market today, most of the world's oil reserves--almost 80 percent--are in the hands of countries that are not open to foreign investment in the upstream sector.

For example, Saudi Arabia, Mexico, some of the world's largest reserve holders, do not allow foreign companies to take equity stakes in the upstream. So China's national oil companies are competing with national oil companies from other countries, with the international oil companies, to gain access to the 23 percent or so of the world's oil reserves that are open to foreign investment.

In terms of the reserve addition question, this is an issue that I believe is a subject of much debate among oil market analysts about the extent to which new reserves can be added, the extent to which non-conventional sources of oil such as oil sands will be able to make up for any decline in conventional oil production.

I'm not trained as an economist, but one answer that an economist would give that I think merits our attention is that demand always equals supply, and it's a question of at what price?

So if reserves become more scarce, and prices go up, then that's going to spur different companies and governments to look at alternatives to oil, and this in turn--I think this issue is something that governments of major oil producing states such as Saudi Arabia keep in mind. These countries want to keep oil prices high enough that they can continue to fill their coffers because oil is an important source of revenue for these states, but they don't want oil prices to get so high that major oil consumers start looking seriously at alternatives.

HEARING COCHAIR WESSEL: That assumes a free market, and we all know that there is OPEC. We all know that while supply may equal demand, we've seen gas over \$3 and the Canadian oil sands which seemed to have bright prospects last year, its ability to fulfill demand has been questioned, I think, of late, and as well as you know, China has been looking at purchasing Canada's oil sand capabilities.

There is no free market in oil though, if you will. There are limited parts of the market that are free, and there is the spot market and everything else. But for the immediate horizon, we've now seen gas prices go up over \$3 a gallon. We have not seen enough reserve additions or the price points change enough that we are seeing any moderation in those prices, and as was related earlier, we're also seeing an increased risk premium, I think, from China's energy acquisition strategies. As they strengthen their ties with Iran, we then see that the volatility, the speculators worry about Mideast conflict, in greater ways. How do you factor all of that in?

DR. DOWNS: Factor all of that into?

HEARING COCHAIR WESSEL: All of that into the challenge of a non-profit market participant, China, versus the market participants in what is truly not a free market? Energy is not a free market when you look at oil with the cartel; correct?

DR. DOWNS: [Nods affirmatively.]

HEARING COCHAIR WESSEL: So should we be looking at energy strategies in a different way than we have in the past?

DR. DOWNS: I think that the foreign acquisitions of China's national oil companies does pose a challenge to the international oil companies in that China's national oil companies are employing a number of tactics that are unavailable to the international oil companies because ultimately it comes down to different shareholder values. But in the case of the international oil companies, they're expected to deliver a certain rate of return. That's what their shareholders expect.

In the case of China's national oil companies, the sole shareholder, or in the case of the listed companies, the majority shareholder is the government, and the government is willing to accept a lower rate of return than that which the international oil companies accept.

HEARING COCHAIR WESSEL: Okay. We may come back, I hope, but Dr. Wortzel.

CHAIRMAN WORTZEL: Dr. Downs, I don't know if you were here when I asked that question about the Tarim Basin oil. After the exploration, there was no exploitation in the Tarim Basin. Was that a long-term strategic decision by the Chinese government to leave what could be huge reserves in the ground or was it a question of exploitation technology at the time in the late '80s, early '90s?

DR. DOWNS: I suspect that the answer may have more to do with what oil there is in the ground under the Tarim Basin. As you may recall, the Chinese government decided to open up the Tarim Basin to foreign companies in 1993, the same year that China shifted to a net oil importer. It was a very controversial decision within China because China National Petroleum Corporation is quite nationalistic.

They did not want to let foreigners into their territory. Nonetheless, this was a decision that they were overruled on by the top leadership, so foreign companies did go in. The Chinese employed a tactic that host countries around the world employ, which is that they held on to what they thought were the choicest blocks for themselves and they gave what they deemed to be less promising exploration blocks to the foreign companies.

The foreign companies did not find anything. I believe that most if not all of the companies, foreign companies who had been operating in the Tarim Basin, had pulled out by the late 1990s. What is the likelihood that there is going to be a substantial discovery in the Tarim Basin?

On the one hand, I think it's quite telling that the international oil companies have left, and I also think the fact that China's oil companies

are looking for oil beyond their borders to replace and grow reserves implies that there may not be that much oil available in the Tarim Basin.

On the other hand, the Tarim Basin is huge: it's about the size of Texas, and it has not been thoroughly explored.

CHAIRMAN WORTZEL: Thank you.

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Welcome, Dr. Downs. I'm an admirer of your work. I know you might have an answer to this question because I've read some of your previous work on energy security, and again, in exchanges with the Chinese, you get a perception of energy security, what they define as energy security that's quite different from our own.

We talk a lot nowadays about Chinese concerns about our ability to disrupt supply. You hear from the Chinese often that we, the Americans, control the oil market, and I think what they mean is we control the seas and so you're seeing attempts to go into places where the United States cannot compete due to sanctions policy, compete for oil in particular.

But you're also seeing what many have referred to, "the string of pearls" strategy, where you develop some alternative ways to get oil back to China. Pipelines--you mentioned Kazakhstan and Russia.

I wonder what your views are on the Chinese, if they are indeed so very concerned about relying upon the United States for the security of their supply, I wonder if you can lay out for us Chinese thinking as far as you can divine how to deal with this, from their point of view, very big problem of securing supply both from a military perspective, and you've already mentioned some of the strategies used in terms of going into some of these volatile countries?

DR. DOWNS: Sure. I'd like to begin by saying that "energy security" is a term in China, like in the United States and many other countries, that is frequently used but not so frequently defined. The shorthand definition that lots of people use in this country and that some analysts in China employ as well is adequate and reliable supplies at reasonable price and being able to obtain them in such a way that does not undermine national values, national interests.

I think that if you look at Chinese writings on energy security, they basically have three concerns. One, of course, is the adequate supply. The second has to do with pricing. What does reasonable price mean for China? I think reasonable price for China means prices that are low enough that they don't threaten social stability, low enough that farmers, taxi drivers, other key segments of society can get the oil they need at prices that they can afford.

But they also don't want prices that are so low that they have an overwhelmingly negative on China's refiners.

The Chinese are also concerned about security of delivery, and this speaks to the questions that you raised in that, as we all know, China

currently does not have a navy capable of ensuring the delivery of its seaborne oil imports to China. And this is a reality the Chinese may not be happy with it. They may not be happy having to effectively rely on the United States Navy to guarantee the safety of the sea lanes, but it's something that they recognize that in the short term they can't do anything about.

I was in Beijing in April, and this issue came up with a foreign policy analyst, and this person's response was by the time China ever has a navy that could rival that of the United States, there's not going to be any oil left in the world. So I think that there's a perception in China that the reality they have to deal with is that they don't have the military power to maintain the security of our seaborne oil imports.

So given that this is the sort of less than desirable, less than ideal world that they are looking at, what are they trying to do? As I mentioned earlier, overland import routes. There's a perception that overland imports are safer than seaborne imports. I think that's debatable, but as we all know, perception is political reality, and so in China there have been big pushes to develop overland pipelines from Kazakhstan and Russia.

The Kazakhstan project is moving forward. It's a multi-phased pipeline, and in December 2005, CNOOC and KazMunaiGaz, the Kazakhstan state oil company, completed the construction of the eastern-most leg that flows to China, and that began commercial operations last month.

HEARING COCHAIR BLUMENTHAL: Can I ask a question on that?

DR. DOWNS: Sure.

HEARING COCHAIR BLUMENTHAL: Which is overland--so you're talking about security of the supply over land. If you have a Chinese consortia that actually owns a piece of these pipelines, how then do the Chinese think about securing that?

Are we talking about different kinds of force structure? Are we talking about relying upon the "stans" themselves to enter into relationships? How is that more secure in the Chinese view?

DR. DOWNS: I think that's an excellent question. I have not come across any materials in my research that talk about militarily what China might do to secure that pipeline, but I think there's a perception that--I think it has to do with if your oil imports are flowing through territories or seas that are controlled by others, which is the lesser threat? And I think that there is a perception that having a pipeline that flows through Kazakhstan is more secure than one, that basically Kazakhstan is less of a threat or potential threat to China's oil supplies than to the United States.

Of course, in a wartime situation, all bets are off. But if you take out a large pump station on one of those pipelines, it's going to be out of operation for awhile.

HEARING COCHAIR BLUMENTHAL: Thank you very much.

HEARING COCHAIR WESSEL: At the chairman's request, I'm going to give him a follow-up.

CHAIRMAN WORTZEL: I want to follow that up. I don't know if you have watched a series of exercises by the 15th Airborne Army of the People's Liberation Army in the past decade that ran mass mobility exercises out into the far west of Xinjiang. The PLA sent in larger units and small special operations units that were air-dropped out there. Could such an effort relate to the protection of pipelines and be an exercise in force projection to protect pipelines through rapid mobility by these airborne forces?

DR. DOWNS: I think it's certainly within the realm of possibility. But again, I haven't come across any materials explicitly linking these exercises to China's energy interests in Central Asia. This is hardly surprising and I don't know that this is something that we're necessarily going to see a lot of publicly available writings on.

HEARING COCHAIR WESSEL: Commissioner Reinsch.

COMMISSIONER REINSCH: I'm tempted to pursue the market issue, but I think I'll leave it to others this time around. We don't seem to be making our point very successfully and rather than dig the hole deeper, let me ask a different question.

Picking up on the last exchange, and I'm sorry if you said this and I missed it, but can you talk a little bit about your sense of the status or viability of pipeline projects coming from outside of China across the west from Kazakhstan or Turkmenistan or wherever?

DR. DOWNS: Certainly. As I mentioned earlier, there is a multi-phase pipeline that's being built from Kazakhstan to China. The ultimate goal from the Chinese side is to have a pipeline running from western Kazakhstan, from the Caspian Sea to Xinjiang. This is being built in stages. The western-most leg of the pipeline was completed in 2003 and that currently flows west to east so it's serving customers west rather than east of Kazakhstan. And so eventually if this proposal is to become a reality, they'll have to reverse the flow of oil.

COMMISSIONER REINSCH: I don't understand that. You said it was flowing west to east?

DR. DOWNS: No, east to west. It's flowing towards Europe, not towards China. Sorry for any confusion on that. So that leg's done.

And they recently completed the eastern-most leg which runs from Kazakhstan to the Chinese border, and there is one leg that is left to be built that has not been built yet. This is a pipeline that when it was first proposed back in 1997 was widely dismissed by industry experts and international commentators as a pipe dream because of the question of project economics.

I suspect that the economics of this project as it currently stands probably are not attractive say to an international oil company that needs



to generate a certain rate of return, but I think that because we have Chinese oil companies involved, and they are driven by multiple corporate and national motivations and they do accept lower rates of return, especially the wholly-owned parent companies, that the rate of return is good enough for them. So this project is moving forward.

So that's the frontrunner. I'd say behind that is the proposed oil pipelines from Russia to China. This has been under discussion for more than a decade, and the fate of this project lies in the hands of Moscow, which has been using oil as a tool to advance a variety of interests, and it benefits Moscow to be able to delay the decision on this pipeline.

Right now the plan is to build a pipeline from Taishet in eastern Siberia down to a town called Skovorodino, which is about 70 kilometers from the Chinese border, and, the Russians have not indicated whether they are then going to continue to make their priority shipping oil from Skovorodino to the Pacific coast either by rail or pipe or building a pipeline to China. My money is probably on the pipeline going to China first because it is so close and the economics are much better, although, as we know, economics don't always carry the day in determining where oil flows.

As you may know, there are also a variety of other projects out there that have been bandied around in Chinese publications such as building an oil pipeline from Burma to China, from Pakistan to China, and to my knowledge, none of these projects have yet gotten off the drawing board, that they're being talked a lot by press. The Burma pipeline was actually proposed initially by some academics in Yunnan Province.

We have a lot of provincial governments that are very interested in moving this project forward because they hope it can bring refineries to their parts of the country, and so on and so forth, but to my knowledge, no pre-feasibility study or feasibility study has been conducted on either of these lines.

COMMISSIONER REINSCH: Thank you very much.

HEARING COCHAIR WESSEL: Thank you. Commissioner Donnelly.

COMMISSIONER DONNELLY: Thank you, Mr. Chairman. I would like to ask again the question, but try to take it from a more microscopic angle and focus in particular on the case of Iran. What I'm really interested in trying to find out is, you say Iran gives China slightly less than 300,000 barrels a day, and that's 11 percent of Chinese imports.

What slice of Iran's exports is that, and is there an increasing slice of Iran's exports that are going to China? What I'm interested in pursuing is whether, and Sudan may be a case of this as well, is whether you're getting an exclusive supplier-consumer or something that approximates that relationship, and obviously the political effect of that is to loosen the constraints on Sudan and Iran, which then, as we discussed in the previous panel, has the effect of making, increasing the political premium on

market supplies of oil.

So if we could take that problem from microscopic up, and particularly if you've got any Iran data, again, in terms of how much of Iran's output goes to China?

DR. DOWNS: That's a great question. I don't have a figure off the top of my head for the amount of oil that Iran exports to China. To put it in some perspective, about, within the past two years or so, Teheran had come out and said we'd like to make China our top destination for crude exports. I believe at that time, Japan was in the top slot, although don't quote me on that.

