

**THE IMPACT OF CHINA'S ECONOMIC AND
SECURITY INTERESTS IN CONTINENTAL ASIA
ON THE UNITED STATES**

HEARING

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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May 20, 2009
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WASHINGTON : June 2009

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June 22, 2009

The Honorable ROBERT C. BYRD
President Pro Tempore of the Senate, Washington, D.C. 20510
The Honorable NANCY PELOSI
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR BYRD AND SPEAKER PELOSI:

We are pleased to transmit the record of our May 20, 2009 public hearing on “*The Impact of China’s Economic and Security Interests in Continental Asia on the United States.*” The Floyd D. Spence National Defense Authorization Act (amended by Pub. L. No. 109-108, section 635(a)) provides the basis for this hearing.

In this hearing, witnesses told the Commission that the United States’ interests in Afghanistan and Pakistan are not necessarily incompatible with China’s, and that there may be opportunities for the United States to engage China in Continental Asia and encourage it to take a more active role in promoting peace, stability, and economic growth. China’s relationships in Central and South Asia have been longstanding, but recently it has refocused its efforts on expanding its commercial and energy interests there. As its economic stake in the region grows, its ability to influence security in the region is likely to grow commensurately, and witnesses urged the United States to engage China on promoting high standards for trade and investment that in turn give rise to good governance and improved human security.

The Commission received testimony from Deputy Assistant Secretary of Defense Michael Schiffer, who noted that as the United States and China develop areas of common interests in Afghanistan and Pakistan, “[t]he challenge before us is to maximize the space for cooperation in pursuit of common interests, and safeguard against any negative impact resulting from areas of disagreement.” China’s overall approach to the region is to balance relations with all regional powers, including the United States and Russia, while at the same time seeking to advance its relative standing in the two countries. It does not appear currently to be seeking military capabilities to project power in the region. However, he noted that the United States must continue to track Chinese behavior in the region in the event that its military becomes more assertive in the future. Regarding Afghanistan, China’s interest in limiting extremism within its own Xinjiang Autonomous Region has resulted in support for U.S.-led efforts against Al Qaeda and the Taliban. Deputy Assistant Secretary Schiffer noted that China also indirectly benefits from US and NATO forces providing security for key infrastructure and development projects in the region, which may include Chinese commercial ventures. However, these

protections extend to all countries which have interests in key infrastructure in Afghanistan and there is no special deal for security of Chinese interests between the United States and China.

Deputy Assistant Secretary Schiffer testified that investment will play as key a role as military security, and the United States wants China engaged as a partner in Afghanistan. However, he noted that China's interests in Pakistan are different, as China and Pakistan have had a longstanding military and security relationship. He urged China to be open and transparent regarding its intentions for use of the Port of Gwadar in Baluchistan, and expansion of civil nuclear cooperation with Pakistan.

Furthering the discussion of China's interests in Afghanistan and Pakistan, Dr. Walid Phares, director of the Future Terrorism Project at the Foundation for Defense of Democracies, testified that China is in a "pre-9/11 mood," not realizing the imminent danger it faces from a jihadi threat if peace is not secured in Afghanistan and Pakistan. This should be the impetus for China's cooperation with the United States in this region. However, China views the two countries' security through a broader lens. Mr. Abraham Denmark, a fellow at the Center for New American Security, explained that, "China sees Afghanistan and Pakistan as components of a broader struggle for dominance over South and Central Asia. China's close relations with Pakistan are largely a check against India's rise as a dominant power in South Asia....According to this logic, China benefits from an Afghanistan that is stable and friendly to Pakistan, because it allows Islamabad to focus on India." He argued that stability in Pakistan is central to the United States' and China's approach to the region, and that China will benefit from realizing that stability in Pakistan will lead to enhanced regional security. Ms. Lisa Curtis, a senior research fellow at The Heritage Foundation concurred, and advised that the United States should "seek to convince China to play a responsible role with regard to its nuclear cooperation with Pakistan, emphasizing the need to discourage nuclear-weapons stockpiling in a country facing the specter of further instability."

In the third and fourth panels of the hearing, the Commission examined China's broader engagement in Continental Asia, including its trade and commercial ties. Given that the new U.S. strategy toward Afghanistan and Pakistan places so much weight on economic development, these panels explored how China's economic interests may affect U.S. strategy, trade, and diplomacy in the region. Energy is one of the sectors for Chinese involvement in Central and South Asia. Ms. Julia Nanay, senior director of Country Strategies at PFC Energy, and Dr. Stephen Blank, professor at the Strategic Studies Institute of the U.S. Army War College, both testified that China's economic position as a cash-rich country with a growing demand for energy will make it a highly sought after business partner for countries seeking to develop their resources. With this relationship, Ms. Nanay noted, "China strengthens its energy security, while Central Asian countries diversify their export options and get investments and cash." China is pursuing energy investments through the expansion of pipeline connections that will connect to China's interior provinces. Dr. Blank explained that an increase in oil and gas supplies through pipelines eases China's concerns about oil supplies relying on access to the Strait of Malacca, also known as China's "Malacca dilemma."

China's other commercial engagement in Central and South Asia is focused on securing access to natural resources. Dr. Martin Spechler, professor of Economics at Indiana University, testified that Central Asian nations have pursued an economic policy of "staple globalism," which "involves state trading of exports and selective imports of capital goods." In this region, China can and does conduct state-to-state trade through its state-owned enterprises. Dr. Spechler noted that even as trading relationships grow, Chinese exports to the region are unlikely to expand due to the difficulty and expense of transporting goods.

Dr. Daniel Twining, senior fellow for Asia at the German Marshall Fund, testified that China has made targeted investments in South Asia, primarily in weak states, and that the United States should consider the strategic impact of this investment. China's investment in infrastructure, such as the Port of Gwadar in Pakistan, may give it access to strategic shipping lanes or land transportation routes. Furthermore, Dr. Twining argued that China's military and security assistance may complicate U.S. diplomacy in the region. He noted that since 1990 the top three recipients of Chinese arms exports have been Pakistan, Burma, and Bangladesh. China's trade and investment in Sri Lanka and Burma have not benefited human security in those countries. Dr. Twining argued, "Both Washington and New Delhi have a compelling interest in investing for the long term in the infrastructure of good governance and rule of law in [Sri Lanka and Burma] both for intrinsic reasons and because transparency and accountability will render them less susceptible to Chinese political influence."

Thank you for your consideration of this summary of the Commission's hearing. We note that the full transcript of the hearing plus the prepared statements and supporting documents submitted by the witnesses can be found on the Commission's website at www.uscc.gov, and that these can be searched by computer for particular words or terms. Members of the Commission are available to provide more detailed briefings. We hope these materials will be helpful to the Congress as it continues its assessment of U.S.-China relations and their impact on U.S. security. The Commission will examine in greater depth these issues, and the other issues enumerated in its statutory mandate, in its 2009 Annual Report that will be submitted to Congress in November 2009.

Sincerely yours,



Carolyn Bartholomew
Chairman



Larry M. Wortzel, Ph.D.
Vice Chairman

cc: Members of Congress and Congressional Staff

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WEDNESDAY, MAY 20, 2009

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THE IMPACT OF CHINA'S ECONOMIC AND SECURITY INTERESTS IN CONTINENTAL ASIA ON THE UNITED STATES

THURSDAY, MAY 20, 2009

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

The Commission met in Room 562, Dirksen Senate Office Building, Washington, DC at 9:15 a.m., Chairman Carolyn Bartholomew, and Commissioners Daniel Blumenthal and Jeffrey Fiedler (Hearing Cochairs), presiding.

OPENING STATEMENT OF COMMISSIONER DANIEL BLUMENTHAL HEARING COCHAIR

HEARING COCHAIR BLUMENTHAL: We're going to get started. We have a number of opening statements before Deputy Assistant Secretary Schiffer, who so kindly and generously agreed to testify here today, will offer his comments.

So I'd like to extend my personal welcome to our panelists and guests, and it's good to see old friends from OSD and new friends from OSD here today.

In March 2009, President Obama announced a new strategy for Afghanistan and Pakistan, and one of the key objectives of this strategy is obviously involving more of the international community and "disrupting terrorist networks,"--I'm quoting President Obama now--"promoting effective governance in Afghanistan and Pakistan, and developing the regional economy."

In addition, the Obama administration committed an additional 17,000 U.S. troops to Afghanistan to carry out this new strategy. As the United States considers the safety and success of its military operation and looks to the international community to take a role in improving the economic and security situation in the region, it is

important to consider China, in particular, because it borders many of the countries that make up this very important arc of threat and arc of instability.

This hearing attempts to examine China's interests in Afghanistan and Pakistan and more broadly its energy and economic interests in the region. From a security perspective, China's internal concerns about Islamic Uighur separatism inform both its security relations and posture towards the countries in the region.

To counter what China identifies as a terrorist threat, it has taken an active role in the region through the Shanghai Cooperation Organization. This appears to be an attempt to limit radical Islamic influences upon the Uighur population, as well as to establish positive relations along its land borders.

Furthermore, through SCO military and counterterrorism exercises, most recently in April of 2009, Chinese forces have been able to demonstrate a physical presence in the region and gain currency with new tactics and techniques.

With these interests, we are here today to ask a number of questions. Is there a role for China to play in cooperating with the United States to implement its new strategy for Afghanistan and Pakistan?

I am confident that our witnesses today may shed light on some of the potential opportunities and challenges affecting the answer to that question.

Thank you, again, and I'm going to turn it over to my cochair, Commissioner Jeff Fiedler.

OPENING STATEMENT OF COMMISSIONER JEFFREY FIEDLER HEARING COCHAIR

HEARING COCHAIR FIEDLER: Thank you, Commissioner Blumenthal, and thanks to our witnesses for being here today.

The Department of Defense 2009 *Annual Report to Congress on Military Power of the People's Republic of China* states, quote:

"China's current strategy is to manage external tensions to assure an environment that is conducive to economic development."

With tensions along its borders in Central and South Asia, China views instability in this region as a challenge for improving its trade and commercial ties.

Currently, China's trade and investment in the region is heavily concentrated in raw materials, infrastructure, and energy. In 2007, China Metallurgical Group's \$3.5 billion investment in Afghanistan's Aynak copper field is Afghanistan's largest foreign investment. Its

participation in the "New Silk Road" project will construct and improve existing roads linking China to the entire region and all the way to Iran.

Furthermore, China's construction of pipelines in Central Asia will provide alternative supply routes of oil and gas that bypass the Malacca Strait.

These investments in Central and South Asia demonstrate that China is diversifying its resources and building critical links to foster trade and commerce.

Therefore, this hearing is to determine the impact of this activity on the United States, particularly as it seeks to build up security in Afghanistan and Pakistan by improving their prospects for economic development.

What role can China play in this endeavor through its investments and trade? What concerns, if any, should the United States have about China's investment strategy in Central and South Asia? And finally, what should be done to ensure that U.S. economic and security interests in the region are protected? These are a few questions that I'm interested in exploring during today's hearing.

We thank you for participating, and I believe Commissioner Blumenthal will introduce Mr. Schiffer.

PANEL I: ADMINISTRATION PERSPECTIVE

HEARING COCHAIR BLUMENTHAL: It's my pleasure to introduce the first panel and to welcome Deputy Assistant Secretary of Defense for East Asia, Michael Schiffer, who is very well known in policy circles for the work he did as the program officer in Policy Analysis and Dialogue at the Stanley Foundation, where he was responsible for the foundation's Asia programs and a range of other U.S. national and global security issues.

He also has extensive experience on Capitol Hill where he worked as senior national security advisor and legislative director for Senator Dianne Feinstein. So welcome back to the Hill as well.

He was also a Center for Asia and Pacific Studies Fellow at the University of Iowa and has published widely on a wide range of international security, political and media issues.

So we're delighted to have you here, Deputy Assistant Secretary of Defense Schiffer, and we welcome your remarks.

Thank you.

**STATEMENT OF MR. MICHAEL SCHIFFER
DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR EAST ASIA
U.S. DEPARTMENT OF DEFENSE, WASHINGTON, DC**

MR. SCHIFFER: Thank you very much for having me here this afternoon and thank you for welcoming me back to Capitol Hill. This is my first opportunity since starting my job a few weeks ago to offer testimony, and I think I am fairly confident that I can state that it is a lot more comfortable on that side of the table than it is on this side; but, nonetheless, thank you.

We are very happy to be here today to address a range of topics related to the department's views on China's economic and security interests in Central Asia, including the war in Afghanistan, its commercial and energy interests in the region, and the impact of Chinese policy on the United States.

Before I dive into my testimony, I want to offer a preemptive apology for what may be a few sniffles along the way. I have some allergies that are acting up this morning so if you see me going for a piece of tissue paper or if my voice otherwise gives out, that's the explanation.

Given the time, and as we discussed earlier, I'm going to take a little bit more of an opportunity to walk through the prepared testimony than would have otherwise been the case given that I'm the sole witness on this panel--so I ask the Commission's indulgence for the time to do that.

As you know, and as Chairman Blumenthal and Chairman Fiedler pointed to, China has comprehensive, regional economic and security interests in South and Central Asia, and pursuit of those interests will naturally guide China's policymaking considerations.

Central and South Asia are also a top policymaking focus for the United States as well, particularly given the situation in Afghanistan and Pakistan. We both have interests in the region, however, does not mean that we are witnessing the rebirth of the 19th century's "great game."

China's interests and those of the United States are not necessarily incompatible. We have and will continue to develop areas of common interests. The challenge before us is to maximize the space for cooperation in pursuit of those common interests, as well as to safeguard against any risks that may result from areas of disagreement because there are obvious areas where there may be friction between the United States and China in the region. If China adopts greater openness and transparency about its activities in the region, that will

help ease concerns about its strategic intent and will assist in developing the trust that can lead to even greater levels of cooperation.

Although China tailors its policy to the specifics of each country in the region, we can also observe some broad commonalities in its overall policy goals. First and foremost is the desire to see stability around China's periphery which China's leaders judge as essential to continued domestic growth and development. Having stable and ideally friendly regimes around its borders provides China political support, reduces China's concern about extremism and terrorist infiltration, and helps to ease China's long-standing fears of encirclement.

China also seeks to benefit economically from positive relations with its neighbors and has sought to develop infrastructure projects throughout the region that would further open markets for China's goods while facilitating its access to natural resources.

China perceives both opportunities and potential dangers in Central Asia where Russia has historically dominated, but where now Russia, Turkey, Iran, India, the United States and others all have active interests. While China is careful not to challenge Russian interests directly or openly, it remains concerned that Russia could resume its past dominant role. Similarly, China seeks to counterbalance U.S. influence, particularly in Pakistan. China has concerns that greater U.S. engagement and force presence may lead to a long-term military presence on China's borders and create uncertainties about China's future access to the region's natural resources. Thus, China's overall approach is to strike a balance, striving for positive relations with all the regional powers, while always alert for additional opportunities to advance its relative standing in Central Asia.

This balance can be seen in the tension between China's claims in promoting economic development in Central Asia and the promotion of its own interests, including its need for energy and natural resources and market access to maintain its economic growth.

The 1,000 kilometer long pipeline from Kazakhstan's central Karaganda region to China's northwest Xinjiang region provides a key link to a planned 3,000 kilometer long project that will link Caspian Sea hydrocarbon deposits to China. China is also constructing a gas pipeline from Turkmenistan and is helping Uzbekistan develop its Ferghana Valley oil fields. China continues to harness Central Asian rail and road networks to build a land bridge to the West that does not transit Russia, and to that end it is also investing in passenger and cargo rail capacity in Kazakhstan. It is also overhauling a key road in

Tajikistan. These investments in regional infrastructure, with reciprocal access to markets, may help enable China to reach its target eight percent annual growth in GDP.

These projects may also create competitive advantages vis-a-vis Russia and others providing market access in Central Asia for products from China, and there are also obvious security implications of this infrastructure effort as well. We have not, however, seen China develop security relationships in Central Asia on par with its economic relationships. That is mainly because Russia continues to play an important role in training and equipping the Central Asian militaries. What security concerns and cooperation we see with China primarily falls under the auspices of the Shanghai Cooperation Organization, which I will touch on near the end of my remarks.

China's competing interests in promoting regional stability while simultaneously enhancing its relative standing in the region and vis-a-vis the United States and Russia is also evident in its approach to Afghanistan. China is concerned about the United States establishing a permanent presence in Afghanistan and could from that perspective be expected to oppose any U.S. attempt to do so. At the same time, China recognizes that the U.S. and NATO-led efforts are the primary force preventing Afghanistan from slipping into greater anarchy, and given China's interest in secure and stable borders, and concerns about extremist terrorists does not want the U.S. to fail either. Indeed, as long as China does not pursue mercantilism or exclusionary policies, its attempt to improve infrastructure through investment in Afghanistan could well help serve U.S. interests. For example, in Afghanistan a small number of Chinese firms have received contracts to install fiber optic cable and to build roads.