In terms of Sudan, there have been some interesting developments in terms of China's trade ties with Sudan and the relationships between Iran. The energy relationships that China has with Iran and Sudan are different. The relationship with Iran as you mentioned is dominated by trade. China's oil companies have very modest investments in Iran's oil and gas sector.

In Sudan it's the opposite. Sudan is the site of China's largest overseas oil production, and until this year, Sudan was supplying China with about five percent of China's crude oil imports. Sudan ranked number seven, in terms of China's crude oil suppliers in 2005.

I don't know for sure--I suspect that some of the oil that was going to, a lot of the oil that was going to China from Sudan was oil produced by China National Petroleum Corporation, and that's because Sudanese crude is highly compatible with Chinese refineries.

However, there's been a huge drop in China's oil trade with Sudan in the first six months of this year. Last year Sudan's crude exports to China were about 130,000 barrels per day. If you look at the statistics that were just released on China's oil trade for the first six months of this year, Sudan is only supplying China with 30,000 per day, so less than one percent of its supplies. So there's been a big decrease in terms of oil trade between--

COMMISSIONER DONNELLY: Just to go back to the Iranian case and try to be very quick. Isn't it a functional equivalence if Iran's international pariah status, and the resultant certainly of the American embargo, but if there are to be further possible sanctions, even being considered by Europeans who are consumers or the Japanese who are consumers of Iranian oil, doesn't that have the same effect as helping to secure the Iranian supply exclusively or disproportionately for China because we won't touch it or we're less likely to? Again, those are resources that don't go into kind of the market, the normal marketplace, but sort of developed.

Again, it's a different mechanism, and it's not really directly acquiring upstream resources, but it is a way of securing those resources, again, in a way that precludes them from being developed in the normal market way.

DR. DOWNS: I have several points I'd like to make in response to that. First, to the extent that China is buying crude oil from Iran or importing oil that its companies produce overseas, it's not really taking the oil off the market in the sense that that oil is simply displacing oil that China would otherwise have to buy elsewhere.

In terms of Iran, China's national oil companies like to invest in states that are at odds with the United States and other major powers because they face less competition there, that Chinese oil companies feel that the world oil market is an uneven playing field. It's stacked against them and if they go into countries like Sudan or Iran, they face less competition from U.S., and in the case of Sudan, other major international oil companies.

I think that China's behavior in the case of Iran is going to be heavily influenced by what other countries and what other oil companies do. That right now, the Chinese feel pretty comfortable pursuing energy investment opportunities in Iran because the Japanese are doing so. The Japanese have a contract for the Azadegan field in Iran, and certainly European firms have expressed interest, and so I think the Chinese feel that if the Europeans the Japanese, if U.S. friends and allies are here, then we can be here too.

I think the interesting question is what happens with the Iran nuclear issue? What happens if the United Nations Security Council moves closer to sanctions? I think if there is a multilateral sanctions regime in place--right now there are unilateral sanctions, economic sanctions from the United States--but if there is a multilateral sanctions regime in place, China would respect that. China historically tends to respect multilateral sanctions regimes. So the interesting question, of course, is are we going to see China actively working to undermine sanctions in Iran the way they did in Sudan? There's a different calculation involved here. The Chinese do realize that Iran is a highly sensitive foreign policy issue for Washington. At the end of the day, I think the bilateral relationship with the United States is more important to China than its bilateral relationship with Iran.

COMMISSIONER DONNELLY: But if the Europeans thought about putting unilateral or EU-wide sanctions or constraints on trade with Iran, that wouldn't necessarily have much effect on Chinese behavior?

DR. DOWNS: I think it might give the Chinese pause, but if we look at what happened in Sudan, although the European countries, I don't know if they have economic sanctions on Sudan, but certainly major international oil companies whose countries of origin are located in Europe have refrained from investing in Sudan because of what's going on there.

HEARING COCHAIR WESSEL: Commissioner Houston.

COMMISSIONER HOUSTON: Dr. Downs, thank you so much for being here today. Your expertise has just been great for us. I think you

gave a number of how much of Sudan's production goes to China. What was that number?

DR. DOWNS: I don't have a number. It's very difficult to figure out how much of the oil that China's oil companies produce overseas actually goes to China. I know that not all of it does. The head of BP China very recently was quoted in a Chinese newspaper saying that 90 percent of the oil China's national oil companies produce overseas is currently sold on the world market.

Looking back over the past few years, I suspect that a lot of the oil that Chinese companies producing in Sudan was going to China because most of the, I do know that most of the oil that Sudan produces goes to China and goes to India. Last year, China received about 130,000 barrels per day of oil, of crude oil from Sudan. That number, though, has dropped dramatically in the first six months of this year.

Between January and June 2006, China was only receiving 30,000 barrels per day of crude from Sudan.

COMMISSIONER HOUSTON: Right. And that was my other question. Why is that? Why the precipitous drop?

DR. DOWNS: Again that's a great question, and I don't know the answer to that. I don't know how much of it has to do with the shifts in the contract. When you're a foreign company and you sign a production sharing contract with the host government, usually what happens is after you recover your cost oil to cover the amount of money you invested in developing the field, then you, the foreign oil company, and the host government will continue to split production, and that's equity oil.

The split increasingly favors the host country over time. I have not seen a copy of the contract that China National Petroleum Corporation signed with Sudapet, so I don't know if it's possible that that kicked in. I don't know. Another feature that is increasingly common with production sharing contracts is the higher the price of oil in the world, the less oil you get.

I don't know if that's a factor because we've seen sustained high oil prices, but who knows if CNPC just decided they would prefer to sell the oil locally, and engage in a swap. There are many possibilities.

COMMISSIONER HOUSTON: I appreciate that. The main question I wanted to ask you is one question with three parts. Every time we have government officials come in and talk to us about a new subject, they always tell us they're working with and talking to the Chinese about pretty much everything, and you can never get any sort of action items, or it's very difficult to pull up actual projects.

So there are three concerns that I see with the oil production in the refinery and the infrastructure that's growing within China. Ms. Fredriksen from the DOE this morning said that China is looking at renewables. So I wonder to what extent that is and what they would be?

Number two, one of our concerns is always intellectual property

rights, and we see theft in pretty much every sector. So could you tell us just a little bit about any concerns that you may have about technology transfer and IPR violations?

Thirdly, environmental degradation. We know in China that there's not a lot of concern for the environment. What you see as far as their domestic infrastructure might be actually addressing any environmental concerns?

DR. DOWNS: Those are all great questions. I'll take them in the order that you raised them. In terms of renewables, you are correct, that the Chinese government is very interested in developing renewable sources of energy. One interesting development that's occurred in China in recent years is that there now appears to be a consensus among the very top leaders on the importance of moderating energy demand growth.

Certainly the idea of placing equal emphasis on energy conservation and in growing supply is an idea that Chinese leaders have talked about many times in the past, but it seems to me that they are increasingly serious about this right now, and they are also interested in diversifying their fuel mix to include renewable energy.

There are a number of challenges that the Chinese face in their efforts to develop renewable energy such as solar, wind power. A lot of this has to do with the fact that the price at which coal is sold to power producers in China is below market. That makes it very hard for other fuels, cleaner fuels, to compete with coal because the price of coal doesn't include any externalities.

Right now one of the problems that the Chinese are facing in the development of wind power, for example, is that they have to import the turbines, and so that makes the cost much higher, the cost of generating power by wind much higher than the cost of generating power by coal, and this leads into the second question that you asked that has to do with intellectual property rights.

In China, historically, there's great willingness to embrace foreign technology, but they like to master it, so that once they have it, then they can go and they can continue to use that technology, and they don't need to involve foreign companies any longer, and I think that there have been concerns with companies that have been looking at various energy projects in China with IPR.

Finally, on environmental degradation, I think that again this is another area where there is a lot of concern. There has been a lot of rhetoric which I think is quite serious coming out of the top leadership about the fact that they cannot continue with the growth at any cost model that they have been pursuing, that they want to clean up the environment in part because a lot of the protests that occur in China have to do with environment-related issues.

The Beijing Olympics are coming up. They want a green Olympics. I think there's a sense that as a major power that you want to have a clean

and green environment. So the efforts are being made in this direction, but again there are challenges because historically in China, every industry has a stronger voice in policymaking than those advocates for environmental protection.

HEARING COCHAIR WESSEL: Thank you.

COMMISSIONER HOUSTON: Thank you very much.

HEARING COCHAIR WESSEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Ms. Downs, thank you very much for being here. You recall last summer about this time there was the controversy over the CNOOC transaction and the protestations by CNOOC that it was acting as a commercial transaction, and that all of these concerns in the U.S. were not valid.

But you also probably recall that the private sector directors of CNOOC all were against that transaction, and the former Swiss Ambassador resigned from the CNOOC board saying that it was no longer acting like a commercial company.

So I was glad to see that you point out in your testimony on page three that the national oil companies in China, of which CNOOC is one--is it not--

DR. DOWNS: Yes.

COMMISSIONER MULLOY: --select projects according to their respective capabilities and corporate objectives, not necessarily--so you put a big qualifier--because of state-directed set of national policy priorities. So they can act according to state direction in seeking national policy priorities.

You further discuss that China believes that they want to have these oil companies out there because in times of a tight market, it might ensure that that oil comes back to China and they're not afflicted with the shortage that other people might face.

So this follows up the question I asked earlier with the DOE representative. We have this oil-sharing mechanism within the IEA and the consumer countries agree that they will not be out there competing against each other for a limited supply. They have mechanisms to try and reduce that. China is not part of that.

If China has the international oil companies taking its share of available supply home, doesn't that have the rest of us competing against one another for a limited supply during a world crisis, a shortage of some sort? Like if Iran went out or Saudi Arabia went out, that could drive the price of oil through the roof, so we try and have mechanisms, and they're not part of those. They got their share, taking it home; is that of concern? What should we do about that problem?

DR. DOWNS: I'd like to make several points in response to that. First, the idea of shipping oil back to China in time of crisis, that's one of the justifications that Chinese analysts have made for why they believe the acquisition of equity positions in oil production and exploration assets

abroad enhances energy security.

As you may know, this is an issue that has perplexed many market analysts in this country because the reality is that oil produced by China's oil companies overseas is not shielded from price volatility, that host countries tend to value the barrels of oil that are produced in their countries at the world market price. And the barrels of oil that China's oil companies produce overseas also face the same transport risks of oil that they buy on the spot market.

What I was trying to do in that part of the testimony was to explain why there is this perception in China that the acquisition of equity oil can enhance energy security. This is an idea that since the late 1990s has been taken as almost axiomatic, that there aren't that many explanations offered, but to the extent that analysts have tried to explain why, quote-unquote, "equity oil is better than trade oil," that's one of the reasons they've come up with, and I think this also gets to the issue that was raised earlier about concerns about how much influence does the United States have on the world oil market, which varies widely in China depending I think how much the respective analysts understand about the world oil market.

But I think that that's one of the explanations that's come up is that "this is our oil; it's produced by our national oil companies; these are state-owned companies. In times of crisis, when push comes to shove, we'd like to think that we can rely on them to send barrels back home."

So that's what's going on in that situation. I don't know how much of the oil China's companies are producing abroad is actually being sent back to China. These companies are commercially oriented. They are profit driven. They may not be as commercially oriented or profit driven as an ExxonMobil, but I think that they do sell oil locally, that not every barrel produced by a Chinese company overseas goes back to China.

Again, just to reiterate the point that I made earlier, today to the extent that if China is sending back any of the oil it produces overseas to consumers in China, this is simply replacing other oil that they would buy on--displacing other oil that they'd have to buy on the world oil market. Today China is, I think, importing--

COMMISSIONER MULLOY: But you make the point on page three underpinning that it's the assumption, at least, that's driving them to think that there is some greater security in the oil produced by their oil companies in a shortage situation?

DR. DOWNS: I think among some actors in China. This is by no means a universal view and if you look at the debate on energy security in China, there have been dissenting voices. I don't know how high up these dissenting voices go, but years ago there was nobody in China saying anything publicly to question the idea of whether the acquisition of equity barrels abroad was indeed an effective measure to enhance energy security.

If you look at what people are saying today, that you have analysts coming out and saying this is not a panacea, it's not a magic bullet. You talk to people in the national oil companies who understand the oil business, they will make the same point to you. I don't know how high up that idea goes, but it's something that is there.

HEARING COCHAIR WESSEL: Commissioner Bartholomew.

COMMISSIONER MULLOY: Thank you.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you, Dr. Downs. It's very interesting. I know you've just said that we don't know the answer to how much of Chinese production overseas is actually going back to China. But that's a really important point. Surely there must be some way of figuring out how much they're consuming and how much they're producing and how much they're purchasing and back it out, and the reason I think it's an important point is because there's been a presumption that the Chinese are engaging in acquisition overseas in order to ensure that they have the energy resources that they need.

If that's not what they're doing with that energy, but that they're selling it on the market, it puts the whole debate into a different light.

DR. DOWNS: You've raised an excellent point. It's very difficult. This is an issue in which I'm quite interested, for which I try very hard to gather data. The Chinese I think in part because of concerns about international perceptions, international opposition, especially in the U.S., to the overseas activities of their oil companies are publishing less and less data than they had in years past about how much oil they're producing overseas on a per field or country basis, how much of that oil is going back to China. This is not unusual I think in the world of oil companies.

But if you look back to the late 1990s, when they first began producing overseas, when China's first barrels of equity oil were sent back to China, this came from Peru in 1997, it was an article in the Chinese Economic Times. You don't see that as much any more. I don't know how much is going back, but again it's just displacing oil that China would produce elsewhere. So for example, China's oil imports from Sudan have dropped 100,000 barrels per day. That means China is now purchasing 100,000 barrels per day of oil from other countries.

COMMISSION VICE CHAIR BARTHOLOMEW: But it's producing in Sudan.

DR. DOWNS: It's producing in Sudan.

COMMISSION VICE CHAIR BARTHOLOMEW: So the explanation hypothetically is that they're selling on the world market what they're producing in Sudan rather than consuming it themselves. I don't know much about the oil market, but do companies have to identify where that production is coming from?

Or is there a way that the oil being produced by Chinese companies in Sudan is essentially being laundered through to bypass any kinds of sanctions? Does that possibility exist? In other words, if there are



sanctions on Sudanese oil and the Chinese are producing it, do they have to identify? Does the Chinese company have to identify that that oil is coming from Sudan or does it just go into some giant pool of oil that they then put out on to the world market?

DR. DOWNS: I'm not an expert on sanctions regimes. I'm assuming that if there were multilateral economic sanctions on Khartoum, that one aspect of those sanctions would target the petroleum sector and that foreign companies operating there would not be able to do so.

In terms of how much oil China's oil companies are sending, that they're producing in Sudan that's being sold on the market or shipped back to China, I'm not exactly sure where you would get that data. Certainly Chinese customs data will let you know how much oil they're importing from various countries, and you can see how much China's oil companies are producing in certain countries, but it's difficult to fill in that gap to figure out how much.

COMMISSION VICE CHAIR BARTHOLOMEW: One more. This is going to be a very ignorant question, but with the production that they are doing, do they also have refining capability that goes along with it? And is it purely pumping oil out of the ground or is it pumping oil out of the ground and refining it and putting it on to the world market in some usable form?

DR. DOWNS: China has invested not only in oil. Chinese oil companies have invested not only in exploration and production in Sudan, but they've also built pipelines from the fields they're producing up to Port Sudan on the Red Sea and those pipelines go to the Khartoum refinery in which CNPC is a 50 percent stakeholder, and so some of the oil that they are producing is also being refined.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you.

HEARING COCHAIR WESSEL: Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman, and thank you for your testimony. I found it quite interesting. I know you've been focusing a bit on oil. I'd like to ask you if you know that much about the coal situation. Obviously, China is highly dependent on coal and has some problems in terms of its internal distribution of coal so it actually imports some coal, even though it has abundant supplies, because of the geographical situation.

My understanding is that China's plan to continue its industrial development would require it to produce new coal-fired power plants on a regular basis. I'm told that they may be producing new coal-fired power plants on the size equivalent to fuel the city the size of Dallas every week for the next ten years. Is there any truth to that?

Even if it's something less than that, this means that the production and use and burning of coal is going to dramatically increase in China. My question is, is there a debate in China over this? And is there a debate in China that is not just with the environmental consequences but--

to be politically correct, Mr. Chairman, we'll call it climate change--to deal with the question of climate change? Is there a debate about the use of coal and its impact on climate change yet maturing in China?

DR. DOWNS: Coal is king in China. Coal accounts for two-thirds of China's primary energy production and consumption, and this is not only because of China's abundant coal reserves, but also because of its coal-based economy. I think the Chinese government and Chinese energy experts are of two minds about coal.

On the one hand, coal is domestic. They can meet almost all of their coal needs with coal produced within their borders. To the extent that they are importing small amounts of coal from places like Australia and Indonesia, it has to do with, as you mentioned, the fact that China's coal-producing centers are located far from some of its coal-consuming centers.

Rail capacity is highly strained and so you have a lot of imports going into Guangdong Province in southeastern China of higher quality coal from Australia, which they'll use to supplement and mix with domestically produced coal.

But by and large, China last year imported maybe one percent of its coal. So basically they're self-sufficient in coal, and the coal sector also employs a lot of people so I think for those reasons it would be nice to continue to use coal.

On the other hand, they recognize that there are environmental and international political costs to heavy coal-burning in China both in terms of degrading China's environment, in terms of degrading the environment of neighbors, for example, acid rain falling on Japan, South Korea, impact on Hong Kong. There are some very interesting writings coming out of the Energy Research Institute in China back in the late 1990s talking about where a number of experts are making the case that we've got to move away from coal; we've got to have oil and gas playing a larger role in our economy.

One of the reasons that they mentioned had to do with international politics, that we don't want to be known as the world's largest polluter. As a rising power, we need to have a different energy mix. So there is some debate going on. However, I think the recent high natural gas prices have set back a bit China's plans to diversify away from coal.

For many years now, the government has spoken about increasing the share of China's energy mix that's supplied by natural gas in hopes that they could limit or perhaps decrease the share represented by coal, but natural gas prices, LNG prices, are linked to oil prices, and as oil prices have gone up in recent years, so have LNG prices, and that's posed a lot of problems for China in that CNOOC walked away from negotiations to buy gas from Chevron from their Gorgon Project because CNOOC thought the prices were too high. They just didn't want to pay the world price. That has to do, again, with price subsidies in China.

As I mentioned earlier, the price at which coal is sold to power producers doesn't include any externalities so how can other fuels compete?

COMMISSIONER D'AMATO: So there is some debate. Just a little follow-up, Mr. Chairman, and this Energy Research Institute, is that playing a major role in the debate in China? In terms of the technologies used to burn coal, is there a serious effort to consider paying for the more expensive clean coal technologies when these new power plants come on line because it's going to be a tremendous amount of CO2 being generated by these new plants?

DR. DOWNS: There is an interest in clean coal technology. And again, this all gets back to pricing, though, and I don't know how that issue is going to be resolved, given that power producers must sell electricity at fixed low prices what's the incentive for them to invest in these technologies?

COMMISSIONER D'AMATO: So it's up in the air.

DR. DOWNS: I think it's up in the air.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman.

HEARING COCHAIR WESSEL: Thank you, Dr. Downs, for your great effort and assistance to us today. Hopefully, we'll be able to call on you for further advice as we move towards our report writing.

We will take a short break as the next panel gets seated.

Thank you.

DR. DOWNS: Thank you.

[Whereupon, a short break was taken.]

## **PANEL IX: CHINA AND THE GLOBAL PETROLEUM SUPPLY**

HEARING COCHAIR WESSEL: This is the last panel for this two-day hearing. The panel will address China's impact on the global petroleum supply, building from our understanding of China's energy needs. Our panelists will discuss China's oil acquisition strategy and its impact on U.S. and global energy security.

Amy Jaffe from the Baker Institute for Public Policy at Rice University will be our first speaker. Ms. Jaffe specializes in oil geopolitics, strategic energy policy, and energy economics, and she has widely written on these subjects.

In addition, she has served as an advisor to the U.S. National Intelligence Council Study on Energy to 2015.

Joining her on the panel is Dr. Martha Brill Olcott, Senior Associate at the Carnegie Endowment for International Peace. Dr. Olcott's work concentrates on the problems of transitions in Central Asia and the Caucasus, and she will speak today about China's energy-related activities in Central Asia, particularly China's attempt to establish oil pipelines providing secure access to Central Asian petroleum.

Additionally, Dr. David Gates, Senior Advisor with PFC Energy, will speak on today's panel. Dr. Gates focus is economic, energy and environmental policies and prospects, especially in China, Japan and Southeast Asia.

His areas of particular interest include the policies and prospects of national oil companies which in China have been so active in pursuing global oil supplies.

Thank you all for coming today. Your written testimony will be inserted into the record, and if you could each speak for roughly seven minutes so that we can have a good round of questions with the commissioners, we'd appreciate it. We will proceed in the order in which the witnesses were introduced.

Ms. Jaffe.

[The statement follows:]

**STATEMENT OF DR. AMY MYERS JAFFE, WALLACE S. WILSON  
FELLOW IN ENERGY STUDIES AND MATTHEW E. CHEN,  
ENERGY RESEARCH ASSISTANT, JAMES A. BAKER III  
INSTITUTE FOR PUBLIC POLICY, RICE UNIVERSITY,  
HOUSTON, TEXAS**

MS. JAFFE: Thank you very much. I'd like to thank the Commission for this opportunity to talk to you today about this important subject. China has actually been exceeding expectations for the pace of their oil demand growth. They have this past summer hit 700 million barrels a day oil demand for the total country. That is a number that people were projecting them to reach sometime between 2010 and 2015. So the growth of their energy demand is quite important.

However, they have embarked in the last six to eight months on a very aggressive national campaign to adjust their domestic energy strategies, and this campaign has been quite comprehensive and quite positive. They have adopted car mileage standards that are far superior to what we have here in the United States. They are embarking on an aggressive investment program, talking to international companies like Chevron and Shell about taking their coal resources and liquefying them to oil.

Those projects are actually very profitable at today's oil levels, but even at levels of oil prices much lower than today's, these projects are all commercial. Credit Suisse recently issued a report on this subject and said that they expected over the next six years that China would be able to produce a million barrels a day for oil for use in their transportation sector from coal.

But I know that people are most interested in talking about China's aggressive international oil diplomacy programs and indeed China has

been really stepping up the pace of its international acquisitions program through its national oil companies of oil and gas exploration acreage, really around the world.

There is no deep focus. It's not like they're just focused on the Middle East or they're just focused on Southeast Asia. The Chinese companies are very diversified. They are looking at properties in Latin America. They have been very active in Africa and so I would say that they are very similar to the largest international oil companies in the sense that they are looking pretty much in every domain where there are good prolific opportunities.

They have been very commercial in their focus. They have in some cases paid a lot of money for those assets, maybe more than some of the other companies would have bid, but I think that's partly because--I give two reasons for that--one is that they have other than commercial considerations. In other words, they are national oil companies and they are trying to meet national security strategy to own and produce oil abroad.

But secondarily, they really have to catch up to get to the stature of being international oil companies in the nature of the competitive landscape. So again sometimes people become concerned the Chinese are so aggressive in the market. What does that mean for American companies or international companies that have to compete with them?

I like to give the statistics. Even with this aggressive campaign since 1996, if you take the international production of a firm like CNOOC, it's only a few hundred thousand barrels a day, whereas Chevron that might be considered a competitor has the production of 1.8 million barrels a day. Our three top American companies, which are Chevron, ExxonMobil and Conoco Phillips, together produce 5.6 million barrels a day.

So the Chinese are very far away from competing even with our largest American oil companies and probably very far away from competing even with our smaller independent oil companies when it comes to international production.

But there is one troubling aspect of China's internationalization program which I think comes not so much from the fact that they're making aggressive investments, because really from our point of view, as a consuming nation, we would like every nation to go out and invest in oil and gas and alternative energy the way the Chinese are, so that we have greater world supply, and there's enough energy to meet the needs of a growing world population.

Really the issue is once ensconced in a country, what role do these Chinese national oil companies play? What role does the Chinese government play in either the domestic politics of a country or in its international standing? And there are these troubling developments we've seen in places like Sudan where CNPC, the Chinese National Oil

Company, has a large stake.

Even though Sudan is not a very significant supplier to China, in other words, China is using seven million barrels a day, 40 or 50 percent of that is imports, and Sudan is only supplying maybe 100,000 barrels a day to China, China has consistently up until very recently blocked any kind of American or European initiative to solve the crisis, the refugee crisis, and human crisis at Darfur.

I think because of its position with the government, China has shielded that government from the international community through its veto at the U.N. and through other means, and it's still unclear in Darfur even though China stepped up to the plate and was a little bit more cooperative in this last round of negotiations on resolving the Darfur crisis, it's still unclear whether it will back the next step which is to have an international peacekeeping force from the U.N.

They've also aggressively pursued energy contracts with Burma, which is another troubled human rights player, drug trafficker, and so forth, in the Southeast Asian context. So really there's an important place in the dialogue between the U.S. and China in establishing a precedent for resolving international conflicts in places where countries like China have oil assets, and we wouldn't want to get to a situation where people become so concerned about their oil assets that we have nations like China or even India, which are now pursuing Burma, on the wrong side of international crisis management or humanitarian assistance because they're thinking about their national oil company's field.

We really need to be setting up rules of engagement for transparency and positive participation in the international community despite people's investment stakes.

[The statement follows:]

**Prepared Statement of Dr. Amy Myers Jaffe, Wallace S. Wilson Fellow  
in Energy Studies and Matthew E. Chen, Energy Research Assistant,  
James A. Baker III Institute for Public Policy, Rice University,  
Houston, Texas**

An expanding economy and growing consumption oriented middle class combined with a stagnant domestic oil sector rendered China a net importer of oil in 1993 for the first time in decades. Today, its oil consumption totals close to 7 million barrels a day (b/d), with imports at 3.3 million b/d representing almost 47% of its supply. By 2020, China's oil imports are expected to double from today's levels.