In 2008, a Chinese state-owned enterprise won a tender for the rights to develop the Aynak copper deposits, a \$3 billion investment that could create 10,000 jobs and annual revenue of \$400 million for the Afghan government. This is currently, as was already noted, the largest foreign investment project in Afghanistan. While China has not made direct security contributions to the war in Afghanistan, it has not opposed U.S. efforts there either. In fact, China indirectly benefits from the security provided by NATO forces stationed near its development of the Aynak mine and other commercial ventures.

China's declared counterterrorism strategy addresses what it identifies as the root causes of terrorism, namely poverty and underdevelopment. Its stated solution is to bring greater economic activity to its western provinces, urging businesses, both domestic and foreign, to locate their operations in western China. In Xinjiang, however, many of the local Uighur population perceive this influx as

yet another manifestation of an unwelcome Han-Chinese domination.

China has largely escaped being the target of the ideology-based global jihadi threat. China's concerns with extremist groups that employ terrorist tactics are understandable, and the United States and China have engaged in counterterrorism cooperation, particularly during the 2008 Beijing Olympics. There are opportunities for further cooperation in this area as well. But the United States should not accept China's use of counterterrorism as an excuse to oppress its Uighur population. China's own constitution guarantees both religious freedom and legitimate political expression for its minority populations, and voicing dissent does not make one a terrorist.

The tension inherent in China's competing desires to promote regional stability while also advancing its interests and relative standing carries over to its involvement in South Asia as well, where it is still, in fact, too early to tell how China's strengths will affect the regional political balance.

In Pakistan, China's construction of a major port facility at Gwadar could serve to promote economic development in the region. On the other hand, China may view the port as an anchor for naval expansion into the Western Indian Ocean, a development that might prove to be very destabilizing. It is in the interest of all parties active in South Asia, including the United States, that China be open and transparent regarding its intentions for Gwadar.

China's security relationship with Pakistan, as members of the Commission know, is long-standing and wide-ranging. It includes sales of short and medium-range ballistic missiles, joint production of major weapons systems. China and Pakistan conduct regular military training exercises together including anti-terrorism training and naval exercises.

Media reports have suggested that China looks to expand civil nuclear cooperation with Pakistan, but it is unclear how this might be done in a way that is consistent with China's international obligations.

We see no evidence, however, that China is working counter to U.S. interests or objectives with either India or Pakistan. China appears to share our interest in stability in South Asia. It is concerned about the rise of extremism in Pakistan and recognizes that fear of conflict with India only distracts the Pakistan government and military from the extremist threat in its western border area.

China's security relationship with Pakistan provides it an opportunity to play a constructive role in advancing the United States development in counterinsurgency goals in the region. While China likely recognizes this opportunity, it also fears a potential backlash from its domestic Muslim population if it is seen as cooperating too

closely with the United States. For this reason, China will likely use private diplomacy to urge Pakistan to prioritize the defeat of militant extremists in its western regions.

Finally, a discussion of China's economic and security interests in Central and South Asia would not be complete without mention of the Shanghai Cooperation Organization. Many of the Asian states have realized over the years that they do not benefit from having one power dominate the region and do not wish to see China, Russia or the U.S. play that role. The frequent gatherings of the SCO are a visible result of China's more active role in Central Asia and attempts to play on those sentiments. The Organization's continuing lack of significant impact or clear purpose, however, demonstrates the limits of Chinese multilateral engagement in the region.

The United States encourages China to participate responsibly in the international system by supporting, strengthening and stabilizing global political, economic and security architecture. In the case of Central and South Asia, we see China carefully choosing its means of engagement to support an underlying goal of increasing China's own economic prosperity, security and regional influence. To ensure that China's activities in Central and South Asia have minimal negative effect on U.S. interests, the U.S. government continues to monitor China's military and commercial involvement in the region. Many of China's activities support interests shared with the United States, and we will continue to work with China to ensure that its activities add to the stability and security of the region. That concludes my prepared remarks, and I'm now happy to take whatever questions you may have.

Thank you.

[The statement follows:]

**Prepared Statement of Mr. Michael Schiffer
Deputy Assistant Secretary of Defense for East Asia
U.S. Department of Defense, Washington, DC**

Madame Chairman, Mr. Vice Chairman, members of the Commission, I thank you for inviting me to appear before you today to address a range of topics related to our views on China's interests in the war in Afghanistan, its security relationship with South and Central Asia, its commercial and energy interests in the region, and their impact on the United States.

China has comprehensive regional economic and security interests in South and Central Asia, and pursuit of those interests will naturally guide China's policymaking and considerations. Central and South Asia are currently a top strategic focus of the U.S. government as well, particularly the situation in Afghanistan and Pakistan. However, this is not a resumption of the "great game," and China's interests and those of the United States are not necessarily incompatible. We have and will continue to develop areas of common interests, although undoubtedly there will also remain areas where our interests diverge. The challenge before us is to maximize the space for cooperation in pursuit of common interests, and safeguard against

any negative impact resulting from areas of disagreement. As China continues to develop its approach to the region, there are numerous opportunities for China to demonstrate its role as a constructive actor in upholding international stability. For example, adopting an open and transparent approach to its activities will help ease concerns that others may harbor about China's strategic intent, and will assist in developing the trust that can lead to greater levels of cooperation.

Although China tailors its approach to the specifics of each country in Central Asia and South Asia, we also observe broad commonalities in its overall policy goals. First and foremost is the desire to see stability around China's periphery, which China's leaders judge is essential to continued domestic growth and development. Having stable and, ideally, friendly regimes around its borders provides China political support, reduces China's concern about extremists who might establish havens for basing attacks against China, and helps to ease long-standing fear of encirclement.

China also seeks to benefit economically from positive relations with its neighbors, and has sought to develop infrastructure throughout the region that would further open markets for PRC goods, while facilitating China's access to natural resources. China perceives both opportunities and potential dangers in a Central Asia where Russia historically dominated, but where now Russia, Turkey, Iran, India, the U.S., and others all have active interests. While China is always careful not to challenge Russian interests directly or openly, it remains concerned that Russia could resume its past dominant role. Similarly, China closely monitors U.S. influence, particularly in Pakistan. Thus, China's overall approach is to strike a balance, striving for positive relations with all regional powers, while always alert for additional opportunities to advance its relative standing in both regions.

This balancing act appears in China's involvement in Central Asia, and the tension between China's claims in promoting the economic development of the region and the promotion of its own interests. Indeed, China's interests in Central Asia are primarily economic, and reflect its need for energy, natural resources and market access to maintain economic growth. The 1,000 kilometer pipeline from Kazakhstan's central Karaganda region to China's northwest Xinjiang region provides a key link to a planned 3,000 kilometer project linking Caspian Sea hydrocarbon deposits to China. China is constructing a gas pipeline from Turkmenistan, and is helping Uzbekistan develop its Ferghana Valley oil fields -- a potential regional source of energy. The United States supports increased Eurasian oil and gas exports, including to China, as a means to deliver additionally energy to global markets. For Caspian Basin countries, China represents an additional independent export route that strengthens the sovereignty of these countries. To the extent that natural gas consumption in China substitutes burning coal, increased gas usage in China also benefits U.S. climate change goals. China continues to harness Central Asian rail and road networks to build a land bridge to the West that does not transit Russia, and to that end is investing in passenger and cargo rail capacity to Kazakhstan. It is also overhauling a key road in Tajikistan. These investments in regional infrastructure, with reciprocal access to markets, may help enable China to reach its target of 8% annual growth in GDP. They may also create competitive advantages vis-a-vis Russia and others, providing markets in Central Asia the option of selecting cheaper products from China.

We have not seen China develop security relationships with Central Asian states on par with its economic relationships, mainly because Russia continues to play an important role in training and equipping Central Asian militaries. Russia is able to meet fully the region's limited appetite for and ability to absorb arms transfers. What security cooperation we see with China primarily falls under the auspices of the Shanghai Cooperation Organization (SCO), which I will touch on near the end of my remarks.

China's competing interests in promoting the common objective of regional stability on the one hand, while enhancing its relative standing in the region and vis-a-vis the U.S. and Russia on the other, are also evident in its approach to Afghanistan. China does not want the U.S. to establish a permanent presence in

the country, and could be expected to oppose any U.S. attempt to do so. At the same time, China recognizes that the U.S.-led efforts are the primary force preventing Afghanistan from slipping into greater anarchy, and given its interests in secure and stable borders and concerns about extremist terrorists, does not want us to fail.

For the most part, as long as China does not pursue mercantilist or exclusionary policies, its attempts to improve the regional infrastructure through investments in Afghanistan serve U.S. interests. China's economic and development activities in Afghanistan have contributed to U.S. objectives for reconstruction and stabilization in that country. A small number of Chinese firms have contracted to install fiber optic cable and to build roads. In 2008, a Chinese state-owned enterprise won tender for the rights to develop the Aynak copper deposit -- a \$3 billion investment that could create 10,000 jobs and annual revenues of \$400 million for the Afghan government. This is currently the largest foreign investment project in Afghanistan.

While China has not made direct security contributions to the war in Afghanistan, it has not opposed U.S. efforts there. In fact, China indirectly benefits from the security provided by NATO forces stationed near its development of the Anyak mine and other commercial ventures.

China's declared counterterrorism strategy addresses what it identifies as the root cause of terrorism -- namely poverty and underdevelopment. Its stated solution is to bring greater economic activity to its western provinces, urging businesses, both domestic and foreign, to locate their operations in western China, although in Xinjiang many in the local Uighur population perceive this influx as yet another manifestation of an unwelcome Han Chinese domination. At the same time, China has likely realized that the terrorist threat it faces derives mainly from domestic separatist movements, and China has largely escaped being a target of the ideology-based global jihadi threat. DoD's "Joint Intelligence Task Force -- Combating Terrorism" likewise concurs that the threat of jihad to China is "relatively low." China presumably wishes to continue to avoid attracting the attention of global jihadi groups. China's concerns with extremist groups that employ terrorist tactics against the state are understandable, and the U.S. and China have engaged in counterterrorism cooperation, particularly during the 2008 Beijing Olympics. There are opportunities for further cooperation in this area, even as we have made clear our support for human rights. China's own constitution guarantees legitimate political expression for its minority populations.

The tension inherent in China's competing desires to promote the common good of regional stability while also advancing its individual interests and relative standing carries over to its involvement in South Asia. In Pakistan, China's construction of a major port facility at Gwadar could serve to promote economic development in the region. If Pakistan provides the needed infrastructure connecting the port to Southern Afghanistan, it could be a boon to trade not only in Baluchistan, but for Afghanistan and Central Asia as well. On the other hand, China may view the port as an anchor for its own naval expansion into the Western Indian ocean, a development that might prove destabilizing. It is in the interest of all parties active in South Asia, including the U.S., that China be open and transparent regarding its intentions for Gwadar.

In South Asia, China's growing economic and military strengths may yet play an increasingly influential role, but it is too early to tell how China's strengths will affect regional politics. India maintains a two-way trade relationship with China that totaled \$41.5 billion in 2008, up from less than \$10 billion in 2005. Overall, bilateral ties have steadily improved since 1988, when then-Prime Minister Rajiv Gandhi made the first state visit to China in 34 years, based on cultural ties, increasing trade, and official visits.

China's security relationship with Pakistan is long standing and wide ranging, including sales of short- and

medium-range ballistic missiles, and joint production of major weapons systems like the K-8 Karakorum, a jet trainer aircraft, as well as advanced multi-role combat aircraft, the JF-17 Thunder. Pakistan may also acquire the Chinese Y-8 Rotodome airborne early warning aircraft. China and Pakistan conduct regular military training exercises together, including anti-terrorism training and naval exercises. China participated in two joint naval exercises that Pakistan hosted, named Aman 07 and Aman 09 for the years in which they were conducted, as did the United States. The most recent, Aman 09, included participants from 11 nations, and featured search and rescue, counter piracy, and fleet formation training. China and Pakistan also conducted two joint counterterrorism exercises named Friendship 2004 and Friendship 2006, for the years in which they occurred. The first exercise took place in China, and the second in Pakistan. China has also provided Pakistan nuclear technology and assistance. In 2008, China agreed to help Pakistan launch a telecommunications satellite by 2011. Media reports have suggested that China looks to expand civil nuclear cooperation with Pakistan, but it is unclear how this might be done in a way that is consistent with China's international obligations.

Regarding the impact of China's relationship with India and Pakistan on U.S. diplomacy toward the two, I have seen no evidence that China is working counter to U.S. interests or objectives with either country. I believe that China shares our interest in stability in South Asia, is concerned about the rise of extremism in Pakistan, and recognizes that fear of conflict with India only distracts the Pakistan government and military from the extremist threat in its Western border area. China's security relationship with Pakistan provides it an opportunity to play a constructive role in advancing the United States' development and counterinsurgency goals in the region. While China likely recognizes this opportunity, it also fears a potential backlash from its domestic Muslim population if it is seen as cooperating too closely with the U.S. For this reason, China will likely use private diplomacy, rather than public admonition, to urge Pakistan to prioritize the defeat of militant extremists in its western regions.

Finally, a discussion of China's economic and security interests in Central and South Asia would not be complete without mention of the Shanghai Cooperation Organization (SCO). The Central Asian states have realized over the years that they do not benefit from having one power dominant in the region, and do not wish to see either China, Russia or the U.S. play that role. The frequent gatherings of the SCO are a visible result of China's more active role in Central Asia. China's military engagement in Central Asia has been slowly increasing, albeit from a low base-line of interactions. Most of it occurs on a bilateral basis, but some limited multilateral military engagements also take place by means of the SCO.

The United States encourages China to participate responsibly in the international system by supporting, strengthening and stabilizing the global security architecture. In the case of Central and South Asia, we see China carefully choosing its means of engagement to support its underlying goal of increasing China's own economic prosperity, security, and regional influence. To promote further cooperation in areas of mutual interest for all actors in the region, we encourage China and India to resolve their long-standing border disputes. Eliminating such points of friction would assist all actors in focusing their attention on addressing the common problem of terrorism. Many of China's activities support interests shared with the United States and other regional countries, and we will continue to work with China to ensure that its activities add to the stability and security of the region.

Panel I: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you very much for that very, very interesting and I think very rich testimony, not bad for a first time, very impressive. Did the chairman have something to say?

CHAIRMAN BARTHOLOMEW: That's all right.

HEARING COCHAIR BLUMENTHAL: All right. I will ask the first question then, if that's okay with you.

HEARING COCHAIR FIEDLER: Please.

HEARING COCHAIR BLUMENTHAL: The question is, with these increasing energy interests and economic interests and pipelines throughout continental Asia, as well as extremism along its borders, what do you see the Chinese doing militarily to try to protect, defend these expanded interests?

We obviously see some interest in power projection on the maritime side because of expanded economic interests, but how about on the land side, on continental Asia?

MR. SCHIFFER: As of yet, there don't appear to be many indicators that the Chinese are taking an active role in seeking to build its capabilities to project power out into the region to protect its interests. In part, I think that's because they are able to take advantage of the fact that Russia continues to occupy a very strong role working with the other governments in Central Asia to provide military and security cooperation, and the United States is also, particularly in Afghanistan and Pakistan, as well, working to help assure that there is security and stability for critical infrastructure.

I think this is clearly an area where we need to continue to track Chinese behavior, both what they say and what they do. It is very easy to plot out different scenarios in which we might see an active and more assertive China at some point in the future. Depending on how that plays out; however, that may not be entirely a bad thing for us. As we seek to encourage China to play a responsible role in the international community, one of those roles, if structured right, will be providing the sorts of public goods that right now the United States plays a predominant role in providing for the global community.

If China, in an open, transparent, and fully cooperative way, is able to help provide some of those public goods in Central Asia in ways that allow the United States to pursue its economic, political and security interests as well, that may not be entirely a bad thing. But it is certainly in an area that we need to keep our eye on.

HEARING COCHAIR BLUMENTHAL: I have time for a quick follow-up. Is the attitude in China just that they think the Americans will take care of something going really wrong in its borders or in Pakistan and Afghanistan and they don't need the military force to project power to protect those interests?

MR. SCHIFFER: I think as their interests continue to develop, it's only to be expected that they will seek to gain additional capabilities, and that's natural. I don't think there's anything

inherently good or bad in that. That's the course of history. I think given where we are right now, and projecting out into the near and mid-term, the Chinese lack those additional capabilities, that do not appear to be doing anything to bring them on line, and the Chinese appear to be navigating very gingerly around Russian and U.S. interests and activities in the region. As long as Russia, the United States, and others are able to provide those security goods and do so in a way that is not adversarial to China's interests, which is largely the case now, there's no reason to expect the Chinese to act otherwise.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR FIEDLER: Let me ask a couple of factual questions. I want to try to get the right context of Chinese military assistance to the Pakistani government as compared to our own. Is the Chinese assistance growing, and what are the rough percentages if you were to break it down in the first question?