China has responsibly begun addressing its energy challenges by pursuing alternative energy and conservation at home. China's first location of a new strategic petroleum reserve will be on line in Zhenhai this month. Three other locations are planned at Qingdao, Zhoushan and Dalian, scheduled to be completed in the next three years. So far, planned stock levels are modest but local provinces are also studying setting up emergency stockpiles. China is hoping to build stockpiles of at least 100 million barrels. China has also begun to investigate building plants to convert coal to oil. Investment house Credit Suisse in a recent report predicts that China may produce up to 1 million barrels a day of oil from coal to oil conversion plants by 2013. Chinese coal producer Shenhua is expected to bring on line the first project, with Shell studying a

large plant that would come on line in Ningxia in 2010. China has also targeted an expansion of renewable energy. It plans to raise the share of renewable energy for the electricity sector to 12% by 2020, up from 3% in 2003, including increased hydroelectric generation. China's National Development and Reform Commission also has released a plan for enhancing energy efficiency in the industrial sector focusing on cogeneration, upgrades to industrial coal burning boilers, improved use of exhaust heat and pressure, and new standards for electrical motors. The NDRC is also adopting stricter standards for energy efficiency of residential buildings and public offices.

China's new fuel efficiency standards for automobiles are also stricter than U.S. standards. China is setting standards by weight class and aims to have most automobiles reach between 21 to 38 miles per gallon fuel efficiency by 2008. Fines of up to 27% of total price will be levied against cars with large engines, including SUVs and other vehicles with 4 liter engines or higher.

In addition to domestic programs, China—through its national oil companies—has for the past decade pursued an aggressive campaign to invest in and acquire oil and gas assets abroad. China's efforts have been very broad based and do not at present focus on only one or two major supply regions. China's NOCs have signed deals across the globe in Africa, South America, Southeast Asia, Russia, the Caspian Basin and the Middle East. China's massive billions of dollars of investment in oil and gas exploration and field development adds to the pool of investment dollars being spent to bring extra supplies to market and will enhance global energy supply and security. The global oil market is like a swimming pool and China's efforts to put more water into one side of the pool will raise the level of water for every swimmer, no matter which section of the pool they reside in. In fact, China's investment activities will help ameliorate tight market conditions. China's active investment program stands in sharp contrast to the reluctance of some major U.S. oil companies to raise exploration spending despite recent price increases. These U.S. companies (among the largest multinational firms) have exhibited a cautious approach to spending, preferring to buy back stock shares and show financial discipline rather than respond full out to U.S. national interests to find and produce more oil.

China's national oil companies have in the past few years provided stiff competition to Western firms bidding for exploration acreage in prime areas like Venezuela, Russia, Angola, and elsewhere in Africa. Most of the Chinese acreage deals have generally been struck within the framework of normal commercial terms. Chinese firms have won international tenders by offered more attractive signing bonuses or higher fiscal terms for contracts than other international oil companies. In one area of hotly contested acreage in Angola, for example, a Chinese firm won a tender by reportedly offering a signing bonus in excess of \$1 billion. To some extent, Chinese firms seem to be willing to bid above other competitors, perhaps because they have other than commercial considerations at stake. As national firms, China's national oil companies are generally speaking more concerned with gaining access to foreign oil and gas fields on behalf of the country than with reaping optimum commercial profits. China's firms are also playing catch up in terms of size and scope of their activities to attain the status as major international players and therefore are thereby willing to pay higher bids to garner access to assets. The largest American firms, ExxonMobil, Chevron, and ConocoPhillips, produced upwards of 5.6 million barrels a day of oil in 2004. The production of Chinese firm CNOOC represents less than 4% of this amount despite a ten year program of acquisitions.

The fact that China's firms are aggressively pursuing exploration acreage and adding to their oil production portfolios is not inherently a security or energy challenge to the United States. However, there are two specific areas where China's oil diplomacy raises concerns:

Firstly, China has actively secured oil deals in countries with which the United States has troubled relations, notably Iran and Sudan, and more recently, Venezuela. In some cases, Beijing has purposely gone this route to take advantage of U.S. sanctions policy to optimize its access to attractive oil field opportunities. This Chinese strategy, which has been publicly acknowledged in writings by important Chinese think tanks commentators, undermines the effectiveness of U.S. efforts to isolate these nations and creates the impression that troubled nations can fruitfully play China off the U.S. if oil assets can be put into play. In one example last spring, China and Iran announced the possibility of Chinese firm Sinopec

signing a \$70 billion deal to develop the Yadavaran oil field in southwestern Iran during the very time frame that the U.S. and European nations were initiating a new concrete proposal on how to resolve the conflict between Iran and the international community regarding Iran's nuclear program.

It is clearly not in America's interest to have China, a nuclear power and Security Council member with veto capability, be susceptible to political pressure from oil producing states such as Iran.

Secondly, China's efforts to secure foreign oil and natural gas are also begetting unintended geopolitical consequences in the areas of human rights and conflict resolution. China's oil diplomacy has been accompanied by attempts to use its massive energy investment in many nations around the world to influence votes and politics at the United Nations, including in some cases quid pro quos of promises on key future issues, such as the status of Taiwan. To the extent that China is successful in utilizing energy diplomacy to strengthen ties with smaller developing nations, this effort could eventually hinder the United States' ability to forge international coalitions on important world challenges if China and the U.S. are not on the same page in terms of policy approach.

Already, clear cases are emerging where China's oil activities are having a negative impact on international efforts to create an effective multinational framework for protection of international human rights and refugee crisis management. It is a mistake to fail to recognize the significance of incidents where China's external oil dealings stand in opposition to international human rights norms. If the United States and other Western nations fail to address such developments properly, they run the risk of encouraging other parties seeking scarce energy supplies to make similar compromises on human rights as they court questionable oil regimes at the expense of local populations. Such a trend would be detrimental to international peace and security.

The most prominent example of this second phenomenon is China's oil trade with Sudan—where China, through its United Nations diplomacy, initially thwarted an international solution to a growing problem of mass atrocities and crisis in Darfur. In addition, a growing energy-driven relationship with the military regime of Burma (Myanmar) is providing support to that regime and even influencing democratic India to consider pursuing energy trade relations despite the troubled political backdrop inside Burma. In early 2006, the Chinese state-owned PetroChina reached an understanding with Burma to pipe natural gas from the new offshore field, Sittwe, to the Yunnan province of China—gas which India also has coveted. Support for Burma's regime as a focal point for Chinese and Indian rivalry for energy resources thwarts U.S. policy goals in Southeast Asia, which include peaceful economic growth, the rule of law, suppression of radical Islamist groups, and combating trafficking in persons and illegal narcotics.

The behavior of Chinese NOCs overseas has set negative precedents for how NOCs in general approach human rights questions both strategically and operationally. And, China's oil relations in places like Africa have often been accompanied by provision of light arms and other military assistance that has hindered conflict resolution. For example, the conflict in Darfur, Sudan has left millions homeless and displaced, while hundreds of thousands have died in extraordinarily violent circumstances or from desperate refugee conditions. Commonly cited estimates hold that over two million people have become internally displaced persons or refugees since 2004 as a result of the Darfur crisis.

China has been Sudan's biggest investor in the country's growing energy industry, and oil revenue has given Khartoum the means to expand its military. But more importantly, China has resisted initiatives by the international community to resolve the Darfur conflict through United Nations channels, particularly a United Nations-backed peacekeeping force. China's opposition in most cases to a stronger UN role in resolving the conflict from 2003-2006 likely exacerbated the scale and depth of the humanitarian crisis and prolonged the armed conflict.

As the crisis in Darfur was unfolding, China vetoed or otherwise opposed UN Security Council measures that might have provided for amelioration of the conflict. China weakened a UNSC resolution (#1564, September 2004) that would have sanctioned Sudan if the government failed to disarm the proxy militias



attacking civilian populations. In early 2006, China sided with Qatar to block the release of a UN report that supported sanctions against individuals believed to be obstructing peace efforts in Darfur. While China has softened its stance more recently at the UN following a partial peace agreement for Darfur in April, many problems remain, not least effectively implementing the new accord. If the agreement does not hold—and most evidence points to continued violence since the Abuja talks—China's position on sending a UN force remains unclear, if likely unfavorable. The African Union Mission in Sudan (AMIS), the 7,000 member monitoring force sent to provide low-level security for civilians in mid-2004, already has proven unable to fulfill its mandate due to inadequate funding, materiel, and personnel. Thus, analysts are suggesting that the presence of a robust 12,000 person strong UN force will be needed to adequately protect civilians.

Improving international institutions to better manage conflicts such as Darfur should be a key goal for great power cooperation between the U.S and China. It is important for the U.S. to establish that oil contracting activities should not divert major powers such as China and the U.S. from cooperating to resolve conflicts via the United Nations or other multinational frameworks. The U.S. needs to look at the Darfur crisis as an important opportunity to establish badly needed joint responses and methods for cooperation and to create precedents that might be tapped down the road on other equal or more vital interests where the stakes for future conflict could be even more monumental than the tragedy in Sudan.

The United States is blessed with a strong and competitive oil and gas private sector that is technically the most proficient in the world. It is in American and global interests to promote open access for foreign investment in oil and gas production around the world to maximize the amount of investment made in oil and gas and thereby enhance world supply. As such, the United States should continue to support free trade and orderly and well functioning global commodity markets. It would be detrimental to the global economic system for China, or any other large consumer for that matter, to try to lock out other consuming countries from important sources of energy. Politicized oil agreements heighten the chances of a market failure during a time of supply crisis, such as seen in 1973 or 1979. Open access to energy provides each nation the opportunity to bid for the supplies it needs in an orderly market, preventing extreme or artificial shortages and allowing for less general economic damage from market adjustments to changes in supply. The International Energy Agency emergency system provides tested methods to best deal with sudden global energy shortages to minimize the impact of market chaos in the early days of a disruption.

China should be encouraged to become a stakeholder in this global system and to be educated on past failures countries have experienced in trying to solve energy supply problems through bilateral diplomacy or military forays. The United States should pursue a high level dialogue with China on energy and the Middle East.

A functioning, open access international market system is the best means for China to ensure its energy supply, especially when considering its rising economy, growing energy demand and limited international naval reach.

HEARING COCHAIR WESSEL: Thank you. Please proceed, Ms. Olcott.

**STATEMENT OF DR. MARTHA BRILL OLCOTT  
SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR  
INTERNATIONAL PEACE, WASHINGTON, D.C**

DR. OLCOTT: Thank you. Thank you very much for the opportunity to appear before you today. China has a growing energy presence in Central Asia, especially Kazakhstan, Turkmenistan and

Uzbekistan. In my seven minutes I'd like to focus on the context of understanding this, and I'd be delighted to take questions on the specific projects themselves in the question period.

I think it's really important for the U.S. not to assume that China's growing presence in Central Asia poses a direct or even indirect threat to U.S. interests in the region.

The Chinese leadership and its quasi-state business community have been very pragmatic in establishing and strengthening their relationships within Central Asia, making careful calculation of China's short, medium and long-term interests in the region. Its short-term concerns are focused or have focused on border delineation issues where China bargained hard but didn't really play dirty, and the Shanghai Cooperation Organization grew out of this question.

Secondly, minimizing, neutralizing the prospect of Central Asian states' involvement in China's own ethnic minority issues, with Central Asian support of Beijing on the Uyghur issue being the priority of Beijing with their relationship with Central Asian states. I would argue this remains the case today. That if forced to choose between energy and the Uyghurs, they would choose support on the Uyghur issues.

So I think it's really important to have a sense of what Chinese priorities are. This said, I would say that China believes now that its basic security issues vis-à-vis the Central Asian states are resolved, and so they've been able to focus more attention on their economic agenda.

China is an incredible economic force in Central Asia. By its size, it is a dominating trade partner in the region, an increasing trade partner in the region, but it is not one whose trade is viewed with hostility by the Central Asian states. Trade with China is of increasing importance to all the Central Asian states.

China obviously is a major investor in Kazakhstan's oil industry, which is what you are concerned with. China sees this as a gateway. Kazakhstan is China's gateway to Caspian oil and gas reserves. And engagement with China is critical to what I see as an increasing trend to triangulation in a Chinese-Russian-Central Asian relationship, and that's something I've actually been doing a lot of work on and would be happy to take questions on.

Kazakhstan and China have entered into a pipeline agreement. But at this point in time, while the pipeline is being built, the project still lacks the necessary oil to fill the pipeline and filling that pipeline will take oil from Russia, oil that I do think will eventually be forthcoming.

The various Chinese oil companies as delineated in my testimony, have an increasing presence in Kazakhstan's oil industry. They have a controlling interest in Aktobemunaigaz, and after a failed effort to get a share of the Kashagan consortium, they did manage to purchase PetraKazakhstan at a highly inflated price. And then in order to keep PetraKazakhstan, they allowed an asset stripping of the project to go on,

allowing shared control of the Shymkent refinery.

So in terms of the negotiations, it was really the Kazakhs getting the better of the Chinese and not the Chinese getting the better of the Kazakhs.

I think this really defines the Kazakh project: the Chinese priority with overpaying for assets in order to get the access they want. While Kazakh government may grumble about Chinese pressure, and the Chinese businessmen complain about Kazakh business ethics or lack thereof, both sides seem relatively content with the relationship, and both understand the capacity for synergy is with Russia, something that Russia is not fully prepared to engage in now.

Kazakh-Chinese energy cooperation I would argue is now effectively preordained. For me, the more open question is Chinese-Turkmen relations, whether they will be anything more than hypothetical, despite the fact that China has committed to purchase 30 bcm of Turkmen gas annually beginning in 2009.

I do take very seriously the prospects of a pipeline going from either Turkmenistan or Uzbekistan up on one of three routes, a gas pipeline to China either through Russia or not. And I believe that this is a project of equal importance, at minimum equal importance to the Kazakh oil project, because I believe that this is a partnership that the Russians will effectively eventually have to bring on board.

China is eager to secure both Turkmen and Uzbek hydrocarbons. They've entered into a \$600 million agreement with Uzbekneftegaz in the past year for oil fields that I think are more important for their associated gas and, unlike Russia's Gazprom, the Chinese are willing to provide the capital for investment in the Central Asian pipeline system that dates from the Soviet period.

This is something that the U.S. and Western companies have not been willing to provide as well with the U.S. priority being building a trans-Caspian pipeline and not investing in the pipeline system within Central Asia itself. Oil pipeline, yes, but not gas on the ground.

So I think that this is a very critical prospect of future cooperation with Central Asia. China, too, is an interested client for surplus electric power from Central Asia. That again puts them in competition with Russia directly and potentially with the U.S., although much less likely with the U.S.

Both the Kazakhs and Kyrgyz are very eager to have the Chinese purchase surplus energy because it makes the Chinese less likely to divert upstream water that they need for agriculture.

Let me just say in conclusion a few things. I think that China is committed to expanding their presence in Central Asia. And that it is important to understand that Central Asia's energy resources can make a huge difference in China's domestic energy supply, both, particularly for domestic use.

It's dependable gas. It's oil and gas. It's secure with a prospect of bilateral military cooperation and enhanced role of a Shanghai Cooperation Organization providing the necessary security guarantees for the energy reliability, plus I feel the developing trilateral relationship with Russia will also provide mutual guarantees to the Central Asians and to the Russians, making this energy sale of much less risk to the sovereignty of the Central Asian states than sale to either Russia or China alone would be.

Moreover, I think it's really important to remember that the Chinese are buying up assets in Central Asia that the West has passed on. They are not pushing the West out of any of their projects and they assume that continued Western investment will exist. China's perspective for Central Asia is really one of a very long term and a belief that both the U.S. and Russia will be much shorter-term presences in the region.

Thank you.

[The statement follows:]

**Prepared Statement of Dr. Martha Brill Olcott  
Senior Associate, Carnegie Endowment for International Peace,  
Washington, D.C**

Thank you very much for the opportunity to appear before you today.

China has a growing presence in Central Asia, but it should not be assumed that their activities in the energy sector will be of direct or even indirect threat to U.S. interests in the region. They are clearly not a direct threat to the U.S. and will only become an indirect threat if U.S. policy-makers decide that they by definition are threatened by any Chinese presence in the Central Asian region.

The authorities in Beijing seem to have been very pragmatic about the independence of the Central Asian countries from the very outset. There is no evidence to suggest that they anticipated the disintegration of the U.S.S.R., and given their own disgruntled Turkic population, there is little reason to believe Beijing thought it was a good thing. But the Chinese leadership and its quasi-state business community have been very pragmatic in establishing and strengthening their relationships with the five Central Asian states, making careful calculation as to China's short, medium and long term interests in the region.

China's short term concerns were initially focused on border delineation issues, and minimizing direct and indirect involvement by the Central Asian states in China's own ethnic minority issues. And China saw issues of long-term economic and security cooperation as being medium and long-term issues, which Beijing authorities would come to address over time.

China has no choice but to view events in Central Asia as having potential direct security impact. China shares a long border with a number of Central Asian states---three in fact---Kazakhstan (which has the longest border with China), Kyrgyzstan, and Tajikistan (with a very small border). By contrast, although Russia's border with Kazakhstan is longer than China's, that is the only one of the five Central Asian states with which Russia shares a land border; Russia and Turkmenistan have a maritime border in the Caspian Sea. China, of course, also has a vast land border with Russia. When the U.S.S.R. collapsed, the Sino-Soviet border was only partially delineated, and the Shanghai Cooperation Organization, originally known as the Shanghai Five, was established in the mid-1990s as a confidence building measure for what were then newly delineated borders, that now involved five rather than two countries.

The Chinese appeared to have bargained hard to get favorable outcomes during the border negotiations with Kazakhstan and Kyrgyzstan, and at one point Kyrgyz president Askar Akayev even turned over more land than necessary to appease his "thirsty" neighbor (the land in question gave Chinese firm claim to an important water shed). But the Kazakhs and even the Kyrgyz did not come out too badly

from this exchange, although critical water usage issues on the Chinese side of the border remain unresolved.

The border delineation went on in an environment of heightened tensions on the Chinese side of their borders with the newly independent Central Asian states. The independence of the Central Asian states had a predictable impact on the aspirations for cultural and national autonomy among China's own Turkic minorities. China's Kazakh and Kyrgyz population were eventually offered limited opportunities to immigrate to newly independent homelands, which dampened, if not eliminated any security threat that they posed. But the challenge posed to Beijing by the Uighurs was far more complex. A much larger ethnic community, they had not achieved any of their political aspirations, and their diaspora community in Central Asia (mainly in Kyrgyzstan and Kazakhstan) was viewed by the Chinese authorities as potential "fifth columnists" who might destabilize the territorial integrity of China.

In fact, the legal status of Uighur political groups in Central Asia is the one area where Chinese leaders clearly signaled to Central Asian authorities that they would use negative as well as positive incentives to the desired outcome. This led Kyrgyz, Kazakh and Uzbek leaders began to restrict the legal operation of pro-Uighur groups, despite the fact that these groups often engaged some support from the respective Kyrgyz and Kazakh nationalist communities in particular.

Over the last five years, though, China has felt the need to move toward its medium term goals. This is largely the result of the introduction of a U.S. military presence in the region, and the increase in Russia's economic and security presence in Central Asia. As a result there has been a growing Chinese economic presence in the region, most particularly in the area of energy, and there is a deepening level of security cooperation, largely through the evolving institution of the SCO.

#### China's Developing Energy Interests in Central Asia

Its basic security issues resolved, China was able to focus more attention to its economic agenda.

China's size and economic potential make Beijing at least a silent presence in virtually every setting of importance involving the Central Asian states—and sometimes it is a visible and vocal one. Trade with China is increasingly important to all the Central Asian states. Unlike in the first years of independence when much of the commerce was "shuttle trade", it is legal trade and investment that is now being encouraged by the various Central Asian governments.

China's economic presence is largest in Kyrgyzstan and Kazakhstan. Kyrgyzstan hopes to be a gateway to China because they are both members of the WTO. Small and medium sized investors from China are now dominating a number of economic sectors in Kyrgyzstan, especially in the north, and the Chinese represent virtually the only group eager to invest in that small and poor Central Asian country.

More relevant to today's hearing, China is a major investor in Kazakhstan's oil industry, as a way to insure increased access to Caspian oil and gas reserves. The Kazakhs and Chinese are building a new jointly owned 2,900-kilometer oil pipeline to which will run from Atyrau through Kenkiyak, on to Kumkol, Atasu, and then Alashankou on the Kazakh-Chinese border. By late 2005 two stretches were already operational. The Chinese National Petroleum Company (CNPC) owns a controlling interest in Aktobemunaigaz, a production company in Western Kazakhstan, but this will not provide enough oil to fill the pipeline, so both the Kazakhs and Chinese are exploring the possibilities of a link with western Siberia, and bringing down Siberian crude.

Chinese ambitions vis a vis Kazakhstan extend a lot further. A 2003 bid China National Offshore Oil Corporation (CNOOC) as well as China Petroleum and Chemical Corporation (Sinopec) to buy British Gas' share of Kazakhstan's massive off-shore Kashagan deposit, was blocked by the consortia partners, who in the end were forced to allow Kazakhstan's own national company (Kazmunaigaz) to acquire half the BG stake, and absorbed the other half themselves. The Chinese remain interested in buying a portion of the Kazmunaigaz stake.

CNPC did manage to acquire the small North Buzachi field, and then finally in 2005 CNPC purchased the assets of PetraKazakhstan, for \$4 billion giving them the assets from the Kumkol field and shared control of the Shymkent refinery (with Kazmunaigaz).

While the Kazakhs sometimes grumble about pressure from China, and the Chinese complain of the bad business practices of their Kazakh partners, the two countries are cementing a longer term relationship. Both realize that the prospect of supplying China could create new synergies between the oil industries of both Kazakhstan and Russia, ones which leave the Kazakhs in particular less vulnerable to

non-competitive transport arrangements offered by Russia.

It is less certain whether Chinese plans in Turkmenistan will prove realizable. The Chinese have contracted to begin moving up to 30 bcm of Turkmen gas annually in 2009, through a pipeline which will go through Kazakhstan, linking up with the existing Bukhara-Tashkent-Almaty pipeline and extending it to the border at Alashankou. The Chinese also are negotiating to get Kazakh gas shipped along this route or through a new pipeline from Ishim in Russia, to Astana, through Karaganda and eventually to Alashankou. It is hard to believe the Chinese would support both options simultaneously, and Russia will certainly be lobbying hard for the second route to be built first, as most industry analysts do not believe that Turkmenistan will have enough production to support contract obligations to both Russia and China.

The China National Petroleum Company (CNPC) also signed a \$600 million agreement with Uzbekneftegaz for some 23 smaller oil fields in the Bukhara area. Very little information has been made public about this agreement, but the location of these fields (near the main gas pipeline) suggests that Beijing is hopeful that there will be large amounts of associated gas available from these projects.

The route of the proposed Chinese gas pipeline will not be finalized until Beijing is confident that Chinese companies have finished cherry-picking available gas projects in Kazakhstan, Turkmenistan and Uzbekistan, with the eventual routing also likely to be designed with an eye of tying up otherwise stranded gas projects to east-west export pipeline routes. This is particularly important for the Uzbeks, many of whose gas fields are now linked only to Central Asian markets.

China too is an interested client for surplus electric power. The Russians are also interested in supplying this market, as are the Kazakhs, who are planning a joint project with China to develop a \$4 billion coal-fired power plant at Ekibastuz, near the Russian-Chinese border. Kyrgyzstan also is interested in selling hydroelectric power to China (which seems more interested in developing its own hydroelectric power than buying foreign-produced electricity).

And in both the Kazakh and Kyrgyz cases the hope is that such purchases might make China less aggressive about diverting upstream water that traditionally flowed into Central Asia. Tajikistan too is attracted by the Chinese market, and even more so by the prospects of exporting surplus energy to Afghanistan, and then on to the large markets in India and Pakistan. The latter route is particularly interesting to U.S. authorities. It would have a developmental impact in Afghanistan and would lead Tajikistan to diversify its resource ownership base beyond Russia.

### China's Security Presence

The increased U.S. presence in Central Asia brought Washington's military presence to within a few hundred miles of the Chinese border, and left Beijing feeling that they had to give more thought to protecting their long-term interests in the region.

Beijing has focused on bilateral as well as multilateral initiatives. The U.S. military presence in the region has contributed to the strengthening of the Shanghai Cooperation Organization (SCO), of which all the Central Asian states except Turkmenistan are members, as are both Russia and China.

The SCO's first-ever joint military exercises held in the summer of 2003. The SCO Anti-Terrorism Center was opened in January 2004 and formally inaugurated at the SCO head of state meeting held there in June 2004. The Chinese are also pushing hard for bilateral military cooperation with other SCO states, and have made real inroads in this regard with the Kyrgyz, Kazakhs, and most recently and significantly with the Uzbeks. As they do not share a border with China, Tashkent sees only positive aspects to bilateral military cooperation with Beijing.

The SCO has not yet fully evolved as an organization, nor is its final membership set. But with Beijing and Moscow both placing real primacy on an organization in which military and intelligence cooperation is a realistic goal, it seems unlikely that other states will be asked to take full membership any time soon. But observer states like Iran may get a lot of attention, as happened at the 10<sup>th</sup> anniversary summit of the SCO in China in June 2006. This attention certainly suited both Russia and China with regard to their concerns about U.S. policy on Iran, but neither country is likely to sacrifice its longer term strategic advantage in Central Asia by expanding the organization prematurely.

The Chinese expect the SCO to help with energy security vis a vis both Russia and China, and this reason alone talk of expansion would be premature to Beijing. The expansion of the SCO, to try and

prevent as well as neutralize future terrorist threats, good bilateral security relations and working to insure friendly regimes come to power in the Central Asian states are all critical to the long-term security of Chinese land-based pipelines through Russia and Central Asia, not to mention Chinese firms maintaining control of oil and gas assets that they have or will purchase.