MR. SCHIFFER: I hate to do this, especially considering my prior position, but if it's possible to arrange for a different setting for us to be able to talk to the Commission on this question, we'd be happy to do so.

HEARING COCHAIR FIEDLER: Okay.

MR. SCHIFFER: I think some of these issues are somewhat sensitive, and it is difficult to really have the sort of discussion that we would like to be able to have with you in an open setting.

HEARING COCHAIR FIEDLER: I understand that and that's fine. I think we'll follow up on that.

Let me go back to Xinjiang for a moment. Our official position on the ETIM versus Uighur dissent, generally speaking, you made reference in your testimony to, you alluded to the fact that they're out of balance in terms of the Chinese claiming that any form of dissent is equated with jihadism. What's our real read of the Uighur dissent versus jihadism among Uighurs?

MR. SCHIFFER: That's not an easy question to answer, and the reason why it is not an easy question to answer is that within any population, including, dare I say it, our own, there are always outliers, and so there are certainly within the Uighur population, writ large, a handful of people that do harbor extremist views.

The ETIM has not been active in any significant way since the mid-1990s. There were a few events that you're all well aware of, ten, 12, 15 years ago, that got the Chinese quite wound up. We haven't seen anything of that nature recently. Those events would lead one to conclude that those that harbor these sorts of sentiments in the Uighur population are a distinct minority and face some considerable operational challenges, and that the vast majority of the Uighur

population, as best as we can tell, are peaceful, law-abiding citizens wanting to be able to express their legitimate rights within China.

As you stated, the Chinese government's reaction and actions are a little out of balance, and we wish and have tried to encourage them to take a slightly more discriminating approach to the challenge that they face so that they can target the terrorists that they need to target and that ought to be targeted while respecting the rights of the vast majority of the Uighur people.

HEARING COCHAIR FIEDLER: One quick question. Do we do anything special to protect the Chinese copper mine in Afghanistan?

MR. SCHIFFER: We do not do anything special to protect the Chinese copper mine in Afghanistan that I'm aware of. Obviously we are seeking to provide protection for key and critical infrastructure in Afghanistan as a general rule as part of our desire to get some traction for economic development, and the mine falls under that, that broad category, but there is no special deal for protection or anything like that that I'm aware of.

HEARING COCHAIR FIEDLER: Thank you.

Mr. Brooks.

MR. BROOKES: Thank you.

Welcome, Mike. Good to see you again. I saw a press report yesterday, and I believe it came out of the Indian press, saying that a Chinese admiral in conversations with our Pacific commander had offered to divide the Pacific into sphere of influences, saying that the Chinese would handle everything from Hawaii west and the United States will handle everything from Hawaii east.

I wonder if you could confirm that that conversation took place, and I understand the U.S. admiral politely declined, but I was wondering if this is indicative of a future Chinese policy or current Chinese policy of dividing the Pacific and Asia up into sphere of influences?

Thank you.

MR. SCHIFFER: It is my understanding, and I saw that report in the Times of India as well, that the conversation between the two admirals was one that was facetious and tongue-in-cheek.

We can have our individual opinions about how good a subject matter this is to joke about, but that was my understanding of what the intent was. Beyond that, the United States has a fairly clear policy of assuring that we have an enduring presence in the Western Pacific and in the Asian-Pacific regions. We are not interested in seeing competition in the Pacific--to divide it up into different competing spheres of influence. I think that this is a more serious policy matter, and a set of issues that we should pay very, very close and careful

attention to. Aside from some bad jokes, we have not seen any serious statements coming from credible Chinese sources noting that is their desire or intent.

MR. BROOKES: Thank you.

Quickly following up on that, the same article also indicated that this same Chinese admiral said that the Chinese are going forward with an aircraft carrier program. Can you update us from the Pentagon's perspective on that?

MR. SCHIFFER: What I know about the aircraft carrier program is essentially what I read in the press, that they are going forward with it. They appear to be having some technical difficulties in pushing the program through to completion so it is not entirely clear to us what the timeline looks like or what its capabilities will be. This is obviously part and parcel of a larger set of concerns that we are paying attention to regarding the modernization of the Chinese Navy and its efforts to acquire true blue water capabilities. There are additional pieces to this and, again, I apologize. I would be happy to talk to you about in a more appropriate setting.

MR. BROOKES: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman. Mr. Schiffer, thank you for being here.

I don't follow the political/military issues as much as I follow the economic, trade and financial, so these questions may be basic. Mr. Abraham Denmark, who is going to be on the next panel, says that stability in Afghanistan and Pakistan both appear to be deteriorating, and President Obama's recent trip to Europe revealed that NATO's willingness to contribute substantial amounts of money or troops is limited.

NATO got into this because we were attacked by al-Qaeda, and then the collective security obligation in the brought NATO to help us against al-Qaeda. That's my understanding. Why is NATO less willing than we are to put troops into this operation?

MR. SCHIFFER: I am going to be able to speak to a very limited degree about NATO's approach to Afghanistan. We do face a very, very difficult challenge in Afghanistan, and I do not think anybody has tried to sugarcoat the security situation. I have heard different characterizations about whether or not it is stable, deteriorating, and how badly it might be deteriorating, if it is deteriorating.

We clearly have a major challenge in Afghanistan and that is the primary reason why President Obama has made it an absolute top priority of his administration to finally get Afghanistan right. Getting back to your question about NATO, there is unfortunately a history of

the past several years that we cannot simply whitewash away, and there are a number of issues that we have to work through with our allies to regain their confidence before they are willing to come to the table in as fulsome a way as we might like. Having said that, I have not seen anything that indicates that our NATO allies are not in Afghanistan shoulder-to-shoulder with us and doing a lot to help us succeed.

COMMISSIONER MULLOY: In his testimony, Mr. Denmark, who will be on our next panel says on page two of his prepared testimony: "many U.S. policymakers continue to focus on NATO for assistance. However, some officials argue that China as a neighbor to the region with significant amounts of liquid capital ready to invest could play a major role in the international effort to defeat terrorism and maintain regional stability."

What are the pros and cons of seeking Chinese assistance if NATO isn't stepping up as much as we would like?

MR. SCHIFFER: I think there are certainly some questions about seeking Chinese security assistance in Afghanistan and filling some of those roles that NATO has traditionally filled. I should note that China has played an increasingly positive role in U.N. peacekeeping operations over the past several years, and so it is certainly more than conceivable to see how we might be able to get to a point down the line where China is able to play a more robust peacekeeping role in Afghanistan.

In terms of investments, infrastructure, and economic development, which ultimately will likely be as key--if not more key to our eventual success, I think China is deeply involved right now. The balancing act on both of these fronts, of course, is that we want China engaged as a partner, and we are very grateful for support that we're able to get from China to help us succeed in Afghanistan. But, clearly, just as China has its concerns about what sort of enduring presence the United States may desire to have in Afghanistan and Central Asia, we would have some concerns about what China's ultimate intentions and role would be, which gets us back to the need to make sure that as we proceed, we do so in a way that is open and transparent so that we have a surety about what their strategic intentions are.

COMMISSIONER MULLOY: Thank you, Mr. Schiffer.

HEARING COCHAIR FIEDLER: Commissioner Cleveland.

COMMISSIONER CLEVELAND: It's great to see you. It's terrific that the administration has somebody with your talent in a DASD position, and so, welcome, and I also want to say how pleased I am with the nomination of John Huntsman. I think that's a terrific

appointment and a potential loss perhaps for Republicans but a gain for the country.

I've got two questions. I'm not sure you'll be able to answer either here, but if you could come back to us. In a number of places, witnesses all day today talk about Chinese sales, military sales to Pakistan, and I'm interested in the terms of the financing. How are those agreements or arrangements being structured?

I'm particularly interested in the context of the administration's new commitments to direct budget support to Pakistan. So if you could talk a little bit about what we know about how the Chinese are and the Pakistanis are financing the military sales and how we think that may play out in the context of direct budget support- that would be helpful.

MR. SCHIFFER: I would be more than happy to do so although, again, in a different setting, and we'll make arrangements to have that discussion.

COMMISSIONER CLEVELAND: And the financing side?

MR. SCHIFFER: Even on the financing side, there are some complexities here that are probably best discussed in a more closed setting.

COMMISSIONER CLEVELAND: Can you talk about the thinking that went into the provision of direct budget support given the fact that it has had a checkered history in terms of being able to track the resources?

MR. SCHIFFER: On direct budget support, I will give you my honest answer, which is that my knowledge of the issue at this point is somewhat thin as I am still coming up to speed on a lot of this stuff, but I will track it down and come back to you with an answer to that one.

HEARING COCHAIR FIEDLER: Commissioner Reinsch.

COMMISSIONER REINSCH: Thanks.

One of the relationships you didn't spend much time in your statement was with India. I'd like you to comment on two things. One, your assessment of the current state of Sino-Indian relations. We could probably do a whole hearing on that, but if you could do a few words on that, I'd appreciate it.

Then, second, how you see the Obama administration's military relationship with India evolving and what your goals are there?

MR. SCHIFFER: Let me start with the second question first, if I may, and that's that even beyond the military relationship, the Obama administration has every intent of creating a full and robust political and security partnership with India. India is one of the great success stories of the 21st century, and there are many areas where the United

States and India share common interests and have opportunities to work together closely, and the administration intends to pursue that as fully as they can.

As you know, there are certain challenges in working with India on military-military relationships, issues that go back many years and are imbedded in a history and a time when the United States and India were not always on as good footing as we are today. It is our hope that we are able to work through that history and to get to a place where the United States and India do have a robust partnership.

In terms of the Sino-Indian relationship, that is also a complicated relationship. There are still outstanding border issues between the two countries. They see each other in somewhat competitive terms in the regional context. There are not that many areas where they rub up against each other directly right now. But as India's power grows, and as China's power grows, managing the Sino-Indian relationship is certainly going to be one of the great issues that we are going to have to face over the next several decades, and there are--I can spin you out rosy scenarios for positive multilateral engagement and non-zero sum relations between India and China, but it is also fairly easy as you go through issue by issue in the region to see areas where we might see quite a bit of friction between the two of them that will require some deft diplomacy and management.

COMMISSIONER REINSCH: Thank you for that.

On the second question that you answered first, the U.S.-India mil-mil relationship, I thought that was a good summary of historic--"difficulties" might be the best word. Do you see anything changing in their attitude on their side, and do you think the recent election there is going to make any difference in that area?

MR. SCHIFFER: I think the recent election will help to solidify some of the current trend lines that we have been seeing. In terms of changes in attitudes on their side, I think there has been on both sides over the past several years, a growing comfort and a growing sense of shared values and shared interests that provide us the foundation that we can then build on. I think that is all to the good; however, it is a process that will take a number of years to reach its full and natural fruition.

COMMISSIONER REINSCH: Are they participating in the effort to deal with piracy off the coast of Somalia?

MR. SCHIFFER: I'll have to get back to you on that.

COMMISSIONER REINSCH: India.

MR. SCHIFFER: --I am not sure of all the details on that, but we'll get back to you on it.

COMMISSIONER REINSCH: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Shea.

COMMISSIONER SHEA: Thank you very much, Mr. Schiffer, for being here and for taking the time to testify.

I just want to follow up quickly on a question that Commissioner Fiedler asked you, and then I have another question. You said--correct me if I'm wrong--but you said that there's no special deal to protect the Chinese interests in the Aynak copper field in Afghanistan. Is that correct? You said that there is no special arrangement.

MR. SCHIFFER: That I'm aware of, yes.

COMMISSIONER SHEA: Just to push that a little bit, are there any arrangements for U.S. forces in Afghanistan to protect any Chinese business or investment activity?

MR. SCHIFFER: I would break the question into two parts. There are arrangements for U.S. and NATO forces in Afghanistan to protect critical infrastructure, and to protect our development programs--and some of the investments and activities that the Chinese are undertaking fall under that heading. If one of the things that we are seeking now in our more multifaceted and multidimensional approach to Afghanistan is to make sure that we can get traction on some of these development projects, for example, then there are protections that we will extend out to that infrastructure, and that is regardless of who the investors are. If the question is, "are we making special deals with Chinese investors," then I would say there is no special accommodation that I'm aware of.

COMMISSIONER SHEA: All right. Thank you.

The Gwadar naval port, in your testimony, you say that it could be an anchor for naval expansion into the Western Indian Ocean, and you called that development or potential development as potentially destabilizing, and then you say it could also be, the port could also be a way to secure, a more benign way to secure Chinese economic interests.

Then you say that there is just lack of transparency. What do you think the purpose of the port is? Do you think there's a military component to the construction of the port, and what efforts is the Obama Administration undertaking to encourage the Chinese to be transparent about their intentions with respect to the port?

MR. SCHIFFER: I think the only honest answer at this point about the port is that we simply do not know. This is a subset of so many of the problems and challenges that we face in dealing with China, not just in Central Asia, but in East Asia, and in some cases globally, which is that there are additional capabilities that the Chinese are bringing on-line.

There are certain behaviors that the Chinese are undertaking that

are open to a multiplicity of interpretations, and China can be remarkably opaque at times and very, very difficult to discern exactly what the intentions, what the intentions are. We are seeking through every mode and mechanism that is appropriate, to engage with the Chinese and to encourage them to talk to us about Gwadar, about other areas where we are trying to get our arms around and our heads around exactly what Chinese intent is and trying to encourage them to see the benefits of being more open and transparent in a strategic sense with the United States overall.

It will be a critical element of getting the bilateral relationship onto stable footing, and so there are a number of discussions that have happened at a number of levels where we have gone to our Chinese friends, and also in speaking with our Pakistani friends, asking to receive more information, additional detail, and to be able to talk about these issues.

COMMISSIONER SHEA: Thank you very much.

HEARING COCHAIR FIEDLER: Chairman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you very much and welcome, Mr. Schiffer.

I join Commissioner Cleveland in saying what a pleasure it is to see you here, and I hope it's not too uncomfortable on that side of the table.

I want to follow up on the question again about Afghanistan and China's commercial participation there. The Chinese government has \$2 trillion in foreign currency reserves, and I suspect that what you're hearing from up here is some concern about the fact that the U.S. and NATO are paying the costs, both in terms of finances and in terms of lives, and that Chinese companies, often Chinese state-owned companies, might be benefiting.

I recognize the importance of infrastructure development, of economic development, that's going to be key to a long-term solution in Afghanistan. But should we expect that the Chinese government somehow be contributing to what's going on either financially or in terms of having soldiers participating? Is that a good idea? Is it something that we should be expecting and working towards?

MR. SCHIFFER: At the broadest level, when you try to think through what is the China we would like to see, we would like to see a china that is a responsible stakeholder in the international system. I would argue that if we were able to get there, then having a China that is, in fact, contributing more to Afghanistan and other security challenges of that nature that would be a good thing. We would like to see a relationship with China where they are a fully engaged member of the international community, pulling their weight in the provision

of public goods.

Unfortunately, I do not think we are there yet and it's going to require a fair amount of additional work with our Chinese friends to get them there. It is also far from clear—this is the paradox of the rise of China--exactly what and where China is going in its own development.

I am not even sure frankly whether the Chinese themselves know where they are going in their own development. As we start to play out some of these different scenarios and pathways, and envisage the sorts of roles and engagement that we might expect to see from China, the type of contributions we might expect to see out of China, in certain circumstances, these contributions would be most welcome by the United States if they are part of a fully cooperative, fully open, and fully transparent effort. In other cases, if there are some questions about Chinese behavior and intentions that continue to persist, we might be less enthusiastic about accepting some of the Chinese contributions, just because the potential risk, which is fairly open and obvious, would still exist--and that is an issue that we need to work through with China.

I am hopeful that we will be able to help China recognize what its own best interests are and encourage China to act in ways that are more responsible and therefore do provide us with an additional partner in the international community.

CHAIRMAN BARTHOLOMEW: I think it's important that we not encourage a free-rider system in this situation, and again I think that that's some of what you're hearing. Now, maybe it means ultimately they contribute to peacekeeping more in other places and things are fungible, but I think that's a very important principle to go forward because we have to continue to convince the American public that U.S. participation in Afghanistan is an important thing to do, and I think if people think that Chinese companies are benefiting and U.S. soldiers are dying, it's going to be kind of a difficult dynamic.

MR. SCHIFFER: I certainly would not argue with that, and I agree wholeheartedly that the free-rider problem is definitely exactly that: a problem. The challenge that we face with this new administration is that we have inherited a certain set of problems. We are where we are. We can't wave a magic wand and get back to seven years ago and do it right from the get-go. We have to figure out how we deal with the situation going forward from today,--and that means that there are an array of political relationships, security challenges, security partnerships, economic development issues, that are on the table and entrain in ways that are perhaps suboptimal, and we have to figure out how we can build everything out going forward to get to the

place that we need to be if we are going to be successful in Afghanistan.

CHAIRMAN BARTHOLOMEW: Thank you.

I'll have a second round, if there is one.

HEARING COCHAIR FIEDLER: Commissioner Slane.

COMMISSIONER SLANE: My opinion, one of the keys to success in Afghanistan is improving their infrastructure. Do you see the Chinese doing anything in this area?

MR. SCHIFFER: They are--broadly speaking--the Aynak copper mine that we have spoken about is not just a pit in the ground. There are transportation links that they have had to put in place to help with that investment. There are, as I think I mentioned in my testimony, some Chinese firms that are doing some work with fiber optic cables and other infrastructure projects in Afghanistan. We could go back and forth as to whether they are doing enough, whether they're doing things that are our top priorities or not. Some may feel that China is doing too much, but it is certainly engaged and trying to build infrastructure in Afghanistan.

HEARING COCHAIR FIEDLER: Commissioner--Dan, do you have a follow-up?

COMMISSIONER SLANE: No, I'm fine.

CHAIRMAN BARTHOLOMEW: Commissioner Videnieks.

COMMISSIONER VIDENIEKS: Good morning. Quick question and you may or may not be able to answer this here. How many military bases and in which countries--do we have? How many personnel do we have over there? How many of these are contractor personnel? And what is the purpose of these bases, if there are any?

MR. SCHIFFER: That is an awfully big question that I will have to say that if we can get back to you with all that detail, we will do so, and we will provide you with as comprehensive a regional brief as you like. Some of that discussion, as well, also obviously has to take place in a closed setting.

COMMISSIONER VIDENIEKS: Thank you.

The second is a little broader question. Are we interested primarily in stability in the region, and if that means keeping a Communist Party in power like it is currently in China, are we weighing those two issues, stability versus keeping Communists in power? Is there a short-run, long-run, medium-term type of outlook towards this? What is the position?

Thank you.

MR. SCHIFFER: This is one of the challenges of national security policymaking, in general, beyond the question of how we interact with China where we are always constantly weighing and

evaluating the different costs and benefits of our engagement with different governments who may undertake activities that are less than savory from our perspective from a variety of ideological points of view. I think our relationship or our intent with China right now is to help to encourage China to engage in the international community as a responsible stakeholder, which I think is a wonderful term, and also to encourage China to continue to grow in ways that will inevitably and invariably lead to great pluralism in China, greater respect for human rights, and greater space for civil society.

This is a process that is not easy. It is not fast, and ultimately it is going to be up to the Chinese people themselves as to what they want to do, where they want to go, and how fast they want to get there.

There are obviously inducements that we can offer. There are ways in which we can seek to shape the environment that we would hope to have influence, but beyond that, I am not sure this is a question of keeping Communists in power. I think it is more an issue of how we as one great power in the world today deal and interact with a rising power.

COMMISSIONER VIDENIEKS: Thank you.

One quick follow-up. Did I understand you correctly that the Uighurs are happy with the set-up the way it is right now? They want to remain in greater China? The majority of the Uighurs?

MR. SCHIFFER: I would be foolish in the utmost to try to presume to speak on behalf of the Uighur population of Xinjiang. I think there are a variety of political views. I am not sure that I would describe many of them as happy. I think it is gradations of unhappiness with some who are most unhappy, obviously not enthusiastic about the prospects of remaining as part of the People's Republic of China, and others obviously with views that if the rights they have, at least theoretically, under China's constitution, and as an autonomous region were granted to them, that they could, in fact, be quite...well, I was about to say quite happy, but that they could be a productive part of the People's Republic of China. there are a range of views that, as I understand it, are held by the Uighurs, and this is an issue where as we seek to encourage the growth of a China that allows for greater political expression, legitimate political expression, that respects pluralism, that respects civil society, that we would hope that the Uighurs would have the opportunity to have more control over their future.

COMMISSIONER VIDENIEKS: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Shea.

COMMISSIONER SHEA: Just hoping you'd give us a bit of a primer on the Shanghai Cooperation Organization, and specifically if

you could provide us a comparison or an assessment of Russian and Chinese attitudes towards the SCO? Do they have different visions of what the SCO can do or will do? If you could just give us your general take on the SCO and its future?

MR. SCHIFFER: My general take on the different Russian and Chinese attitudes essentially comes down to the fact that entering into the SCO, Russia and China were coming from two very different historical places.

There are millions of people, tens of millions of people in Russia right now who are quite disgruntled about Russia's place in the world and can reflect back to a time when Russia was a superpower, and still believe that that is Russia's rightful role in the world, and that Russia should be playing a much more active and assertive role in Central Asia, as it had in the past. I should be clear here, I am not casting judgments one way or another, just trying to capture and describe. For tens of millions, hundreds of millions of Chinese, there has never been a better time, certainly not in the last 400 years, to be Chinese-- China is clearly on the rise.

I think China and Russia enter into the prospect of what an SCO is and may be from two very, very different, different places. I think the Russians are, and particularly as we have seen in some of their behavior, not just in Central Asia, but also in Europe, in the past couple of years, are trying to reassert some of their prerogatives and to make it clear that they still wish to be seen as the major center of power. I think for China, the question is given the sensitivities of the other countries in the region not to see any one other player dominate them, and how can they play the seams and in so doing continue with China's path of economic growth and development and its increasing power?

The Chinese has not yet managed to figure out what they can actually effectively do with the SCO. It meets with a fair amount of frequency. But it is awfully hard to draw a line between SCO meetings and actual policy outputs or influence, but I think they see it as an organization that may be able to be developed into something that as Chinese power and influence grows, they may be able to use it more effectively to shape multilateral diplomacy in the region.

The Chinese are also extraordinarily sensitive as they consider balancing off against Russia in the region. They have not at all pushed, as we have been able to see, for any sort of open confrontations where they try to assert their prerogatives vis-a-vis the Russians, and I do not expect to see that any time soon either.

HEARING COCHAIR FIEDLER: Commissioner Blumenthal and then Commissioner Bartholomew.

HEARING COCHAIR BLUMENTHAL: Thank you.

The picture you painted of China in Central Asia, in continental Asia, the 1,000 kilometer pipeline from Kazakhstan and the planned link to the Caspian Sea hydrocarbon deposits, the gas pipeline through Turkmenistan, and involvement in the Shanghai Cooperation Organization, again, I come back to the point that that is a lot of skin in the game now. That's a lot of investment.

It's hard to contemplate, I guess, from an American perspective, how the military actually thinks about. A lot of things can happen, and whether it's a terrorist attack against the Chinese pipeline, a terrorist attack against Chinese citizens, you know, any number of things now with this much investment in Central Asia.

Again, I come back to how is the Chinese military thinking about this problem, if they're thinking about it at all, or is it just a question of not yet having the capability and therefore not being able to think about it?

MR. SCHIFFER: I would offer a couple of thoughts. First, we very much tend to think of these issues as Americans, and very often from the perspective of U.S. policy. To that end, we lead with our military first, and then infrastructure and everything else follows.

The Chinese, and this has been the case throughout history, tend to lead with other things and hold the military in reserve until the end of whatever situation it is that they are seeking to develop. I think there may be--and part of this may be explained by just a cultural difference in how we approach achieving our strategic objectives and how China often approaches achieving its strategic objectives.

Beyond that, a big part of the answer is that we are just not sure right now how the Chinese military is thinking about these issues. This is one of the reasons why we are trying to push them to engage with us through some of our military-to-military dialogues. If we can get that back on track, and other venues with the Chinese to be a little bit more open and transparent about what their intentions are, about what their thinking is.

I think clearly some of it does have to do with capabilities. They have managed to move out at a much greater speed on the economic, and development and infrastructure front, than I think their military. Even if they intended to, the PLA is capable of following up right now in a region, and so they're trying to figure how they do some of that backfill.

I do not think they have managed to fully think it all the way through yet, but that is an assessment that quite frankly is based on ignorance in part because we do not have the sort of insight and clarity about the Chinese mind-set on these issues that we would like to be

able to have. That is one of the things that we are trying to develop and trying to encourage them to speak with us about, more openly and more often.

I am hopeful that given the positive statement that President Obama and President Hu made earlier this year, and some of the indications that we have received recently that China is willing to engage more seriously on these issues, that we will be able to make some progress. Until we make that progress, I am somewhat hesitant to be optimistic that, in fact, we will.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR FIEDLER: Can you indulge us for a couple more minutes?

MR. SCHIFFER: I'm happy to indulge you.

HEARING COCHAIR FIEDLER: Commissioner Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you and thanks for your indulgence.

You note that stability on its borders is a top priority for the Chinese government, and it's not impossible that an extremist government in Pakistan would be more stable certainly than the current situation. I'm not advocating that, but I do wonder if we can expect that the Chinese government, as you say, would be using private diplomacy to urge Pakistan to prioritize the defeat of militant extremists if they believe that stable extremism is better than the status quo.

Do we have any read or knowledge on what they want as the ultimate goal in Pakistan? What kind of government they want as the ultimate goal in Pakistan? Because from that would flow anything that we can expect them to participate in.

MR. SCHIFFER: I think, and again this is supposition on my part, because we do not have as much good information as it would be nice and useful to have here. I think that they are, by and large, agnostic on the question of what form of government might exist in Pakistan so long as there is stability.

One of the questions when it comes to an extremist form of government in Pakistan is also making or helping China to understand that there's a wider aperture, and this is the same question that we have to deal with when we talk to our Chinese friends about North Korea, or Burma--which is that you may have a very stable government in and of itself and that may help you to secure a few miles of border, but if you are creating a much larger regional instability, and making your neighborhood much less safe because of the type of government that may exist in this country, then that is not actually something that is going to help you to achieve your overall goal of a more stable

neighborhood and more stable borders. And that is something, I think, that they appreciate.

CHAIRMAN BARTHOLOMEW: You think that we are making progress in convincing them that autocratic governments, for example, would not be the preferred form of government?

MR. SCHIFFER: I do not think we are making progress in convincing them that autocratic governments are not a preferred form of government. I think we are making progress in helping to convince them that there can be some unintended consequences in terms of a regional environment in which they find themselves in. If they support an autocratic government, that has other effects on other actors in the region. In using the North Korea example, just because it is in the news and lends itself particularly well to the sort of case, there is clearly a Chinese goal in maintaining stability in North Korea and maintaining a stable border between China and North Korea. If North Korea continues to make bad choices and takes provocative actions, then, that leads to a closer U.S.-Japan-ROK cooperation. If North Korea continues to take provocative actions, that then, in turn leads to actions by others in the region that creates a much less stable Northeast Asian security environment that is not so good for the Chinese.

Even though they may have achieved one goal, which is stability in North Korea, if they have created a regional environment that is much less to their liking, as a result of that--then that is something that they have to take into consideration as well.

CHAIRMAN BARTHOLOMEW: Thank you.

HEARING COCHAIR FIEDLER: Thank you very much.

We've run out of time and have to keep our schedule. The next panel will begin at 10:45.

Thank you, Michael.

MR. SCHIFFER: Thank you; we will certainly follow up on those questions and issues that we have left on the table. Thank you.

[Whereupon, a short recess was taken.]

PANEL II: CHINA'S INTERESTS IN AFGHANISTAN AND PAKISTAN AND THEIR IMPACT ON THE UNITED STATES

HEARING COCHAIR BLUMENTHAL: I want to welcome our second panel or part of it. Our second panel today will examine China's interests in Afghanistan and Pakistan and their impact on the United States.

Our first speaker is Mr. Abraham Denmark, who is a Fellow with

the Center for a New American Security. At CNAS, he directs the Contested Commons Project and works on the Asia Initiative and a range of other defense strategy and planning projects.

He's editor of upcoming, forthcoming publication called *China's Arrival: A Framework for a Global Relationship*.

He was previously a Country Director for China Affairs in the Office of the Secretary of Defense.

Following him will be Dr. Walid Phares. He is Director of the Foundation for Defense of Democracies' Future Terrorism Project. He is also a Senior Fellow there serving as an expert on terrorism and jihadi movements.

He has written seven books on the Middle East and published hundreds of articles in newspapers and scholarly publications.

The final speaker will be Ms. Lisa Curtis, a Senior Research Fellow at the Heritage Foundation, focusing on America's economic, security and political relationships with India, Pakistan, Afghanistan, Sri Lanka, Bangladesh and Nepal.

Prior to joining Heritage, she worked on South Asia issues as a Professional Staff Member of the Senate Foreign Relations Committee, as well as serving in the executive branch before that.

Thank you for joining us, and we'll begin this panel with Mr. Denmark's testimony.

HEARING COCHAIR FIEDLER: Before you start, Mr. Denmark, I'd just like to remind you all that you each have seven minutes, and you will all testify before we start asking questions.

Thank you.

**STATEMENT OF MR. ABRAHAM M. DENMARK
FELLOW, CENTER FOR A NEW AMERICAN SECURITY
WASHINGTON, DC**

MR. DENMARK: Thank you. Chairman Bartholomew, Commissioner Blumenthal, Commissioner Fiedler, I thank you for inviting me to appear before you today to speak on this topic.

China's rapid emergence as a political and economic power is a pivotal element in Asian security dynamics. While the United States normally sees China as an East Asian power, China's relations with Afghanistan and Pakistan demonstrate that its interests and influence extend south and west as well.

My testimony this morning will offer my own analysis of the strategic and geopolitical implications of China's engagement in Afghanistan and Pakistan on American interests. These issues have important connotations for the region, for U.S.-China relations, and

most importantly for U.S. national security. I commend the Commission for its interest in this topic.

Determining a way forward in Afghanistan and Pakistan currently represents the most pressing national security challenge to the United States.

Stability in Afghanistan and Pakistan both appear to be deteriorating, and President Obama's recent trip to Europe revealed that NATO's willingness to contribute substantial amounts of money or troops is limited.

The U.S. economy continues to flounder, which will constrain the ability of the U.S. government to continue to support military operations and economic reconstruction in either country.

At the same time, the U.S. military is strained by two ongoing wars and it is unclear how much longer the American people will support continued deployments overseas.

Some analysts are now looking to China to play a significant role in contributing to regional stability.

The United States has long called on China to be a responsible international stakeholder that helps solve common problems. While China has often pledged its support for international counterterrorism efforts, some of China's other actions such as pressing for the closure of Central Asian military bases involved in operations in Afghanistan suggest a less than total commitment.

The recent implementation of a new strategy toward Afghanistan and Pakistan by the Obama administration gives China an opportunity to demonstrate a substantive commitment against terrorism and instability in South Asia.

China's interests in Afghanistan and Pakistan are complex and multidimensional, yet are primarily driven by the Chinese Communist Party's need to preserve its hold on political power by maintaining domestic economic growth.

This drives an approach to the region focused on preserving regional stability and maintaining China's access to regional resources and transit routes. Regionally, China sees Afghanistan and Pakistan as components of a broader struggle for dominance in South and Central Asia.

China's close relationship with Pakistan is largely a check against India's rise as a dominant power in South Asia. From this point of view, a stable and friendly Afghanistan gives Pakistan an important degree of strategic depth against India's nuclear capabilities and conventional military superiority.

According to this logic, China benefits from an Afghanistan that is stable and friendly to Pakistan because it allows Islamabad to focus

on India.

Of particular concern to Chinese authorities is the possibility that extremists could migrate into Western China or catalyze its Uighur population.

Beijing's concerns about its Uighur population raise questions about China's willingness to tolerate U.S. military forces in these countries as a tool to keep extremist forces pinned down and focused away from China.

Chinese strategists are uncomfortable with a large U.S. military presence along China's border, and some analysts have expressed concern that U.S. bases in the region are, in fact, intended to perpetuate U.S. regional domination.

At the same time, however, the U.S. presence in Afghanistan prevents al-Qaeda from focusing on China and helps suppress Islamist groups along China's periphery.

China's interests in Afghanistan are both economic and strategic. China has developed significant portions of Afghanistan's infrastructure, but the crown jewel in China's investment is a \$3.5 billion stake in Afghanistan's Aynak copper field, one of the world's largest, with the potential for \$88 billion worth of ore that would provide Kabul with \$400 million of projected annual royalties which represents more than half of its annual, current annual state budget.

Also important to China is Afghanistan's geographic location at the triangular crossroads between China, energy suppliers in the Middle East, and key Indian Ocean transit points from Pakistan, and its potential as a resource for raw materials.

Pakistan is a tremendously important country in China's foreign policy calculations. China sees Pakistan as its primary partner in South Asia with a 50-year history of political and military ties. Pakistan serves as a conduit for China into South Asia and the Indian Ocean and most importantly as a foundation of its regional strategy to counter Indian regional preeminence.

It should be noted that China's interest in Pakistan is purely strategic and not economic. China's military relationship with Pakistan is deep and robust including joint exercises, arms sales, and defense industrial cooperation.

China is currently Pakistan's largest weapons supplier, and Pakistan is by far China's primary customer for conventional weapons. 36 percent of China's arms sales from 2003 through 2007 was directed to Pakistan; the next largest customer being Sudan with seven percent. Sales include the co-developed JF-17 multi-role combat aircraft and related production facilities, frigates, tanks and missile technologies.