#### Conclusion

China is committed to expanding their presence in Central Asia, and to acquire a substantial stake in the development of Central Asia's hydrocarbon reserves. For China, much like Russia, Central Asian energy resources can make a huge difference in their energy supply, both for domestic use and for export. By contrast, Kazakh oil and Kazakh, Turkmen, and Uzbek gas will only produce marginal improvements in supply for western countries. China, unlike the western countries, is happy to finance improvements in the oil and gas transport system within the Central Asian region itself, and not just potential international export routes. This makes China, a potentially attractive partner for Russia, who lacks the capital to make improvements to the Soviet-era gas transport system through the region, upon which Russia continues to depend in order to make export targets in Europe, money which Gazprom itself now lacks. Moreover, especially given the likelihood that in the medium and long-term Chinese-Central Asian-Russian energy cooperation will increase, there seems little reason to expect the Chinese the Central Asian energy market, no matter how effectively they pursue alternative forms of energy.

From the point of view of U.S. and Western interests more generally, increasing Chinese reliance on Central Asian and Russian reserves (particularly if they are developed in concert with Central Asian reserves) should be a good thing. The U.S. and Western energy companies will remain engaged in the region. China is predominantly buying assets that the West has passed on, and the triangular nature of the relationship with Central Asia, Russia and China will create a fulcrum that minimizes the likelihood that Russia and China will "gang up" against the West in the area of energy security.

It is also not in U.S. interest to try and create chasms in the relationships of the Central Asian states and China. The Kazakhs and the Kyrgyz understand that there is no way that the fate of the future of their countries can be fully separated from that of China. Yet there is little indication that they have become more nervous about China in the past few years. In fact, the opposite seems to be true. Both countries seem a bit more comfortable in their ability to manage this relationship, which they see as sometimes requiring concessions on their part, as was the case with the delineations of borders. But the relationship with China is still more problematic than the one with Russia, because China's potential power seems almost limitless, and the needs of its growing population could overwhelm those of the Central Asians. For the near term, however, China's posture toward the Central Asian states seems quite predictable and generally supportive.

For now at least, China is behaving responsibly in Central Asia. If anything they are overpaying to get control of the assets that they desire, and even tolerating asset stripping, which occurred when they lost the refinery to Kazmunaigaz (the Kazakh state oil and Gas Company) that had belonged to PetroKazakhstan at the time of CNPC's purchase of the company. Obviously, the Central Asians are aware of the fact that there may be a cost down the road for leaving Beijing frustrated, but for now at least the relationship between these states and China is developing more smoothly than the Central Asians anticipated.

China is also committed to being a source of growing influence in the region, with Beijing confident that the U.S. influence in the region is unlikely to expand significantly, and that Russia's presence will eventually recede, as the Russian state slowly continues to weaken.

China sees itself as an increasingly more active partner for the Central Asian states, but shows no signs that it is likely to substantially increase their pace of growing engagement in the region. They will continue to acquire energy assets and buy up other strategic natural resources and industries should they become available, and with so much surplus capital they are likely to continue to pay top dollar as they do so. Moreover, the Chinese are likely to continue to tolerate bad working conditions---far worse than their Western counterparts would accept---in order to maintain their position in these investments. And they are likely to continue to offer the region's poorer states---Tajikistan, Kyrgyzstan and Uzbekistan---economic loans and loans for the purchase of military equipment. In other words, the Chinese are likely to continue to proceed in Central Asia as they have for the last several years, with a strong sense of confidence that time is on their side, and that they are entering the region to stay.

HEARING COCHAIR WESSEL: Thank you. Dr. Gates.

**STATEMENT OF DR. DAVID F. GATES  
SENIOR ADVISOR, PFC ENERGY, CHATHAM, NEW JERSEY**

DR. GATES: Thank you. My formal statement begins with some points on oil demand and supply in China that should be helpful in placing my answers in context. The thrust of this is that if China continues to develop, as many expect, growth in energy demand will mean that China is going to need all the technologies, conservation steps, oil, gas, coal and alternatives that it can find and develop. Even imports of oil, and probably gas, are likely to grow by large amounts.

Turning to the specific questions, China has a very substantial energy superstructure and it has a lot of activity in conservation and alternative energy, as has been mentioned. To put these together, I focus on three things: the government's approach to economic reform in energy, and pricing, and two ongoing initiatives in alternative energy.

From the beginning of economic reform, China's approach has been marked by pragmatism and experimentation. Government has focused on finding policies that work in particular sectors and applying them in other sectors.

In many cases, this has involved introduction of competition and market prices that together with ongoing improvements in economic institutions have been catalysts for spectacular growth.

From the outset, energy has been one of a small number of industries that the government has viewed as too important to be turned over to competition and market forces.

Perhaps the most critical area is pricing. China recognized the importance of moving to market prices for crude and products in the late 1990s. That has now happened in the case of crude, but it has not yet happened in the case of product.

Simply stated, allowing product prices to move with international prices would provide a clearer incentive to consumers to conserve or to consider alternatives.

Turning to the second question, China will be a net importer of oil for years, probably decades. What China does to secure this oil may be important, but not for the question of what its net requirements will mean for global demand and supply.

The world demand supply balance will almost certainly be tighter than it would have been if China had grown more slowly. But the same could be said for the U.S. or anywhere else that is a major net importer.

On the third question, my formal statement covers three areas: what is happening with the major NOCs; their experience and strength; and finally what I see as their leverage. It also makes the point that these are not private sector actors.



Skipping to leverage, the most important may be the access that these companies can provide with respect to the Chinese market. But finding opportunities to invest in a downstream business is not a big deal in much of the world. But finding opportunities to invest in the downstream or a petrochemical industry that is growing as rapidly as China's may be different and this represents an important element of NOC leverage.

Another comes from having a government that has the financial resources and the willingness to use those resources to back NOC bids for other companies or for access to acreage in areas that are believed to have potential.

My thought here is that if the world's oil resources are going to remain concentrated in a small number of countries, the fact that China has huge financial resources that it is willing to use is a challenge but not necessarily something that makes things a lot more serious than they already are.

On the fourth question, China's approach to securing energy resources is a combination of participating in the international market for resources that I have commented on, plus diplomacy, aid and other political means that are the subject of this question.

In this regard, the interesting question may be exactly what China does when it uses diplomacy, aid and other political means to secure energy resources. Can China with a permanent seat on the U.N. Security Council or substantial holdings of American government debt provide a defense against sanctions that will buy itself something in terms of security of supply?

I don't know. At one point most of the analysts were convinced that it did. At this point, I do not sense that those same analysts are as confident as they might have been once.

Another area is business ethics. Years ago I would have said that this was an advantage for China. Short-term I think it can still be an advantage. On the other hand, when the objective is to operate over an extended period of time, as it is when you get into production, I think the American approach probably works better.

On the fifth question, the fact is that almost anything we do to reduce demand or increase supply in this country and anywhere else in the world, including China, will mean easier balances and probably lower prices.

Beyond this, in terms of specifics, I think there is merit in having a world-class navy, as long as we are going to be importing large volumes of oil and gas from long distances, and in having a reasonable number of world-class international oil companies and independents that are financially strong and have the world's best technologies.

This is the case today if we include the European companies in the best technologies category. The way that Washington can be most helpful

is by not making it any more difficult to maintain our leading edge in financial strength and technology. No one in the industry is looking for affection, but our energy situation would not be helped say by an excess profits tax.

Finally, on the sixth question, the areas of interest here are the waters between China and Japan and China's claims in the South China Sea. My thought here is that costs of military engagement aside, China has made a huge investment in building its reputation as a constructive regional leader, and anything that it does in the way of unilateral action in this area is going to upset a lot of its neighbors, not to mention the United States.

That concludes my comments.  
[The statement follows:]<sup>5</sup>

### **Panel IX: Discussion, Questions and Answers**

HEARING COCHAIR WESSEL: Thank you and thanks to all the witnesses. Dr. Wortzel.

CHAIRMAN WORTZEL: I have a question for Dr. Olcott. In your lead sentence, you say that China has a growing presence in Central Asia, but it should not be assumed that their activities will be of direct or even indirect threat to U.S. interests in the region. However, neither in your oral nor written testimony, do you lay out what U.S. interests are. So I would ask you, does the United States have national security interests in Central Asia? If so, what are the vital or important American national security interests in Central Asia that could not or would not be affected by any of China's actions?

DR. OLCOTT: Thank you for such a good question. I think the biggest problem is the U.S. government has yet to decide whether it has vital security interests in Central Asia. It has pursued a policy, on the one hand, sometimes it looks like we believe we have vital security interests and other times it's not clear that we have.

I think that the U.S. does have a vital security interest in Central Asia which was demonstrated in Afghanistan when it collapsed. I think that it would be a direct threat to U.S. security to allow this region to become a black hole, but I'm not sure that we are being very effective about that, and I think that while we do not agree oftentimes with China's view on the war on terrorism, even in the context of Central Asia, they too share our view that they don't want it to become a black hole.

We'd fight on the Uyghurs and where the line between peaceful and not-peaceful is, but that we share with the Chinese.

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<sup>5</sup> [Click here to read the prepared testimony of Dr. David F. Gates](#)

The U.S. would like Central Asia to be able to be used as a forward deployment place for U.S. bases, but we have not been very effective in guaranteeing that in the past few years. We've lost one base for a number of reasons that I can go into if we're interested, and the base in Kyrgyzstan has been secured, but its long-term security is really under serious question.

There's a lot of confusion as to whether China would like the U.S. out or not, and this is something I've done a lot of interviewing on. I believe that China has no interest in getting the U.S. out in the short term from Central Asia, would be very upset, though, if we had a 50-year horizon for our base there. But they see us as a balance, I think, so I don't see China as a direct threat on that question.

On the question of energy security, I think that there are certain deposits that the U.S. and China might come into competition. The Chinese tried to buy into Kashagan which is a Western-owned consortium and the Western partners would not sell to them. Yet this was not a source of escalating bad relations with the Chinese. I think the Chinese will eventually get a piece of that from the Kazakhs, but for this point in time the Chinese took other assets instead. Mostly, as I said in my testimony, they're picking up what the Western firms don't want, and the big thing is that the pipelines through China get at exactly what the administration says it wants for Central Asia: it creates alternate pipelines that are not dependent on Russia turning off the faucets.

So in that sense, cooperation with Central Asia, as long as it's not Russia dictating the terms through China, which it isn't at this point in time, and I don't see that occurring, is really likely to not be a direct threat. In fact, the Central Asians are very savvy in dealing with the Chinese.

Most of the Central Asian diplomats who deal with China do speak Chinese and we've had foreign ministers from these Central Asian countries, including the present one in Kazakhstan, who is a Chinese speaker. They're managing these relationships much better than we often give them credit for. They have a lot of balls up in the air, and they're not making either the U.S., China or Russia mad, and that I think is a real accomplishment.

CHAIRMAN WORTZEL: Any of the other panelists have anything? Thanks.

HEARING COCHAIR WESSEL: If you could help, as it relates to these Central Asian assets, what are we looking at in terms of their impact on the Chinese market? You mentioned the Turkmen gas reserves, et cetera. Where do they fit in terms of China's demand and what are we looking at, to the extent any of the panelists know, in terms of the ability to access the distribution network?

You talked about, electricity potentially being actually wheeled into China. I don't have enough knowledge on what China's grid is like, but

how does all that work? Where does Central Asia fit in terms of China's long-term energy needs

DR. OLCOTT: I'm sure others have more information on the problems of the Chinese internal market. I'll take the electrical grid because that's easier. The Chinese and Russians and Kazakhs are committed to creating an interlocking grid for part of the border area.

So this, I think, is a question of just a willingness to spend money. You meet part of China's problem with needing coal to create hydroelectric power by having Kazakh coal create hydroelectric power on the Kazakh side of the border which is exactly what's going on in that project.

The question of whether Central Asian gas will meet Chinese need, at this point in time, will require a great deal more infrastructure investment than has been on the table now.

That's part of why I firmly believe we're going to get this triangular relationship because where China, where you get the biggest bang for the Chinese buck from Chinese point of view is if they can get some of the Russian assets into the Kazakh system now because you have the excess supply. But when the supply problems are reversed, then you have more pipe going in Western Siberia to get a tradeoff for assets where the Kazakh assets will meet Russian need in Siberia, some of the European need, and then allow the diversion of Russian assets into China.

Now this is something that the Chinese and the Kazakhs understand. Their perspective is medium term and long term. That's why nobody is jumping for the infrastructure investment within China now to make use of the Kazakh oil that's going to come and more importantly the gas that they're looking for for 2010 on.

Because the Chinese understand that they have to get the longer-term issues with Russian supply worked out, to either get Russia on board as a provider or to give up the idea of Russian assets entirely, and then they'll figure out how much of the Central Asian assets they will actually use in China and how much they'll just take the commercial value of.

The big thing about those assets now is what they're denying to Russia. They will deny Russia control, the guarantee of Turkmen gas to sell in Europe, and that's why Russia is going to try to push China into Uzbek assets and Kazakh assets and have the Turkmen assets be left for the Russians, but again China has the capital to invest in what is a deteriorating or rapidly deteriorating gas pipeline system within Central Asia.

So they're there much less now to guarantee supply for China as they are to shore up their position in the region over the long term.

HEARING COCHAIR WESSEL: Comments from other witnesses?

MS. JAFFE: Yes. I would just like to add a layer to what Dr. Olcott is saying because there is this confusion in U.S. foreign policy over this issue. There's an overemphasis in U.S.-Caspian policy or a

complete emphasis in U.S.-Caspian policy to make sure that all gas and all oil goes out some other route other than Russia.