The relationship with Pakistan is also important to Beijing

because of its easy access to the Indian Ocean. China is building a major port in Gwadar that would enable support of military presence closer to the Middle East and along vulnerable sea lanes of communication.

The new U.S. strategy toward Afghanistan and Pakistan involves several military and civilian initiatives intended to degrade terrorist networks, train indigenous security forces and focus them on counterinsurgency operations, establish economic alternatives to the insurgency, and improve the effectiveness, accountability and popular legitimacy of the Afghan and Pakistani governments.

At this point, I would like to specify two initiatives toward Afghanistan and Pakistan proposed by the Obama administration and discuss how China's interests may affect these efforts.

Regarding the initiative to coordinate effective international economic aid to Afghanistan and Pakistan, in April 2009, the "Friends of Democratic Pakistan," an international organization of which the U.S. and China are members, pledged \$5.28 billion to aid Pakistan with the U.S. and Japan pledging \$1 billion each.

However, despite previous statements from Beijing emphasizing the need for well-coordinated international cooperation, the Chinese representative announced that China's economic assistance to Pakistan would be provided through bilateral means.

This is potentially a significant problem. Because China's economic assistance practices are at odds with many proposals for an international approach that emphasizes conditional assistance based on fighting corruption, achieving performance goals, creating economic alternatives to the insurgency, and cutting the Pakistani military's ties to extremist groups.

China, on the other hand, typically focuses on ensuring its own access to resources and markets and is not constrained by issues of good governance, lack of corruption, and public accountability.

These differing approaches raise the possibility that the Chinese economic aid to Afghanistan and Pakistan may undercut U.S. efforts to bundle international aid and condition it on Islamabad's ability to achieve important objectives.

On the initiative to assist Pakistan's military in combating terrorism and maintaining stability, a key, if largely unspoken, aspect of the U.S. strategy toward Pakistan is to convince Islamabad to shift its forces from the border with India in the East to Pakistan's West to battle the insurgents.

U.S. messages are clouded by perceptions in Islamabad that the U.S. is a, quote, "fair-weather friend" with quickly shifting interests. China's, quote, "all-weather relationship" with Pakistan represents an

important potential avenue of influence.

Working with China to emphasize to Pakistan's military the importance of fighting terrorism and preserving stability in the West while cutting its ties to terrorist groups will send a powerful message to Islamabad that it is not just a U.S. concern but an international concern.

In conclusion, the United States and China share two common goals: defeating the terrorist threat and supporting regional stability. However, U.S. policymakers must be realistic in what Beijing can do and what it will do. China's increasing economic, political and military power has made it a significant regional power with global influence.

The United States has long urged China to act as a responsible international stakeholder which means contributing to solving global and regional problems, especially along its periphery.

U.S. policymakers should engage their Chinese counterparts and encourage them to integrate their efforts toward Afghanistan and Pakistan within the broader international effort.

Afghanistan and Pakistan are not solely a U.S. problem. They're an international problem. And as a neighbor and a regional power, China has the ability to contribute to the international solution. And with that, I'll close.

Thank you very much.

[The statement follows:]

**Prepared Statement of Mr. Abraham M. Denmark
Fellow, Center for a New American Security, Washington, DC**

**The Impact of China's Economic and Security Interests in Continental Asia on the
United States**

**Prepared Statement of
Abraham M Denmark
Fellow, Center for a New American Security**

Testimony before the U.S.-China Economic and Security Review Commission

Wednesday, 20 May, 2009

Chairmen, Commissioners, I thank you for inviting me to appear before you today to speak on this topic. Afghanistan and Pakistan are currently the most pressing national security challenge to the United States. At the same time, China's rapid emergence as a political and economic power is a pivotal element in Asian security dynamics. While the

United States normally sees China as an East Asian power, China's relations with Afghanistan and Pakistan demonstrate that its interests and influence extend South and West as well. My testimony this morning will offer my own analysis of the strategic and geopolitical implications of China's engagement in Afghanistan and Pakistan on American interests. These issues have important connotations for the region, for U.S.-China relations, and most importantly for U.S. national security. I commend the Commission for its interest in this topic.

Introduction

Determining a way forward in Afghanistan and Pakistan currently represents the most pressing national security challenge to the United States. Stability in Afghanistan and Pakistan both appear to be deteriorating, and President Obama's recent trip to Europe revealed that NATO's willingness to contribute substantial amounts of money or troops is limited. The U.S. economy continues to flounder, which will constrain the ability of the U.S. government to continue to support military operations and economic reconstruction in either country. At the same time, the U.S. military is strained by two ongoing wars, and it is unclear how much longer the American people will support continued deployments overseas.

The Obama administration's recent "white paper" pronounced U.S. objectives to be the disruption, dismantling, and defeat of al Qaeda and its safe havens in Pakistan, and prevent their return to Pakistan and Afghanistan.¹ To this end, the U.S. will use its military to degrade terrorist networks and train indigenous security forces while civilian efforts establish economic alternatives to the insurgency and improve the effectiveness, accountability, and popular legitimacy of the Afghan and Pakistani governments.

This strategy, with the constraints detailed above in mind, clearly highlight the need for the U.S. to find partners in order to sustain momentum and preserve the progress we've made. Indeed, at several points of the white paper, the Obama administration calls for international assistance in our efforts to stabilize Afghanistan and Pakistan. Experts and policymakers emphasize that economic assistance and reconstruction will be critical to the long-term stability of the region. Most U.S. policymakers continue to focus on the European Union and NATO for assistance. However, some officials and analysts argue that China, as a neighbor to the region with significant amounts of liquid capital ready to invest, could play a major role in the international effort to defeat terrorism and maintain regional stability. This paper will describe China's leaders' views of Afghanistan and Pakistan, and will conclude by evaluating how China could play a significant role in the international effort to combat terrorism and instability in these countries.

China's Strategic Perspective

China's interests in Afghanistan and Pakistan are complex and multi-dimensional, and

¹ "White Paper of the Interagency Policy Group's Report on U.S. Policy toward Afghanistan and Pakistan," http://www.whitehouse.gov/assets/documents/Afghanistan-Pakistan_White_Paper.pdf, March 27, 2009.

are primarily driven by internal considerations. Currently, China's leaders are concerned that a significant drop in economic growth – a result of the global economic crisis – will lead to increased levels of unemployment and destabilizing levels of popular unrest. China's need to maintain economic growth and domestic stability significantly inform its approach to Afghanistan and Pakistan. China certainly does not want to see nuclear-armed Pakistan be overrun by Islamic extremists. Nor does it want to see a degree of instability in either country that could complicate China's access to their resources and transit routes. Additionally, of particular concern to Chinese authorities is the possibility that extremists could migrate from Afghanistan or Pakistan into China, or that their activities could catalyze extremists groups in its interior provinces.

Regionally, China sees Afghanistan and Pakistan as components of a broader struggle for dominance over South and Central Asia. China's close relationship with Pakistan is largely a check against India's rise as a dominant power in South Asia. From this point of view, a stable and friendly Afghanistan gives Pakistan an important degree of "strategic depth" against India's nuclear capabilities and conventional military superiority. According to this logic, China benefits from an Afghanistan that is stable and friendly to Pakistan, because it allows Islamabad to focus on India. Thus, India's forays into Afghanistan are seen by some in China as "designed to achieve four objectives: contain Pakistan, enhance energy security, combat terrorism, and pin down China's development."²

Another key dimension of China's approach to Afghanistan and Pakistan is Beijing's perception of the United States. Since 2001, the United States has been profoundly focused on the "Arc of Instability" from the Middle East to South Asia, and the ongoing shift of military resources from Iraq to Afghanistan. In addition to requiring significant amounts of policymaker attention, this focus directly impacts the ability of U.S. leaders to engage in the Asia-Pacific region. This focus, combined with a difficult economic picture constraining future defense and international aid budgets, has necessarily diverted resources and high-level attention away from China and the Asia-Pacific, forcing the U.S. to essentially operate in the region with one hand tied behind its back. Washington's focus elsewhere, and a relatively stable strategic environment with no military threats, reinforces Chinese perceptions of the current period as a "window of opportunity" allowing China to focus on its own economic growth and development.

To date, China's leaders have not commented directly on the implications of the U.S. involvement in extended occupations in Iraq and Afghanistan. Beijing continues to view the United States as the world's most powerful nation and China's most important

² "India Participates in Central Asia," *Bingqi Zhishi*, Issue 197, No. 3, 2004, p. 6. Cited in Srikanth Kondapalli, "The Chinese Military Eyes South Asia," in Andrew Scobell and Larry Wortzel, Eds., *Shaping China's Security Environment: The Role of the People's Liberation Army*, US Army Strategic Studies Institute, October 2006.

relationship, and does not want to jeopardize US-Sino relations with unvarnished criticism or harping about the ongoing wars. However, since the U.S. invasion of Afghanistan in 2001, official Chinese media has not hesitated to emphasize indications of instability, reports of civilian deaths, and questions about U.S. will to preserve stability in Afghanistan and Pakistan.³ China highlights problems in Afghanistan and Pakistan for several reasons. First, China perceives itself as the leader of the developing world and is therefore charged with highlighting what they see as victims of U.S. hegemony. Second, China seeks to cultivate positive relations with Muslim-majority countries for their natural resources and their votes in multilateral fora.⁴

Another key driver of China's perspective on Afghanistan and Pakistan is concern about ties between Islamic militants in Afghanistan and Pakistan and the Uyghur Muslim minority population in Xinjiang province. China is concerned that the militant Islamist ideology in Afghanistan could bleed into China's Uyghur population and feed what many in Beijing see as a terrorist problem. The difficulty for U.S. policymakers is distinguishing between terrorist groups and legitimate resisters against the Chinese Communist Party. China claims that a Uyghur separatist group called the East Turkestan Islamic Movement (ETIM) has had contacts with Al Qaeda, and the U.S. has designated ETIM as a terrorist organization. That being said, ETIM's true size and the accuracy of its reported connections with Al Qaeda remain unclear. However, Beijing's concerns about its Uyghur population and possible connections with extremists in Afghanistan and Pakistan raise questions about China's willingness to tolerate U.S. military forces in these countries as a tool to keep extremist forces pinned down and focused away from China. Chinese strategists are uncomfortable with a large U.S. military presence along China's border, and some analysts have expressed concern that U.S. bases in the region supporting operations in Afghanistan are part of a plot to perpetuate U.S. domination of the region.⁵ At the same time, however, the U.S. presence in Afghanistan prevents Al Qaeda from focusing on China and helps suppress Islamist groups along China's periphery.

³ Author's assessment, based on a review of Chinese state media, including: Chen Yiming, "Will the US Strategic Adjustments Be Effective?" *Renmin Ribao*, February 23, 2009; Guo Fenghua and Zhang Xinzhi, "Obama Administration's 'New Policy' on Afghanistan," *Jiefangjun Bao*, February 14, 2009; Luo Zheng, "'Two' Become 'One'?" *Jiefangjun Bao*, 14 February 2009; Yan Guoqun, "Intention of the United States' Troop Increase is To Hold on to Its Allies," *Jiefangjun Bao*, February 14, 2009; Ma Gang, "Unlikely for New Afghan Strategy to Have New Ideas," *Jiefangjun Bao*, February 14, 2009; Li Qinggong, "Afghanistan May Become Another Iraq," *Jiefangjun Bao*, February 14, 2009; Wang Baofu, "Conflicts Interwoven with Moderation While Competition Coexisting with Cooperation" *Jiefangjun Bao*, December 26, 2007; Ou Yangwei, "Impression and Observation of the World Situation in 2007 – the Threat of Terrorism and Global Security and Stability," *Jiefangjun Bao*, December 31, 2007; and, "Commentary: When will 'accidental bombing' be put to an end?" *Renmin Ribao*, July 7, 2005.

⁴ For example, see Li Xuejiang, "'New Strategy' is Biased," *Renmin Ribao*, September 1, 2006 and "How has US Anti-Terror Strategy Lead to More Terrorism," *Renmin Ribao*, September 11, 2006.

⁵ Zhang Guangzheng, "The Host Will Be At Ease When the 'Guests' Leave," *Renmin Ribao*, June 15, 2007.

China's Approach to Afghanistan

China's interests in Afghanistan are both economic and strategic. China was largely disengaged from Afghanistan until President Hamid Karzai's government opened up its energy, mineral, and raw materials to foreign investors. In 2007, China was Afghanistan's fifth-largest trading partner, behind Pakistan, the EU, the U.S., and India.⁶ China has developed significant portions of Afghanistan's infrastructure, including telephone networks, irrigation projects, public hospitals, and several other construction projects.⁷ The crown jewel in China's investments is the \$3.5 billion stake in Afghanistan's Aynak copper field, one of the world's largest with the potential for \$88 billion worth of ore.⁸ This investment was coupled with the construction of a \$500 million electrical plant and the development of a railway from Tajikistan to Pakistan for distribution. Equally important for Kabul is the project's potential need to employ 10,000 Afghans and the \$400 million of projected royalties it would accrue yearly, representing more than half of its current annual state budget.⁹

Also important to China is Afghanistan's potential as a source for raw materials. China's booming economy is fueled by foreign natural resources like oil, natural gas, and other minerals. China's iron-ore demand increased close to 15 percent in the first 8 months of 2007, while copper demand surged by almost 35 percent in the same period.¹⁰ This is driving an approach to the region focused on maintaining access to foreign resources and markets. Afghan oil reserves were recently upgraded 18 times by a U.S. geological survey, estimates standing at an average of 1,596 million barrels, while Afghanistan's natural gas reserves were upgraded by a factor of three, standing at a mean of 15,687 trillion cubic feet.¹¹ Afghanistan also has large iron ore deposits between Herat and the Panjsher Valley, and gold reserves in the northern provinces of Badakshan, Takhar, and Ghazni. Major copper fields also exist in Jawkhar, Darband, and in abovementioned Aynak, located around 30 km southeast of Kabul.¹²

Also of great importance to Beijing is Afghanistan's geographic location, which sets it at the triangular cross-roads between China, energy suppliers in the Middle East, and key Indian Ocean transit points from Pakistan. As the easiest transportation route for the exploitation of the estimated 23 billion tons of oil and 3 trillion cubic meters of gas in the Central Asian Republics, Afghanistan plays a central role in China's attempts to diversify

⁶ The European Commission, "Afghanistan: EU Bilateral Trade and Trade with the World", September 10, 2008, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_114134.pdf.

⁷ Norling, Nicklas. "The Emerging China-Afghanistan Relationship." Central Asia Caucasus Institute. May 14, 2008. <http://www.cacianalyst.org/?q=node/4858>

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

¹² Ibid.

its access to foreign resources.¹³

China's Approach to Pakistan

Pakistan is a tremendously important country in China's foreign policy calculations. China sees Pakistan as its primary partner in South Asia, with a 50-year history of political and military ties. Pakistan serves as a conduit for China into South Asia and the Indian Ocean and, most importantly, as a foundation of its regional strategy to counter to Indian regional preeminence. For Pakistan, China has been a steady and (mostly) dependable provider of money and weapons and a deterrent against Indian regional domination.

It should be noted that China's interest in Pakistan is purely strategic, and not economic. In 2005, bilateral trade was \$4.26 billion.¹⁴ By October 2008, annual trade between Pakistan and China had already surpassed \$7 billion, and the two sides set the target of \$15 billion in trade by 2011.¹⁵ To put these numbers in perspective, the target 2011 trade level between China and Pakistan (\$15 billion) is 4% of US-China trade in 2008 (\$333.8 billion).¹⁶

China's military relationship with Pakistan is deep and robust, including joint exercises, arms sales, and defense industrial cooperation. Beijing transferred equipment and technologies to Pakistan's nuclear weapons and ballistic missile programs throughout the 1980s and 1990s. China is currently Pakistan's largest weapons supplier,¹⁷ and Pakistan is by far China's primary customer for conventional weapons: 36% of China's arms sales from 2003 through 2007 were directed to Pakistan (the next-largest customer was Sudan with 7%).¹⁸ Sales include the co-developed JF-17 multi-role combat aircraft and related production facilities, F-22P frigates with helicopters, jet trainers, tanks, the F-7 fighter, anti-ship cruise missiles, missile technologies, small arms, and ammunition.¹⁹

The JF-17 program has important geopolitical ramifications beyond providing Pakistan with an improved combat aircraft. Pakistan has a longstanding, yet unfilled, order for

¹³ Asma Shakir Khawaja, "Pakistan and the 'New Great Game,'" Islamabad Policy Research Institute Paper No. 5, Asia Printers, Islamabad, April 2003. Cited in "Afghanistan in Chinese Strategy Toward South and Central Asia," *China Brief*, Vol. 8, Issue 10, March 13, 2008.