In some other bureau in our foreign policy apparatus, we stand up and adamantly support Germany's relationship with Russia and the security of supplies that the Russians should provide to our European allies of gas, and it's unclear now, depending on investment patterns, but the Russians without reforming Gazprom and without some big change in their current plans and pace of investment in Russian domestic gas in west Siberia are going to have difficulty meeting European demand in the future without being able to capture the Caspian gas to use in Russia.

So we're struck in this competing policy here in the United States where I think a lot of people maybe have not quite connected the dots, that supporting Europe's ability to get gas from Russia and having an aggressive policy of getting Caspian gas to go elsewhere than Russia have this little inconsistency to it, and it's very "jello-ie" because it's very hard to get a projection of Russian demand.

It's very hard to get a projection of which fields the Russians will or won't be able to invest in by 2009, but ultimately there is a conflict between those two strategies that I think is not properly recognized and needs to be taken into account and studied with more care.

HEARING COCHAIR WESSEL: Thank you. Very helpful. Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Thank you all for your testimony. I have a question for Dr. Olcott, and then if time for Ms. Jaffe. Going to this question of the national interests in Central Asia, it sounds like what you're saying actually is we the United States have national interests, whether they be counterterrorism operations or whether they be a minimal oil and gas interest, but we're not going about securing them very well. Would that be a correct statement or a correct way that I've interpreted your statement or your answer?

DR. OLCOTT: Yes. I think, on the one hand, we overstate how important Central Asia is for the U.S. We exaggerate the oil and gas reserves, both the likelihood of them coming, some of them coming to the West, because we're focusing on an undersea trans-Caspian pipeline project that I don't think will ever see the light of day.

So we exaggerate the importance. At best, Central Asia Caspian reserves are going to be an alternative supply, an add-on supply in Europe. They're much less important for the U.S., even for Europe, whereas for China or Russia, these are major assets.

So, on the one hand, we pretend like this is a major energy asset for the U.S. On the other hand, there is a security need there. Like any other volatile part of the world, it threatens directly U.S. security, particularly because it's in this crux between Europe and Asia. But I think that the administration's goals have been further diluted after the beginning of the war on terror by the democratization, this campaign to liberate the world,

and I think that that has been a serious problem in Central Asia, that they have pursued very conflicting goals with one hand with the democratization, on the other hand, security. So--

HEARING COCHAIR BLUMENTHAL: But, yes, if you're in China, you probably view the United States' ongoing operations in Afghanistan, the concern about terrorism in Central Asia, you probably think that the Americans actually want to stay, right, for awhile in Central Asia?

DR. OLCOTT: In a recent conversation with a senior Chinese advisor to SCO, he talked exactly the opposite, the fear that the U.S. was diluting its presence in Central Asia, that his fear was that we were not as serious about cleaning out the--

HEARING COCHAIR BLUMENTHAL: But how does that reconcile with the statement that Chinese sponsored that they want the U.S. out of Central Asia at the SCO?

DR. OLCOTT: I think that it reconciles in two ways. First of all, it didn't have a date, and I think China does not want a permanent U.S. military presence in Central Asia. And secondly, I feel very strongly that that statement was brought to the SCO at the behest of the Uzbeks, that it was not the Chinese asking for it, but happy to subscribe to it, as the Russians were, but this was in the aftermath of the Andijon uprising and this really was Karimov being mad at the U.S. and wanting to put the U.S. on notice that they were going to be pushed out of Central Asia, and this suited Chinese medium and long-term interests.

HEARING COCHAIR BLUMENTHAL: This leads to my next question which is how do the Chinese think they're going to secure--we heard testimony beforehand that they feel safer with land pipelines in terms of just securing the supply back to China. How do think they're going to secure that supply, through relationships in Central Asia, that Central Asian militaries are going to be responsible for securing the pipelines? Are the Chinese looking at new types of force structure to secure those pipelines?

DR. OLCOTT: I think the hope on the Chinese part is that the SCO structure will provide sufficient loose security guarantees. I think their emphasis is going to be on, in the long run, creating this not as a new NATO but as a set of forces that are capable of effective joint military activity.

HEARING COCHAIR BLUMENTHAL: Are they going to want the Americans not to be part of that? Are they scared that the Americans would muck things up for them in terms of supply?

DR. OLCOTT: I think that their more important concern would be that these be effectively reformed military. So I don't think that they yet know whether this is at the expense of joint NATO programs are not. Their thinking on these questions is very in coy at this point of time.

HEARING COCHAIR BLUMENTHAL: All right.

DR. OLCOTT: I think they're also committed to friendly regimes being in power there.

HEARING COCHAIR BLUMENTHAL: Right. The last question. It could be that our new friendship with India affects our calculations about what our national interests in Central Asia are in the sense that the Indians, it would seem to me, want to play a more active role in Central Asia as well, and could call upon us to support what they see as a type of strategic competition in Central Asia?

DR. OLCOTT: Thank you for that question because that's a really critical point. I think that we are actually miscalculating on the question of India in Central Asia. The Central Asians, the Uzbeks and Kazakhs, in particular, actively pursued India for many years, the years that China was not as active in Central Asia, and the Indians were much less willing to get directly involved either in non-allied security structures that the Kazakhs pursued or in investment in these countries in the energy sector and other forms of industry that they were pursuing them.

Now I think to try to bring them, which I agree is part of this administration's current strategy with regard to Central Asia evolving over the last year or 18 months, it's almost too late. I'm not sure that the Indians are so interested, but even if we can attract Indian interests, a lot of the train is now occupied by China. So you have already a Chinese presence that India would have a great deal of trouble matching both in terms of the intensity of trade or in any energy projects.

There are not the kinds of projects available right now that would create the interplay with India's energy needs, and India itself is looking more to Russia. So the strategy abstractly is a good one, but in reality if it had been done ten years ago, it might have worked, but right now you have realities on the ground that there's just a much greater Chinese presence than you had five years ago or ten years ago.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR WESSEL: Commissioner Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much and thank you to our witnesses. It's a very interesting topic and interesting testimony. Dr. Downs, who just testified before you, mentioned something that seemed to me to shake a bunch of the presumptions that a number of people have about what China is doing as it is investing overseas including in countries like Sudan. And she mentioned that I think it was the head of BP China had said that 90 percent of production by Chinese oil companies overseas goes into the world market, not back to China.

I think that there has been a presumption that China is engaging in the activities that it's engaging in in order to ensure its own domestic supply as its increasing energy demands go. And I think in some ways, although people don't excuse what they're doing in Sudan and Iran and Burma, people have used the growing Chinese energy consumption as an

explanation for why they're doing it, but if they're not using that energy back in China, shipping it back to China, but putting it into the world market, I think it really changes the whole nature of the consideration of what's going on.

I was wondering if you had any factual information about what China is doing with the oil that it is producing and/or refining overseas and any suggestions on where we can try to track that down?

MS. JAFFE: I think the thing you need to understand is how owning oil matters or doesn't matter. Really truly it doesn't matter because you can own the oil, and if there's an international market crisis, go tell some oil producer that you want to take it home. If they can sell it to somebody else for twice as much money, they're probably just going to break your contract. Right? And that was the experience we all learned in '79. That was the experience the French learned in Iran where they got kicked out along with everybody else despite their foreign policy and despite their huge investment, not only in Iran, but in the Ayatollah and his future.

So the Chinese haven't quite learned that lesson. But just because they don't take the energy home today doesn't mean they wouldn't take the energy home at some other time. You always have the option to decide shall I sell it, shall I take it home? World War II is a very good lesson in that when it came to the Western oil companies.

So I wouldn't focus so much on that. I think you're hitting the nail on the head when you consider the fact that it's a global market and we want a global market. That's what is in the U.S. interests. That should be what's in the Chinese interests, and what we're really most interested in is not having any country, whether it's China or any country, get so involved in bilateral diplomacy that in some future crisis, we have a market failure because somebody uses extra market means to get oil to go in one place and not another.

Given the fact that we're a naval power, I think that's less of a security risk for the United States, but all countries have a stake in having the market function and not having these political market failures like we saw in '73. But in thinking about the Chinese situation, whether the Chinese bring the oil from Sudan home or not, and whether CNPC just wants to invest and become ExxonMobil, and therefore they've taken some national strategy's slogan/logo, and sold it to the powers that be in China, but they're really out for themselves as a corporation, we still need to concern ourselves as international citizens in how CNPC behaves or how the Chinese drilling companies behave when they're in-country.

You're talking about the displacement of two million people because this one corporation has a corporate stake in what happens inside that country. That matters to the United States. If CNPC is such an important player and they have cross-board directors in the Communist Party that they can say, no, it will hurt my company if we save those two



million people so vote against this, that matters. That matters on a moral basis; that matters on a humanitarian basis; that matters on a U.S. strategic basis.

We need to be able to put together coalitions to solve international conflict, whether it's Iran's nuclear program, something of great significance to the international community, or whether it's a humanitarian crisis in a place where people might feel the stakes are a little lower.

It's the methodology that we need to be concerned about. It's the ability to use the United Nations or some kind of other international multilateral system to solve international conflict and international crisis, and if the activities of any kind of corporation are going to get in the way of that, and that happens to be because it's a national oil company and it has political ties inside its own system, we still need to be concerned about that, regardless of where the oil goes.

COMMISSION VICE CHAIR BARTHOLOMEW: Either of our other witnesses, comments?

DR. GATES: Yes, I'd just make a couple of observations. First, I completely agree with Ms. Jaffe's point about this being an integrated market and in that context it's not only demand but supply, and related to that, I think over the past 25 years or so, maybe longer, the market has become much more transparent, much better understood, not only by people in the industry but people in general.

As far as tracking particular barrels of oil, it can be done, but it's very complicated. I have not been near that part of the business for many years now, but it can be done. I think the thing that always impressed me as a sometime participant in the market was how often some of these cargoes change owners as they're moving around the world.

The oil business is very much a 24-hour-a-day business, and there are people trading oil, trading specific cargoes 24 hours a day everyday, and so it can be tracked, but I think at the end of the day, the impression that you have is that this material is just moving all around all over the place, and that's the way the market is viewed and approached.

The other thing, which goes back to a point I tried to make in my formal remarks, we talk about the diplomacy and the money and the business ethics and all these things that come into play for particular participants in this market. At the end of the day, what the Western companies bring to this party, what the American companies and the European companies in particular bring is the best technology in the world. It is not just poking holes in the ground. It's a lot more than that.

Our ability to do this in terms of going forward is probably going to make more of a difference in where the American business entities, European business entities actually participate. Some of the stuff that we have to do from here on out is going to be fairly sophisticated in terms of technology, and in many respects, there's a distinction between the

American/European companies that have that technology and that they continue to develop, and many of the national oil companies that do not yet have that technology.

HEARING COCHAIR WESSEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman. I want to thank you and the staff for putting together this excellent morning of hearing. I want to thank this panel. Your prepared testimony is really quite, quite good and very helpful to me and I'm sure the Commission as a whole.

I want to read a quote from Ms. Jaffe and just file this away, and then want to follow up with a question for Dr. Gates. But you point out that on page two of your testimony that U.S. companies are preferring to buy back stock shares and show financial discipline rather than respond full out to U.S. national interests to find and produce more oil. If you have a chance to comment on that later on, I'd be interested in understanding why.

Dr. Gates, during the CNOOC-Unocal transaction last year, the Congress and this Commission were criticized because we questioned the claims by CNOOC that this was a normal commercial transaction that so many people in the media bought into and that somehow we were interfering with free markets to be questioning about that transaction.

On page three of Ms. Jaffe's testimony, she tells us that China's national oil companies are, generally speaking, more concerned with gaining access to foreign oil and gas fields on behalf of the country rather than reaping optimum commercial profits. That doesn't sound to me like that's a commercially-driven company then.

You make the same point on page six of your testimony where you tell us that you would not want to call these private sector actors. Then you go on to tell us on pages six and seven of your testimony that they have important leverage in the way they behave because they've got government backing for what they're doing.

We used to call that the deep pocket, that a private sector player might not have when I was dealing with these issues with the Senate Banking Committee. And lastly, on page nine, you tell us maybe there would have been a different reaction to that whole thing--we were criticized in our country at the same time--you tell us in your testimony that the Chinese don't permit people to buy up their oil and oil companies in China.

You make the point that if there were greater reciprocity and fairness in terms of access in markets and resources, maybe it would be a different story. I think Senator Schumer has talked about this issue, the reciprocity of the way this all works.

What would be your reaction if the Chinese--and they've got about a trillion dollars now worth of U.S. dollar assets-- if they wanted to come over here and buy ExxonMobil, would that be a good idea for us to let

that happen? Or should we be more searching in our review of these purchases by Chinese companies and should we be more insistent on a reciprocal approach?

DR. GATES: Interesting question. Having spent 32 years with ExxonMobil, that would be an interesting outcome. I'm not entirely sure where I would come out on that. I think what I see from an American perspective, I really take seriously my point about the merits of having not just one but a number of internationally competent companies such as ExxonMobil, Chevron, Conoco Phillips, go down the list, and also the independents.

I think that is a national asset. I think it's not appreciated as a national asset based on what I read in the newspapers, but I think it is a national asset, and I think these companies, as private companies taking a long-term view of the future, have been investing in the technology that they need, and I think that is terribly important from an American standpoint.