¹⁴ Fu Xiaoqiang, "Sino-Pakistani Ties Usher in Vast Room for Development," *Renmin Ribao (People's Daily)*, November 24, 2006.

¹⁵ "China promises to help Pakistan during financial difficulty," *The Indian*, October 16, 2008.

¹⁶ "US-China Trade Statistics and China's World Trade Statistics," *US-China Business Council*, <http://www.uschina.org/statistics/tradetable.html>.

¹⁷ "China promises to help Pakistan during financial difficulty," *The Indian*, October 16, 2008.

¹⁸ Department of Defense Annual Report to Congress on the Military Power of the People's Republic of China, 2009, p. 58.

¹⁹ Department of Defense Annual Report to Congress on the Military Power of the People's Republic of China, 2009, p. 57.

American F-16s. The U.S. decision to not fill the order, while prudent, hurt our ability to cultivate closer relations with the Pakistani military. More important for this discussion, however, is that the JF-17 would primarily be useful to Pakistan in an India contingency. China's continued selling of the JF-17 reinforces Pakistan's focus on India, which the U.S. has been attempting to shift to the insurgents in Pakistan's West.

For China, the relationship with Pakistan is also important because of its easy access to the Indian Ocean. China is building a major port in Gwadar that would enable support of a military presence closer to the Middle East and along vulnerable sea lanes of communication. Road and rail links would need to go through Afghanistan. Pakistan is interested in exploiting its geography as a Trade and Energy Corridor (TEC) for China. In February 2008, Pakistan's then-President Musharraf told an audience at Tsinghua University in Beijing that "Pakistan is very much in favor of a pipeline between the Gulf and China through Pakistan and I have been speaking with your leadership about this. I am very sure in the future – it will happen".²⁰

Implications for US Interests

As elucidated in President Obama's "white paper," the new U.S. strategy toward Afghanistan and Pakistan involves several military and civilian initiatives intended to degrade terrorist networks, train indigenous security forces and focus them on counter-insurgency operations, establish economic alternatives to the insurgency, and improve the effectiveness, accountability, and popular legitimacy of the Afghan and Pakistani governments.

The United States has long called on China to be a responsible international stakeholder that helps solve common problems. China has contributed, to a degree, on international attempts to address problems with Iran and Darfur. Yet, even with Afghanistan and Pakistan on China's periphery, Beijing has too long been on the sidelines of the international effort to defeat terrorism and improve stability in the region. China has often pledged its support for international counterterrorism efforts, and has even participated in some counterterrorism initiatives with the United States, such as the Container Security Initiative.²¹ However, some of China's other actions, such as its pressuring of Central Asian military bases being used to support operations in Afghanistan, suggest a less-than-total commitment to contributing significantly to international counterterrorism operations. The renewed effort by the Obama administration to stabilize Afghanistan and Pakistan and defeat terrorism in the region gives China a new chance to demonstrate their substantive commitment to the international effort against terrorism.

²⁰ Cited in "Afghanistan in Chinese Strategy Toward South and Central Asia," *China Brief*, Vol. 8, Issue 10, March 13, 2008.

²¹ Shirley Kan, "U.S.-China Counterterrorism Cooperation: Issues for U.S. Policy," *Congressional Research Services*, September 11, 2008, p. 20.

As a neighbor to Afghanistan and a close partner to Pakistan, China potentially has a significant role to play. As already discussed, defeating terrorism and promoting stability are shared U.S. and Chinese interests. Yet, China to date has not yet joined the international effort toward Afghanistan and Pakistan, primarily because Beijing probably calculates that it can free-ride on the stability brought by the U.S. and its coalition partners. U.S. should initiate a sustained dialogue with their Chinese counterparts to emphasize shared interests and highlight the important role China can play in achieving our shared objectives.

At this point, I would like to review the U.S. initiatives toward Afghanistan and Pakistan proposed by the Obama administration, and discuss how China's interests could support or undercut U.S. efforts.

Coordinating effective international economic aid to Afghanistan and Pakistan

In September 2008, the “Friends of Democratic Pakistan” was established by several donor countries, including the United States and China, to coordinate international economic aid projects. The group pledged \$5.28 billion in aid at a meeting of the group in April 2009, with the U.S. and Japan pledging \$1 billion each. However, even though Chinese officials had previously stated that a “well-coordinated international cooperation was needed” to address Pakistan's economic challenges,²² the Chinese representative emphasized the need to respect Pakistan's sovereignty and announced that China's economic assistance to Pakistan would be provided through bilateral means.²³

This is a significant problem because China's economic assistance practices are at odds with the international approach, which emphasizes the importance of coordinating international aid to Afghanistan and Pakistan in order to ensure that money is properly spent and does not contribute to local corruption, that the local government meets certain performance goals, and that economic alternatives for the local populations are created. Similarly, there are indications that the U.S. may condition future military assistance to Pakistan on Islamabad's efforts to fight terrorism and permanently break the links between its security services and elements of the Taliban and other extremist groups.

China, on the other hand, typically focuses on ensuring its own access to resources and markets, and is not constrained by issues of good governance, lack of corruption, public accountability, and human rights. These differing approaches raise the possibility that Chinese economic aid to Afghanistan and Pakistan may undercut U.S. efforts to bundle international aid and condition it on Islamabad's ability to achieve important objectives. Thus, Chinese economic aid to Afghanistan and Pakistan should be coordinated, if not

²² “Friends of Pakistan adopts work plan for cooperation,” *Xinhua*, November 17, 2008.

²³ “Ministerial Meeting of the Friends of Democratic Pakistan/Donors' Conference Tokyo – 17 April 2009,” *Pakistan Ministry of Foreign Affairs*, April 17, 2009, http://www.mofe.gov.pk/Press_Releases/2009/PR161_09.htm.

integrated, with international aid efforts in order to promote good governance. The U.S. should engage China to discuss the benefits of the coordinated, international approach and publicly call on Beijing to participate in the international effort.

Assisting Afghanistan's military in combating terrorism

The U.S. has committed 21,000 additional troops to Afghanistan in order to secure the population, fight the insurgents, and train Afghanistan's military and police forces. The U.S. has called on the international community, especially NATO, to assist in training police forces and fighting terrorists.

Cooperation between Washington and Beijing on Afghanistan is not unprecedented: following the Soviet invasion of Afghanistan, China provided the mujahedeen with significant amounts of arms in cooperation with the CIA. China and the United States had fewer common interests than they do now, yet opposition to the Soviet Union was enough of a reason to drive several years of significant cooperation.

While Beijing certainly has no interest in sending troops into Afghanistan, especially if they would be under NATO command, there are some indications that some security role in Afghanistan is not out of the picture. A foreign policy analyst from the Chinese Academy of Social Sciences – a Chinese think tank with close connections to the government – was recently quoted as saying that China may participate in an international peacekeeping effort in Afghanistan under the rubric of the UN.²⁴

That being said, the United States should not look to China to play a significant direct military role in Afghanistan, for the foreseeable future. China would not want to be seen as meddling in Afghanistan's internal affairs, nor would it want to be party to an effort that is unpopular in the developing world. Moreover, it is unclear if China's military has the capabilities needed to substantially contribute to the international security effort.

Assisting Pakistan's military in combating terrorism and maintaining stability

Since fiscal year 2002, the U.S. has given \$10.4 billion and almost \$12 billion to Afghanistan and Pakistan, respectively.²⁵ Of the assistance to Pakistan, 73% has gone to security-related programs, including reimbursement for Pakistan's support of U.S. military operations, and U.S. officials estimate that 70 % of aid to Pakistan was misspent.²⁶ Of the \$5.8 billion of U.S. aid to Pakistan spent in the Federally Administered Tribal Areas from 2002 through 2007, only 1% was directed toward economic development.²⁷

A key, if largely unspoken, aspect of the U.S. strategy toward Pakistan is to convince Islamabad to shift the bulk of its forces from the border with India in the East into Pakistan's West to battle the insurgents. Currently, 125,000 of Pakistan's 650,000 man

²⁴ Melinda Liu, "How China Could Quietly Play a Key Role in Afghanistan," *Newsweek*, December 1, 2008.

²⁵ Center for American Progress, "U.S. Aid to Afghanistan by the Numbers," August 14, 2008; and U.S. Department of State, "Direct Overt U.S. Aid and Military Reimbursements to Pakistan, FY2002-FY2009," April 20, 2009.

²⁶ U.S. Department of State, "Direct Overt U.S. Aid and Military Reimbursements to Pakistan, FY2002-FY2009," April 20, 2009; and Jeremy Page, "Pakistan turns to 'friends' in its hour of need," *The Times*, November 17, 2008.

²⁷ Center for American Progress, "U.S. Aid to Pakistan by the Numbers," August 21, 2008.

military are in the West, and Pakistan's military appears to remain significantly focused on India.²⁸ There is a great deal of discussion about tying future U.S. military aid to Pakistan to specific benchmarks to ensure that the aid is directed toward fighting insurgents in the West and severing ties between Pakistan's military and intelligence organizations and the Taliban.²⁹

While the U.S. has repeatedly urged Islamabad to shift more forces to the West, this message is clouded by perceptions that the U.S. is a "fair-weather friend" with quickly shifting interests that is too close to India. China's "all-weather relationship" with Pakistan represents an important potential avenue of influence. Working with China to emphasize to Pakistan's military the importance of fighting terrorism and preserving stability in the West while cutting its ties to terrorist groups would send a powerful message to Islamabad that this is not just a U.S. concern, but an international concern.

For 50 years, the strategic architecture in South Asia has focused on China's support of Pakistan as a check against India, based on traditional balance-of-power concepts. The key for policymakers is not to abandon this architecture – which has been fundamental to the preservation of relative inter-state stability between China, India, and Pakistan – but rather to enhance the architecture to better deal with the realities of today. For example, one of the more likely risks of an India-Pakistan war would occur as the result of attacks in India similar to the 11/26 attacks in Mumbai, which occurred as a result of internal instability in Pakistan and a terrorist group's ability to train, equip, and seek safe harbor. Establishing a linkage between internal instability in Pakistan and a conventional war between India and Pakistan suggests a need to update the traditional South Asian strategic architecture to incorporate the fundamental need for stability inside Pakistan to guard against war. This would manifest itself in the Chinese assuring Pakistan of its continued commitment to Pakistan's security and regional stability. With this assurance in place, the Chinese would need to recognize the importance of maintaining Pakistan's internal stability to regional peace and its own internal security. Beijing then would be able to approach Islamabad and assure them they could shift the balance of their military forces to the West to combat the internal threat without diminishing its deterrent against an Indian attack.

The key to this approach will be in demonstrating to Beijing that such a position is in China's interest. As discussed at the beginning of this paper, China is primarily interested in maintaining regional stability and ensuring that terrorism does not spread into China. It is clear that terrorism is a threat to the stability of Afghanistan, Pakistan, and the region as a whole. By coordinating its economic aid with the international system and encouraging Pakistan to focus on the systemic threat posed by domestic militants, China could play a significant role in reducing the threat of terrorism and

²⁸ "Meet the Press Transcript for May 10, 2009," *MSNBC*, May 10, 2009, <http://www.msnbc.msn.com/id/30658135/>.

²⁹ "U.S. Sends Emergency Aid to Pakistan," *CNN.com*, www.cnn.com/2009/POLITICS/05/12/pakistan.holbrooke/, May 12, 2009.

instability. This will have the effect of enhancing stability in China's Western provinces, preserving its access to regional resources, and contributing to the broader international effort.

Conclusions

It is clear that, while they share core interests, Washington's and Beijing's approaches to Afghanistan and Pakistan fundamentally differ in significant ways. While China has an important role to play in making these countries more secure, U.S. policymakers must be realistic in what Beijing can do and what it will do. China could and should play an important role as a political and economic supporter of the international effort toward Afghanistan and Pakistan, and could play a decisive role in shifting Pakistan's attention toward its own internal militant problem.

China's increasing economic, political, and military power has made it a significant regional power with global influence. The United States has urged China to act as a responsible international stakeholder, which means contributing to solving global and regional problems. The primary test of a responsible power should be its ability to effectively solve problems, especially along its periphery. To date, China's performance related to the North Korea issue has been mixed. Afghanistan and Pakistan represent two areas where China has the potential to significantly influence events for the better.

U.S. policymakers should engage their Chinese counterparts and encourage them to integrate their efforts toward Afghanistan and Pakistan within the broader international effort. While China's role will primarily be economic and political, U.S. policymakers should also encourage China to use its close connections with Pakistan's military to encourage it to break connections with the Taliban and other extremists and focus on the threat of militants in its Western provinces.

The United States and China share two common goals: defeating the terrorist threat and supporting regional stability. While the United States has the lead role in achieving these objectives, Afghanistan and Pakistan are not solely a U.S. problem. They are an international problem, and as a neighbor and regional power, China has the ability to contribute to the international solution.

HEARING COCHAIR BLUMENTHAL: Dr. Phares.

**STATEMENT OF PROF. WALID PHARES
DIRECTOR, FUTURE TERRORISM PROJECT, FOUNDATION
FOR DEFENSE OF DEMOCRACIES, WASHINGTON, DC**

DR. PHARES: Thank you. Madam Chairwoman, members of the

Commission, thank you very much for giving me the opportunity to appear in front of this Commission.

In the wider web of China's economic and security interests in continental Asia and that impact on the United States, I do believe that China's strategic interests in AFPAK, that is Afghanistan and Pakistan, is crucial and is developing with time, especially after the campaign, after 2001, that the U.S. and NATO are basically developing in Afghanistan and as the Pakistani government is battling the Taliban inside their own country.

China's positions and their perception of their national security with regard to these two issues can either complicate the problems that we're having in Pakistan and in Afghanistan or strengthen actually campaigns in both countries, but at the same time, Afghanistan and Pakistan's development, particularly through the Taliban action, can have an impact and will have an impact on Chinese national security.

In this testimony, I would like to talk about seven quick points. One is perception of Chinese national security of AFPAK.

Two is the benefit that jihadist groups around the world and in the region are grabbing or having from China's strategic inaction in some cases or action in some other cases.

Three is the jihadist domestic problems in China and projection for the future.

Four is the existence of a Taliban-al-Qaeda-jihadist strategy towards China that should be understood.

Five is China's real stakes in AFPAK campaigns.

And six, Chinese current policy in AFPAK.

Last, seven, suggestions for U.S. initiatives towards China with regard AFPAK.

One, China's perception of national security is in concentric circles, big circles. Begins with territorial integrity on the inside, making sure that all the provinces that have been acquired in the past will remain in the Chinese realm of territory. They think mostly of Tibet, Xinjiang, but also of other potential developments that could occur in lower Mongolia and Manchuria.

A wider circle is about territories to be regained. Two of those have been reunified: Hong Kong and Macao. The next is Taiwan on the mind of the Chinese government.

Third is to retain Communist influence in the region, lesser than under the Cold War, the red lines that have been established south of China in Vietnam during the conflict and east of China in North Korea.

With regard Pakistan, Chinese perception of national security is to establish a balance of power with India; hence, the Chinese policy towards Pakistan.

Last, but not least, more interesting to our analysis of AFPAC, China's new, more recent policy of establishing military and strategic relationship far beyond Pakistan and Afghanistan into the greater Middle East, including with Iran, with Syria, with Sudan and beyond.

China's strategic benefit to global jihadist forces. By establishing a relationship with Pakistan towards a balance with India, over the past decades, China has pushed actually Pakistan and India towards an escalation of technologies.

On the other hand, by focusing solely on Pakistan's nuclear balance and military balance with India, China has basically disallowed Pakistan to focus fully on the Taliban and on the borders question.

On the other hand, the Chinese government reach-out to Iran and to other regimes in the region has led to a reinforcement of what is known in the region as the "confrontational axis," al Muma'naa. And these regimes, by reaching out to Sudan, Sudan, by reaching out to jihadi elements and organizations in Africa, are strengthening the international jihadist Salafi movement, which in turn is reaching out to jihadists inside China, which brings me back to number three, China's jihadi problem domestically.

While on the one hand, the Tibet problem is led by a non-armed political movement for separation, the Xinjiang ethnic problem has witnessed the rise of an armed separatist movement. Within that separatist movement, there has been significant activities by jihadist terrorist organization.

Now, what is important about the separatist Xinjiang problem is the ethnic conflict, and we need to separate between the ethnic conflict and the rise of a specific jihadist movement in that province.

A rundown of the numbers will tell us that 45 percent are Uyghur or Uighur, 40 percent are Han Chinese, and the rest are of various minorities. The issue is that the East Turkistan Islamic movement, ETIM, and their allies have been able to make progress within the ethnic group and therefore cause a problem for China.

The jihadist strategies towards China can be summarized in seven quick points: one, to create large indoctrinated pools; two, to launch an intifada when the pools are of great numbers; three, to strike China with terrorist activities beyond the province; four, to establish when possible Taliban-like enclaves; five, to declare an emirate; six, to link that emirate with other emirates to be declared in Central Asia and ultimately separation.