As far as the Chinese buying one of these major assets, I'm not sure that I have a good solid economics answer to that, that particular question.

COMMISSIONER MULLOY: You'd be a little--

DR. GATES: I'd be a little hesitant. Yes.

COMMISSIONER MULLOY: You wouldn't think it would be such a good idea?

DR. GATES: Yes, I think I'd be hesitant. On the other hand, to be very clear, as an American, I'm quite happy with the outcome of the Chevron discussion, the Chevron-Unocal discussion. I would have been happier if we could have arrived at it more smoothly because as an economist, I tend to look at what a sensible market solution would be, and that means people, all people involved in the thing, kind of understanding the way the oil market works and what have you and proceeding on that basis.

To the extent that we get statements being made that lead to less than satisfactory responses on the parts of the other participants in this market, I don't think that's terribly helpful.

HEARING COCHAIR WESSEL: Commissioner Donnelly.

COMMISSIONER DONNELLY: Thank you, Mr. Chairman. I'm afraid I've got a statement or two before the question. I can't resist tossing in my two cents on Central Asia. It may be that the triangulation that you speak of has helped to guarantee the sovereignty of the Central Asian states, but it has also served to ensure the rule of some rather unattractive regimes. So the democracy promotion agenda may be at odds with other elements of U.S. policy and it may be where we are now is the best possible outcome, but it is also a suboptimal outcome.

I would also offer that it raises the question of radicalization within Uzbekistan, in particular, but hardly likely to be limited to that country if

you accept that radicalization is at least in part a response to the repression of the central government. So just to be a twit, I toss that out.

Also, just the trust in the marketplace is something that I'm not quite as convinced about as everybody. The marketplace is a contingent phenomenon that's within a framework of American geopolitical power that is the cocoon in which the marketplace operates, and I'm not sure that China's geopolitical rise doesn't have the potential to distort that in ways and compound particularly problems like Iran.

Dr. Gates suggested that the Chinese are not getting a whole lot of economic value for their political influence, but from Iran's perspective, the protection or the shelter of a veto-wielding U.N. Security Council member probably has some pretty significant, but I wouldn't want to quantify it, but I think it probably accounts for something.

My question would be to try to get back to the broader framework of the hearings that we've been having, and that is to ask you what particular benchmarks you would set out as measures that the Chinese are becoming genuinely responsible stakeholders in the international order or you could translate that into the marketplace, if you will, as it currently exists?

Again, that is the buzzword that seems to have certainly captured the government, but it's very difficult to measure that in specific terms. So just within, however you choose to bound the question, either near or long term, what specific things would represent Chinese accommodation to, again broadly speaking, the order as it currently exists. Thanks.

DR. GATES: Let me start.

COMMISSIONER DONNELLY: In three seconds or fewer.

DR. GATES: Yes. Or less. I go back to my initial statement. I think if you look at what is happening to the Chinese energy situation, they feel a fair amount of pressure at the moment. I'm not party to any internal discussions, but if you look at China's energy requirements over any reasonable future, they're enormous. In that context, it's not at all surprising that we're seeing all this activity in alternative energies and the like, but I think at the end of the day, there's going to be a tremendous need for oil and gas everywhere they can develop it.

And so in context, they're clearly under a lot of pressure. I think it would help if we could have more discussions with the Chinese that would indicate an understanding, that we understand their situation, and help them to understand our situation. I think from my standpoint that would really be the best way forward. How you get there is another matter.

DR. OLCOTT: My three seconds. First, I'm all for democracy building in Central Asia. I just think we did it ineffectively, and I'll happily share with you my book on that topic.

Second, so it's us and not the Chinese that have been part of the source of the problem, but we can talk about that afterwards--the question of Chinese and transparency, I think one way that we work towards this is

not pushing them out of consortium like the Kashagan consortium. I think the more dealings that Western firms can have with China where they are minority stakeholders in big projects, the better chance we have of having the kinds of Western standards of behavior and these firms have some impact on them.

That's a very different transaction than saying that they should have been allowed to buy Unocal, but when you're talking about minority stakes in big projects where they are not the project manager, I think it's a great solution for them to get a shot at improving their standards and also us in learning to believe that they may have changed.

MS. JAFFE: Let me take that a step further. Part of the reason why, and it's written in Chinese policy literature, part of the reason why they went to Sudan and Iran and some of these places is because the international oil companies wouldn't let them buy into consortia, so they were blocked out of very attractive acreage and they were forced into the acreage where the majors didn't want to go.

So we partly created that problem ourselves. But you raise a very important question for which there's a very simple answer. We want to see CNPC, CNOOC and Sinochem and Sinopec, we want to see them come into markets. There's a tendency, I think, sometimes on the Commission to say, well, gee, they're not transparent so we shouldn't let them into markets; right. We want them in markets because being in markets forces them to be more transparent.

They have to produce more materials on their operations, right. When you think about how did they wind up in Sudan, they wound up in Sudan because Talisman, a public company, was kicked out by its shareholders. Its shareholders forced Talisman to stop supporting the Sudanese government. So we need to see, like the World Bank has been working with China and other countries, we need to see CNPC, CNOOC, the Chinese firms, be pulled up to the international standard for corporate responsibility.

We want to see them participating in international forum on corporate responsibility. We want the public markets for IPOs and things like that to insist and to press that these companies be forced to present transparent materials about their operations.

COMMISSIONER DONNELLY: Mike, if I could, 30 seconds. The experience of recent years has been that in other forms of economic activity, Chinese entrance into international marketplaces, international norms, has left people uncertain as to whether the Chinese are going to change the norms or adapt to the norms.

Is there any reason to believe in the energy marketplace, that that same question is at least an open question?

MS. JAFFE: I think the point is, and we've seen it with the Russian companies that there is this pressure, especially if they're going to want to use public equity markets or other public markets to finance major

projects or have the World Bank be involved in major projects. One of the ways that international companies can reduce their risk when they're building giant energy infrastructure is to bring in the international lending institutions because that can reduce some of the sovereign risk hopefully.

So really it's by getting them in the system, and you're right, we've had closed seminars between the Baker Institute and some of the major Chinese think tanks, and they'll explain to you, well, we didn't make the rules of this game so why should we abide by them and I find that a very specious argument.

When those arguments are brought up to me by senior Chinese officials and analysts, what I say is we developed those rules after years of experiences where we realized that we needed those rules. Why do we have the International Energy Agency? We have it because we learned through the disasters of '73 and '79 what works and what doesn't work.

So there is no point in there recreating the wheel if we already have a wheel that works, and that's really an education issue. It's making the people who are corporate leaders in CNPC realize that the international majors have faced these difficulties in Africa and other places and understand that the corporate responsibility program is a means to avoid those problems, and that it's in their stakeholder interest to learn those practices and participate with them.

HEARING COCHAIR WESSEL: Commissioner Reinsch.

COMMISSIONER REINSCH: Once again my question has already been asked so I yield back my time.

HEARING COCHAIR WESSEL: I will yield your time then to Commissioner Blumenthal who had a follow-up question.

HEARING COCHAIR BLUMENTHAL: Yes. It seems to me there is not a one-to-one ratio between being more transparent in IPOs and public markets and calling upon better behavior. Shareholders want shareholder value. So why would they necessarily care that Chinese companies are doing business in murky areas? That's one comment.

The other comment is, is it really the case that it's just a question of --But is it really the case that more education and letting the Chinese into international consortia would really solve the problem? We heard testimony beforehand that is exceedingly concerned and distrustful that the Americans may disrupt China's supply in a crisis so they're going about paying larger premiums of all sorts, not just on the oil, but on the relationships, on the diplomacy, and so forth, to get land pipelines.

If you have a China that just thinks about bringing oil and the concept of petroleum and petroleum security very differently than the Americans, if they don't think that, as in your testimony, Ms. Jaffe, that they don't think they can compete in some other areas, so they go into the Sudan and the Iran, is it really the case that if we just keep talking to them, and tell them that they can come into international consortia, that they actually reduce their national suspicion that the Americans are going

to use the disruption of oil as a weapon against them and therefore they will just stop their behavior in the Sudan and stop their behavior in Iran and just invest in places that we'd like them to?

MS. JAFFE: Let me say this. There are many Chinese articles that Ms. Downs has read and quoted in her work that acknowledge the Chinese understanding that if there was a conflict with the United States, we'd blow up those pipelines and they wouldn't get the energy from it. Right? We have a magnificent Air Force. We have a tremendous naval power, and if we decided in some punishing blow over some issue I hope would never arise that we wanted to deprive China of energy supply, their only hope is their own coal.

So I think they understand that. They've written it in public forum in English, so clearly they understand that. Right? So the point is really--what is my behavior internationally, and do I apply standards? How did American companies wind up not in Iran, not in Sudan?

HEARING COCHAIR BLUMENTHAL: Sanctions.

MS. JAFFE: Not in Burma. Not necessarily sanctions. In a lot of cases, you got blocks of investors that came in and said we're not going to purchase this stock because it's in a political risk area. We're not going to lend to this institution--right--because it's not transparent, and the Russian companies learned very quickly that if they weren't transparent enough or they looked, you know, dicey, that investors would flee their shares; right? Or that they wouldn't be able to borrow effectively.

HEARING COCHAIR BLUMENTHAL: Let me just push on that a little bit. But it comes down to we have a very different political system where we have NGOs and human rights groups that would make reputational problems for American companies who do business in some of these areas. China does not have that system. China does not necessarily care about--they might care that the world is putting the spotlight on them in terms of human rights abuses, but there's nothing within the Chinese domestic system that says, well, we really want you to stop doing business in the Sudan because of genocide. We do.

MS. JAFFE: Let me just say that there is a nascent NGO activity inside China. They have a nascent environmental movement. They have a very aware environmental population. If you come to the Baker Institute Web site and look at some of the survey research we've done with Chinese urban elites, you'll see that the population is actually a little bit more educated on some of these issues than you might think.

HEARING COCHAIR BLUMENTHAL: I know they are, but--

MS. JAFFE: And here's the point. It's not a democratic system. People aren't going to vote out their government, but the government still has to concern itself with how the general population feels, and it also has to compete and rival with local and provincial leaders for the mandate of making policy outside of Beijing, and so I really do feel that even though maybe in certain circles inside the government in China we don't have

shared values, and then sometimes when we get into international arenas, that lack of shared values is a problem, there are a lot of reasons why pressing the international system on top of these companies is important. Look at the fact that you have India, a country that does have a democratic system, that does have the same kinds of values and concerns we do, and yet the Chinese pressure on the Burma issue caused the Indian National Oil Company to reconsider its position on investments in Burma.

We don't want a trend out here where suddenly everybody is short on energy and even we the United States say, we're going to turn a blind eye to two million people being killed because we need the oil. We don't want to move into that world. So we need to hold our values in place and financial markets, there is a way that those values translate into financial markets, whether it's because we have what I call ideological blocs of investors, pensions and so forth, and we've seen that post-September 11 or because investors shun companies that have high political risk, right, or will penalize companies if they have too high a political risk.

How did Unocal wind up on the block? All these places I'm mentioning are places where Unocal was having difficulty operating business because they were in Burma, right, so it does matter where these companies go. They want to move themselves into public finance. You have a lot of Chinese individuals today--I forget the statistics--I wish Steve Lewis was here sitting behind me because he knows them off the top of his head--but the amount of private Chinese pension money chasing Chinese shares today is huge.

If you go back to these polling numbers and you see what it says in terms of Chinese elite educated values, in terms of environmental and so forth, you could see that some day if Chinese pension holders are going to own a portion of these shares, and they're going to have a say in what these companies do, there really could be a blending of the international community's values in terms of how corporate responsibility is handled.

DR. GATES: May I add a couple of points on that? I think what impresses me about the Chinese is the pragmatism of the way they approach things, so that I don't think we have to assume that the Chinese are going to adopt our values to begin to behave in a more consistent manner with what we'd like to see.

On something on, for example, air quality and the use of coal, just the simple fact of air quality in Beijing is enough to move you away from coal, and you can pitch that in terms of concern for climate change and the like, but at the end of the day, it's the fact that you can't walk two blocks in downtown Beijing in the middle of the winter without ending up coughing. It's a simple pragmatism.

HEARING COCHAIR BLUMENTHAL: Yes.

DR. GATES: But let me just say I think that carries over into the upstream as well, that the point is that as I mentioned before, the Chinese like many other national oil companies do not have the same technologies.



That means that whether they want to or not, they may well have to draw in or become partners with some of the American and European companies, just to do business in some of these areas.

HEARING COCHAIR BLUMENTHAL: That pragmatism can very much translate into we don't get involved in other countries' human rights. Pragmatism can be very amoral or immoral. I agree with you that there is pragmatism, but--

DR. GATES: But I think there's a distinction. We have a set of values that we pursue, and that's fine. But what the Chinese do, even though they don't share those values, it's not inconceivable that they would begin to act in a similar manner for totally different reasons.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR WESSEL: Thank you to the witnesses for all your help and I hope that we can again call on you for continuing advice. Thank you to the staff for a great job in putting together two days of hearings, and with that we stand adjourned.

[Whereupon, at 12:00 noon, the hearing was adjourned.]