China's stakes in AFPAC are significant. If the Taliban comes back to Afghanistan, there is 76 kilometers of borders between Afghanistan and China that borders that specific province leading to

potential cross-border attacks between jihadist Uighurs based in Afghanistan and in China. If Pakistan's northern areas are controlled by the Taliban or if the government falls into the hands of the Taliban, the problem is even greater for national security of China.

We're talking about 523 kilometers of borders and the possibility that future Taliban deployment would reach not just the borders between Pakistan and China, but also through Kashmir.

Last, but not least, obviously is the nuclear threat. Having a nuclear jihadi Taliban regime south of China definitely would be to the expense of Chinese national security.

And I do add a number of recommendations. The core recommendation is that the United States must engage China on a discussion for a joint cooperation against terrorism regardless of the other problems and not with abandoning human rights issues and ethnic claims issues in China.

[The statement follows:]

**Prepared Statement of Prof. Walid Phares, Director,
Foundation for Defense of Democracies, Washington, DC**

China's strategic interests in AfPak Conflicts

By Professor Walid Phares

Director, Future Terrorism Project
Foundation for Defense of Democracies

Testimony before the U.S.-China Economic and Security Review Commission

*“The Impact of China’s Economic and Security Interests in Continental Asia
On the United States”*

May 20, 2009

**Room 562 Dirksen Senate Office Building
1st Street and Constitution Avenue, NE
Washington, DC 20510**

Panel II:

**China’s Interests in Afghanistan and Pakistan and Their Impact on the
United States**

Dear Commissioners,

China's strategic interest in the "AFPAK" region (Afghanistan and Pakistan) is of great importance to US interests, particularly since the fall of the Taliban regime in December 2001 and even more importantly as Taliban forces are escalating their offensive against Pakistan's government and while the US Administration is preparing a renewed campaign inside Afghanistan and is devising a new plan to provide support to the government of Pakistan. Chinese strategic options in central and southern Asia can complicate and mitigate US, NATO and allied efforts against terrorism, or it can bring additional strength to the international campaign against dangerous radical forces in the region. Chinese strategic behavior regarding the ongoing conflict in Afghanistan and Pakistan can also have an impact on China's internal national security and territorial integrity on the longer term.

This testimony aims at drawing the attention of the US Government to a key factor: If China's leadership develops an accurate long range perception of the Jihadi threat in the region, its behavior and strategic response can bring about a significant effort against the Taliban and al Qaeda and therefore tighten cooperation in Asia and beyond against the terror forces

Hence in this testimony I will review quickly the impact of the AFPAK conflict on China's national security and argue that Beijing has a vital interest in joining the US-led efforts in the subcontinent against the threat of Jihadi terrorism and should be engaged by Washington from that perspective. I will also raise questions about China's understanding of the threat, its potential policies regarding the latter and make recommendations regarding US initiatives to influence that understanding and encourage a new Chinese participation in the global confrontation with the common threat, al Qaeda and the Taliban.³⁰

China's Global Geopolitical interests

Traditionally China's leadership has perceived its geopolitical and economic interests in several concentric circles from the inside out. In the inner circle, the regime's primordial interest has been to insure the territorial integrity of the country. Several regions of China, some acquired via past military campaigns, have continued to witness separatist movements. Most active has been Tibet followed by Xinjiang (Sinkiang) northwestern province. Other areas have been candidate to potential separatist trends including lower Mongolia and Manchuria. The next wider circle of national security concerns and geopolitical goals has been the return of former territorial possessions. Reuniting with Hong Kong, Macao and Taiwan has been on the list of goals to achieve, in one way or another. The reintegration of Hong Kong and Macao at century's end was seen as a tremendous success and as a indicator for future possibilities regarding Taiwan. In

³⁰ From Washington to Kabul to Beijing *Assessing Prospects for U.S.-China-Afghanistan Cooperation* by Nirav Patel and David Capezza, *Small Wars Journal*

addition to the highly publicized claims for reunification, other less visible claims had developed during the Cold War but never pursued: contiguous territories belonging then to the Soviet Union and now to the Russian Federation along the northern frontiers of the People's Republic of China (PRC). Beyond the two territorial circles of national security interest, China's projection of power expressed itself eastbound militarily during the Korean conflict drawing a red line against the West in defense of North Korea's Communist regime and southbound during the Vietnam War. But on its western and south western frontiers, China's regime developed also transnational attitudes. With India, at times, Beijing experienced border tensions generated over border delineation disagreements. However with Pakistan, even as Islamabad and Washington entertained good relations, China built a series of relationships, which can be defined as close to strategic in more than one domain. Chinese Pakistani partnership in more than one area, has been traditionally perceived in Beijing as a balance of power play with a growing India. But beyond regional consideration, the Chinese "window" into Pakistan has also served as a testing ground of influence into the wider Muslim world.³¹

In the past few years, China's government has increased its level of trade and military transactions deeper in the Greater Middle East, particularly with regimes hostile to the US and Western efforts against terrorism and under UN sanctions, including Iran, Syria and Sudan. Hence, one major trend to be noted is Chinese strategic cooperation with Pakistan against India on the one hand and supplying the axis Iran-Syria-Sudan -- themselves supporters of terrorist organizations -- with advanced weapons on the other. In short, China's strategic policies regarding two parties in the Muslim world, collides with US and Western interests. With Pakistan, Beijing's interest is aimed at a strategic balance with India. With the axis Iran-Syria-Sudan, Beijing's interest is to empower the latter against US-led efforts.³²

China's strategic benefit to Global Jihadi forces

By engaging in backing Pakistan's military exclusively against India while ignoring the Taliban threat in Afghanistan and Pakistan, Beijing indirectly -- and perhaps unwillingly -- finds itself injecting strength into the sub Indian regional Jihadi web. Indeed, by supplying Pakistan with missile technology and weapons capable of escalating the military buildup with India, China would be encouraging both nuclear countries to expand their strategic armament and reduce their diplomatic attempts to reach solutions to their bilateral crises. By supplying Pakistan with long range missiles, Beijing would be forcing India to improve its own. And by focusing on equipping Pakistan's military with weapons aimed at India, China would be lessening Islamabad's focus on the Taliban and the Jihadi organizations operating on the Pakistani-Indian and the Afghani-Pakistani borders. In short, Chinese support to Pakistan is aiming at the wrong foe: India.

³¹ "Regional autonomy for China's ethnic minorities," April 30, 2008 (Xinhua). See also Colin Mackerras, *China's Ethnic Minorities and Globalisation* London, New York, Routledge Curzon, 2003.

³² See "Iran's New Alliance With China Could Cost U.S. Leverage." Robin Wright, *Washington Post* Wednesday, November 17, 2004; Page A21

On the other hand, China's strategic arms support to the "confrontational axis" (known as *al Muma'naa* in Arabic) including the Iranian, Syrian and Sudanese regimes, is also strengthening the two large trees of the global Jihadi web, directly and indirectly. Iran's regime is Khomeinist-Jihadist. Tehran and Damascus strategically support Hezbollah, a Khomeinist-Jihadist organization. Iran, Syria and Hezbollah openly support Hamas and Palestinian Islamic Jihad (PIJ), both Salafi Jihadists. Furthermore, Iran and Hezbollah cooperate with Sudan's regime which is Salafist and has ties to international Jihadi organizations in Africa and beyond, themselves with ties to the Taliban and al Qaeda. In short, eventually, China's strategic arming of the "confrontational axis" ends up backing international Jihadism, including the Taliban and al Qaeda -- even if Beijing is not directly supplying the latter with weapons, as far as we know. This raises the question: is supporting Jihadi forces in the interest of China's national security?³³

China's Jihadi problem domestically

At the core of China's self perceived priorities with respect to its national security are two secessionist movements, one in Tibet and the other in Xinjiang. Both movements are ethnically and historically grounded and have developed international outreach. While Tibet's independence movement inspired and led by the Dalai Lama, is essentially non violent and non armed, some networks in the Xinjiang's separatist movement have adopted terror methods and have conducted operations against Chinese authorities as recently as last summer. The latest security reports, including some by Chinese authorities confirm that a Jihadist terrorist organization is now operational in Xinjiang province and its latest actions have reached areas across China and its capital. What is the nature of that Jihadi threat inside China?

The Xinjiang province inside China is inhabited by 45% Uyghurs, 40.6% Han Chinese, 6.7% Kazakhs and 7.5% from other ethnicities. The Uyghurs have been opposing Chinese domination of the province for decades and in alliance with other non Han ethnicities, form close to 60% majority inside the province. Xinjiang has a Muslim majority. The separatist claim in the province is a classical ethnic conflict but in the last few years a Jihadist movement has made inroads inside the Muslim communities, indoctrinating and recruiting a significant number of Jihadi militants. Many "Chinese Jihadists" have been recruited by al Qaeda and fought in Afghanistan. Some are now fighting in the ranks of the Taliban in Pakistan. These Xinjiang Jihadists have been dispatched by the Jihadi network to countries and areas remote from central Asia, such as Chechnya, the Caucuses, the Horn of Africa and south Asia. Hence, the Chinese-based Jihadist movement not only aims at separating Xinjiang from China but is now embedded in the worldwide terror network threatening several countries around the world.

The East Turkestan Islamic Movement (ETIM, *Doğu Türkistan İslâm Hareketi*) is declared as a terrorist organization by the governments of the PRC, Kazakhstan, Pakistan

³³ See "Iran's China Option," Roger Cohen, *The New York Times*, February 8, 2009.

and the United States, as well as the United Nations.³⁴ The Chinese government accused ETIM for car bomb attacks in Xinjiang during the 1990s, as well as the death of a Chinese diplomat in Kyrgyzstan in 2002. ETIM is linked to al Qaeda as well. In its 2005 report on terrorism, the US State Department said that the group was "linked to al Qaeda and the international jihadist movement" and that al Qaeda provided the group with "training and financial assistance." In January 2002, the Chinese government released a report in which it revealed that Hassan Mahsum, the head of ETIM, met with Osama bin Laden in 1999 and received promises of money, and that bin Laden sent "scores of terrorists" into China. During the summer of 2008, Chinese authorities arrested members of ETIM and other Jihadist terror groups such as the Turkistan Islamic Party (TIP) and stopped others as they were planning or executing terror attacks against the Olympics. To this date, ETIM and TIP as well as other Jihadi factions are still operational inside China, in Central Asia and embedded in international networks.³⁵

Jihadi strategies towards China

What are the strategic goals of the "Chinese Jihadists"? By exploring the available literature produced by ETIM, TIP and other transnational central Asian Jihadi groups as well as al Qaeda, Taliban and international Salafists, one can understand the long term goals of the movement as follow:

1. To indoctrinate a vast pool of ethnic Uyghurs and other non-Hans inside Xinjiang province into Jihadism before recruiting them into a local Jihadi urban army.
2. Unleash a Jihadi intifada inside Xinjiang by attacking Chinese military, economic and urban targets.
3. Organizing terror strikes across China, focusing on major cities, financial and economic centers, including foreign establishments with the aim of weakening the political resolve in Beijing.
4. Establish large Taliban-like enclaves inside Xinjiang and implement tightly interpreted Sharia Law.
5. When time is ripe and amidst severe internal crises in China, to declare a Taliban-like Emirate in parts or all of Xinjiang.
6. Launch Jihadi operations from Xinjiang into the other Turkic speaking republics of central Asia and link up with their local Jihadi movements
7. Separate Xinjiang from China and merge it with the other "Emirates" of central Asia to form a regional Taliban like power with ambitions to unite with all other Emirates already formed in Afghanistan and parts of Pakistan and India.

³⁴ Council on Foreign Relations, *Backgrounder*, Holly Fletcher and Jayshree Bajoria, ETIM: "East Turkestan Islamic Movement," July 31, 2008

³⁵ See "China hands death penalty to 2 'bent on jihad.' *MSNBC*; December 17, 2008; also "Jihad in China's Far West," *Times*, Austin Ramzy / Kashgar, August 6, 2008

In a sum, the ETIM-TIP terror campaign in China may overlap (or claim to overlap) with the ethnic Uyghur struggle for liberation or separation, but in fact exceeds that goal in order to create a totalitarian fundamentalist regime, similar and parallel to the Taliban and al Qaeda model. Note that the “Chinese Jihadist” movement is part of the international Jihadist movement at the center of which is al Qaeda and the Taliban. ETIM-TIP terrorists have been spotted, arrested or killed in “battlefields” as far as Afghanistan, Pakistan, central Asia, the Caucuses and Africa, in addition to China. Therefore, Beijing is facing off with a Jihadi international threat as are the United States, Europe, Russia, India and the moderates in the Arab and Muslim world. But is the Chinese government acting accordingly and what are its real stakes in Afghanistan and Pakistan?

China’s stakes in “AFPAK”

Had the Taliban not been removed from power in Kabul, it would have pressed forward north to defeat the Northern Alliance and eventually reached the international borders including with China. The 76 km long frontier between a Taliban/AQ state and the Chinese state would have been a corridor for Jihadist crossing into and from China. A well established Jihadi regime in Afghanistan would be compelled ideologically and strategically to lend its support to Jihadi activities in Xinjiang. The presence of ETIM Uyghur fighters with al Qaeda in Afghanistan prior to September 11, 2001 is clear evidence that the projection was for Kabul under Mullah Umar and Usama Bin Laden to serve as a base for an insurrection in China’s northwestern provinces. Beyond the “Islamist” ideological agenda, a Taliban “Jihad” for power across Xinjiang has other strategic incentives. This vast province has an annual runoff of about 88 billion cubic meters of surface water together with 25 billion cubic meters of exploitable groundwater. Glaciers covering 24,000 square kilometers lock away about 2,580 billion cubic meters of water. Xingjian’s coal reserves are about 38% of China’s national total. Petroleum and natural gas reserves estimated at 30 billion tons and that is more than 25% of the national total. Add to it the strategically important nuclear installations in the province as well as some of China’s space program components in the near future.

In short, a Jihadist takeover of Xinjiang, outside any norm of peaceful resolution to the ethnic minorities question, will be catastrophic to Chinese economic and political stability. It would also add severe threats to world security. Thus, the return of the Taliban to power in Kabul must be perceived by China’s strategists as a direct threat to the country’s national security and economic development.

The Chinese stakes in Pakistan aren’t that different. In some regards they may be higher. A Taliban victory over the secular government in Islamabad will have cataclysmic consequences on China’s national security and economy as well. Pakistan has 523 km of borders with the Popular Republic of China. A Jihadi takeover of the Islamic Republic of Pakistan will lead to a campaign of Jihadi activities via the common borders and through

the two zones of Kashmir (India and Pakistan) into Chinese territories to link up with and support an intifada in Xinjiang. The Jihadi strategic agenda in the sub Indian continent consists of seizing Afghanistan, Pakistan and Indian Kashmir and wage a massive “Jihad” along the entire western borders of China including with central Asia. The minor Chinese experience with few terror attacks or attempted plots inside the country are only a minute sampler of what will hit the Asian giant if US efforts collapse in Afghanistan and Pakistan’s government crumbles under the Taliban. Beijing, a super nuclear power, understands perhaps better than other countries the cataclysmic meaning of a nuclear armed Taliban federation of Emirates across its southern borders. Simply put, China will be the next nuclear threatened target along with India. But is the Chinese leadership aware of the menace? And if so, is it applying the right strategic choices to preempt this mounting danger? ³⁶

China’s current policy on “AFPAK”

In 2006 Chinese and Afghan authorities signed an agreement of cooperation on their joint border. One of stipulations stated

Both sides agreed that terrorism constitutes an international menace, as it poses a grave threat to world peace and security. China and Afghanistan are both victims of terrorism and they both firmly oppose terrorism of any form. The Chinese side supported Afghanistan’s efforts in combating terrorism and safeguarding national stability and is ready to work with the Afghan side to fight terrorism, separatism, extremism, organized crime as well as illegal immigration, drug trafficking and illegal arms trade. The Afghan side reaffirmed its strong support to the Chinese side in combating the three forces.

Without naming the threat, both countries committed to fight terrorism on both sides of the border. This is a good step in the right direction.

On the other hand, Beijing and Islamabad have a web of relationships related to the military, economic and technological realms. This web of connections can become a starter for a new Chinese involvement in counterterrorism on a regional scale. On August 8, 2008 a joint statement said “Pakistan and China have agreed to coordinate and help closely with each other in fight against terrorism.” More recently on May 5, a high encounter between the Punjab Governor with the Chinese Ambassador reaffirmed the common concern:

All of us have realized that the terrorists were the country’s “number 1 enemy” and we need to unite to overcome the threat posed by them. By joining hands with the international forces, Pakistan would eradicate terrorism from the region, the governor said. Reciprocating Taseer’s friendly gestures, Zhaohui expressed his satisfaction over

³⁶ See Peter Lee, “Taliban force a China switch” *Asia Times*. March 6, 2009

the pace and depth of cooperation between the two countries and hoped that mutual cooperation at the strategic level will go a long way.

However, Beijing must come to realize that a set of classical bilateral measures with Kabul and Islamabad aren't enough to stop the Taliban threat, which rapidly would generate into a Xinjiang "Jihad" if Afghanistan and Pakistan fail to contain the flow of terror on short, medium and long terms. China's strategic planning must preempt the scenarios where terror forces would establish launching pads for future attacks across the borders from the Vakhan corridor and the Karkoram range. Hence, Beijing needs to develop a new policy of strategic cooperation with the international campaigns in AFPAK, particularly with the US-led NATO efforts along with the Afghan and Pakistani Government.³⁷

China's needed new approach

Beijing must redesign its platform for AFPAK along the following tracks:

1. Reconvert its support to Pakistan, not to escalate the balance of power with India but to enable Islamabad to contain and roll back the Taliban.
2. Open a dialogue with India based on joint efforts against the Jihadi threat in the subcontinent covering the three nuclear powers, China, Pakistan and India.
3. Increase its cooperation with Afghanistan against the joint menace of the Taliban and the Xinjiang Jihadists.
4. Establish a strategic dialogue with the United States and NATO on common concerns regarding international Jihadist terror and lay the groundwork for economic, political, security and military joint measures against Al Qaeda, the Taliban and their global web.
5. Join a consortium on terror threat in central and south Asia along with the US, NATO, Russia, India, Pakistan and all concerned governments so to isolate the Jihadists and deny them the control of any country in the area, particularly if nuclear.

US suggested initiatives

³⁷ Read "China Versus the Taliban" *Strategy Page*; August 14, 2007

The United States relations with the People's Republic of China depends of a wide array of components ranging from strategic nuclear security, military balance, economic issues, diplomatic questions to human rights and the question of Taiwan and North Korea. The web of areas of concerns and of areas of cooperation is large and complex. Washington's decision makers must indeed take into consideration all other factors when dealing with one issue at the table. Based on this overarching reality, I suggest the development of a new initiative towards China focusing on an elevated cooperation against terrorism in general and on the Taliban-Al Qaeda threat in central and south Asia in particular.

China has a vested interest in stopping the Talibanization of AFPAK and thus preempting a projected terror campaign in Xinjiang; and the United States has a vested interest in defeating the Jihadi threat in Afghanistan and rolling it back in Pakistan. Hence I do propose the following measures:

- a. That the United States of America engages the People's Republic of China in a joint program to counter Jihadi terrorism in AFPAK, in particular, and in south and central Asia, in general.
- b. To form a consortium including the US, China, Russia, Afghanistan, Pakistan, the European Union, India and other willing governments to fight the scourge of Jihadi terrorism and work on de-radicalization programs across the region.
- c. The US must not abandon its policies of defense of human rights and democracy towards China as a price for such a new initiative.
- d. The US must not turn a blind eye on any legitimate ethnic and cultural claim of any minority in China in return for cooperation with Beijing on countering Jihadi terrorism. American Foreign Policy must be able to perform, both missions with equal success.

Dr Walid Phares is the Director of the Future Terrorism Project at the Foundation for the Defense of Democracies and a visiting scholar at the European Foundation for Democracy. Professor Phares teaches Global Strategies at the National Defense University and the author of several books on ethnic and ideological conflicts.

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HEARING COCHAIR BLUMENTHAL: Thank you very much.

DR. PHARES: Thank you.

HEARING COCHAIR BLUMENTHAL: Ms. Curtis.

**STATEMENT OF MS. LISA CURTIS
SENIOR RESEARCH FELLOW, THE HERITAGE FOUNDATION
WASHINGTON, DC**

MS. CURTIS: Thank you, Chairman Bartholomew, Commissioner Blumenthal, and the rest of the commissioners for inviting me here today.

I've been asked to talk specifically about Pakistan-China security relations. Pakistan and China have long-standing strategic ties dating back five decades. The two countries first established diplomatic relations during the mid-1950s but really deepened their ties during the period of Sino-Indian hostility dating from 1962, the Indo-China War, to the late 1980s.

Chinese policy toward Pakistan is driven primarily by its interests in countering Indian power in the region and diverting Indian military force and strategic attention away from China.

China is Pakistan's largest defense supplier. China transferred equipment and technology and provided scientific expertise to Pakistan's nuclear weapons and ballistic missile programs throughout the 1980s and 1990s.

The most significant development in China-Pakistan military cooperation was in the early 1990s with the transfer of dozens of short-range ballistic M-11 missiles from China to Pakistan.

While the U.S. has sanctioned Pakistan in the past, China has consistently supported Pakistan's military modernization effort. China has helped Pakistan build two nuclear reactors at the Chasma site in the Punjab Province and continues to support Pakistan's nuclear program.

During Pakistani President Asif Ali Zardari's visit to Beijing in mid-October 2008, Beijing pledged to help Pakistan construct two new nuclear power plants at Chasma.

China is also helping Pakistan develop a deep-sea port at the naval base at Gwadar in Pakistan's province of Baluchistan. The port would allow China to secure oil and gas supplies from the Persian Gulf and project its power in the Indian Ocean.

There is also concern that China may turn its investment in Gwadar port into access for its warships.

China has been able to simultaneously pursue strong military and strategic ties to Pakistan while also building closer relations with India over the last decade.

China's interest in improving ties to India has spurred Beijing to develop a more neutral position on the Kashmir issue and signal its interest in bilateral Indo-Pakistani negotiations to resolve their differences, even playing a helpful role in preventing the outbreak of full scale war between the two countries during the 1999 Indo-Pakistani crisis over Kargil.

Still, Beijing views the pursuit of strategic ties to Pakistan as a useful way to contain Indian power. China's attempts to scuttle the U.S.-India civil nuclear agreement at the September 2008 Nuclear Suppliers Group meeting was evidence for many Indians that China does not willingly accept India's rise on the world stage.

One source of tension between Beijing and Islamabad that has been raised by our other two witnesses has been the issue of Islamist extremism and especially over Chinese Uighur separatists receiving sanctuary and training on Pakistani territory.

This tension came to a head in the summer of 2007 when Islamic vigilantes kidnapped several Chinese citizens. China was incensed by this incident and its complaints to Pakistani authorities likely contributed to Pakistan's decision to finally launch a military operation at the Red Mosque in Islamabad where the militants had been holed up since January 2007.

Also, last August, Islamist extremists abducted a Chinese engineer in Pakistan's Swat Valley. The Chinese protested vehemently to the Pakistani government, and the engineer was released just in February.

Security concerns about Pakistan could move the Chinese in the direction of working more closely with the international community to help stabilize the country. China is part of the 11- member "Friends of Democratic Pakistan." The grouping was formed last September and, of course, met in April in Tokyo.

The grouping has pledged to lend collective support to Pakistan in consolidating democratic institutions, the rule of law, good governance, socioeconomic development, and meeting the challenge of terrorism.

In another sign that China may feel increasingly compelled to pressure Pakistan on counterterrorism policy, Beijing in December finally dropped its resistance to banning the Jamaat-ud-Dawa, which is a front organization for the Pakistan-based Lashkar-e-Tayyiba, which

was responsible for last November's terrorist attacks in Mumbai.

This happened in the United Nations Security Council after Beijing had previously vetoed similar resolutions seeking to ban the group several times over the past few years.

The U.S. should seek to convince China to play a more responsible role with regard to its nuclear cooperation with Pakistan, emphasizing the need to discourage nuclear weapon stockpiling in a country facing the specter of further instability.

China and the U.S. share the goal of preventing Pakistan's nuclear weapons from falling into the wrong hands. Recent encroachments by the Taliban into parts of northwest Pakistan have added a more dangerous dimension to nuclear proliferation in Pakistan and require new thinking among stakeholders in the region for avoiding a potential nightmare scenario in which al-Qaeda gains access to Pakistan's nuclear weapons.

There is little reason to panic about the safety and security of Pakistan's weapons programs at this moment, but I think recent developments should add a new impetus to regional efforts to control nuclear proliferation.

The U.S. can also involve China in efforts to encourage greater South Asia regional economic integration and cooperation. Washington should encourage the Chinese to take part in economic and trade ventures that involve bringing Afghanistan and Pakistan together for mutual economic benefit.

With rising instability in nuclear-armed Pakistan, China must take greater responsibility for encouraging stability and coherence among Pakistan's leadership.

China's handling of the current crisis in Pakistan is a true test of its credentials as a responsible global player, and that completes my remarks.

Thank you.

[The statement follows:]

**Prepared Statement of Ms. Lisa Curtis
Senior Research Fellow, The Heritage Foundation
Washington, DC**

“China’s Military and Security Relationship with Pakistan”

Testimony before the U.S.–China Economic and Security Review Commission

May 20, 2009

Lisa Curtis
Senior Research Fellow
The Heritage Foundation³⁸

My name is Lisa Curtis. I am a senior research fellow at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Pakistan and China have long-standing strategic ties, dating back five decades. Pakistani President Asif Ali Zardari wrote in a recent op-ed that, “No relationship between two sovereign states is as unique and durable as that between Pakistan and China.”³⁹ China’s partnership with Pakistan first emerged during the mid-1950s when Beijing reached out to several developing countries, and then deepened significantly during the period of Sino–Indian hostility from 1962 to the late 1980s.

Chinese policy toward Pakistan is driven primarily by its interest in countering Indian power in the region and diverting Indian military force and strategic attention away from China. South Asia expert Stephen Cohen describes China as pursuing a classic balance of power by supporting Pakistan in a relationship that mirrors the one between the U.S. and Israel.⁴⁰ The China–Pakistan partnership serves both Chinese and Pakistani interests by presenting India with a potential two-front theater in the event of war with either country.⁴¹

Chinese officials also view a certain degree of India–Pakistan tension as advancing their own strategic interests as such friction bogs India down in South Asia and interferes with

³⁸The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(c)(3). It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work. The Heritage Foundation is the most broadly supported think tank in the United States. In 2008, it had nearly 400,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2008 income came from the following sources:

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³⁹Asif Ali Zardari, “Sino–Pakistan Relations Higher than Himalayas,” *China Daily*, February 23, 2009, at http://www.chinadaily.cn/opinion/2009-02/23/content_7501699.htm (May 13, 2009).

⁴⁰Stephen P. Cohen, *India: Emerging Power* (Washington, D.C.: Brookings Institution, 2001), p. 259.

⁴¹John W. Garver, *Protracted Contest: Sino–Indian Rivalry in the Twentieth Century* (Seattle: University of Washington Press, 2001), p. 188.

New Delhi's ability to assert its global ambitions and compete with China at the international level. That said, Beijing has demonstrated in recent years that it favors bilateral Indo-Pakistani negotiations to resolve their differences and has played a helpful role in preventing the outbreak of full-scale war between the two countries, especially during the 1999 Indo-Pakistani border conflict in the heights of Kargil.

Chinese-Pakistan Defense Ties

China is Pakistan's largest defense supplier. China transferred equipment and technology and provided scientific expertise to Pakistan's nuclear weapons and ballistic missile programs throughout the 1980s and 1990s, enhancing Pakistan's strength in the South Asian strategic balance. The most significant development in China-Pakistan military cooperation occurred in 1992 when China supplied Pakistan with 34 short-range ballistic M-11 missiles.⁴² Recent sales of conventional weapons to Pakistan include JF-17 aircraft, JF-17 production facilities, F-22P frigates with helicopters, K-8 jet trainers, T-85 tanks, F-7 aircraft, small arms, and ammunition.⁴³ Beijing also built a turnkey ballistic-missile manufacturing facility near the city of Rawalpindi and helped Pakistan develop the 750-km-range, solid-fueled Shaheen-1 ballistic missile.⁴⁴ While the U.S. has sanctioned Pakistan in the past—in 1965 and again in 1990—China has consistently supported Pakistan's military modernization effort.

China has helped Pakistan build two nuclear reactors at the Chasma site in the Punjab Province and continues to support Pakistan's nuclear program, although it has been sensitive to international condemnation of the A. Q. Khan affair and has calibrated its nuclear assistance to Pakistan accordingly. During Pakistani President Zardari's visit to Beijing in mid-October 2008, Beijing pledged to help Pakistan construct two new nuclear power plants at Chasma, but did not propose or agree to a major China-Pakistan nuclear deal akin to the U.S.-India civil nuclear agreement. U.S. congressional Members have expressed concern about China's failure to apply Nuclear Suppliers Group (NSG) "full-scope safeguards" to its nuclear projects in Pakistan.⁴⁵

China also is helping Pakistan develop a deep-sea port at the naval base at Gwadar in Pakistan's province of Baluchistan on the Arabian Sea. The port would allow China to secure oil and gas supplies from the Persian Gulf and project power in the Indian Ocean. China financed 80 percent of the \$250 million for completion of the first phase of the

⁴²Ahmad Faruqui, "The Complex Dynamics of Pakistan's Relationship with China," Islamabad Policy Research Institute (Summer 2001), at <http://www.ipripak.org/journal/summer2001/thecomplex.shtml> (May 14, 2009).

⁴³"Annual Report to Congress: Military Power of the People's Republic of China, 2009," Office of the Secretary to Defense, p. 57.

⁴⁴"Pakistan Profile," Nuclear Threat Initiative, January 2009, at http://www.nti.org/e_research/profiles/Pakistan/index.html (May 14, 2009).

⁴⁵Shirley A. Khan, "China and Proliferation of Weapons of Mass Destruction and Missiles: Policy Issues," Congressional Research Services Report RL31555, January 7, 2009, p. 3.

project and reportedly is funding most of the second phase of the project as well.⁴⁶ The complex will provide a port, warehouses, and industrial facilities for more than 20 countries and will eventually have the capability to receive oil tankers with a capacity of 200,000 tons. There is concern that China may turn its investment in Gwadar Port into access for its warships.

The India Factor

China has been able to successfully pursue closer relations with India, especially on the economic front (bilateral trade rose from \$5 billion to \$40 billion in the course of five years), while continuing to pursue strong military and strategic ties to Pakistan.

China's interest in improving ties to India over the last decade has spurred Beijing to develop a more neutral position on the Kashmir issue, rather than reflexively taking Pakistan's side, which has traditionally meant supporting United Nations resolutions calling for a plebiscite or backing Pakistan's attempts to wrest the region by force, as with Pakistan's 1965 Operation Gibraltar.⁴⁷ A turning point in China's position on Kashmir came during the 1999 Kargil crisis when Beijing helped convince Pakistan to withdraw forces from the Indian side of the Line of Control following its incursion into the Kargil region of Jammu and Kashmir. Beijing made clear its position that the two sides should resolve the Kashmir conflict through bilateral negotiations, not military force. India was pleased with China's stance on the Kargil crisis, which allowed Beijing and New Delhi to overcome tensions in their relations that had developed over India's 1998 nuclear tests.

Despite the evolution in the Chinese position on Kashmir, China continues to maintain a robust defense relationship with Pakistan, and to view a strong partnership with Pakistan as a useful way to contain Indian power. China's attempt to scuttle the U.S.–India civil nuclear agreement at the September 2008 Nuclear Suppliers Group (NSG) meeting was evidence for many Indians that China does not willingly accept India's rise on the world stage. The Chinese—buoyed by the unexpected opposition from NSG nations like New Zealand, Austria, and Ireland—threatened the agreement with delaying tactics and last-minute concerns signaled through an article in the Chinese Communist Party's English-language paper, *The People's Daily*.⁴⁸ The public rebuke of the deal followed several earlier assurances from Chinese leaders that Beijing would not block consensus at the NSG.

⁴⁶Ziad Haider, "Baluchis, Beijing, and Pakistan's Gwadar Port," *Politics and Diplomacy* (Winter/Spring 2005), pp. 96, 97.

⁴⁷Operation Gibraltar was an operation launched in August 1965 by the Pakistani military that sought to infiltrate militants into Indian Kashmir to provoke an insurrection among Kashmiri Muslims against Indian rule in the region. However, the strategy was not well-coordinated and the infiltrators were quickly discovered, precipitating an Indian counterattack that resulted in the 1965 Indo–Pakistani War.

⁴⁸Chris Buckley, "China State Paper Lashes India–U.S. Nuclear Deal," Reuters India, September 1, 2008, at <http://in.reuters.com/article/topNews/idINIndia-35260420080901> (May 14, 2009).

Indian observers claim the Chinese tried to walk out of the NSG meetings in order to prevent a consensus, but that last-minute interventions from senior U.S. and Indian officials convinced them that the price of scuttling the deal would be too high, forcing them to return to the meeting.⁴⁹ Indian strategic affairs analyst Uday Bhaskar attributed the Chinese maneuvering to longstanding competition between the two Asian rivals. “Clearly, until now China has been the major power in Asia,” said Bhaskar. “With India entering the NSG, a new strategic equation has been introduced into Asia and this clearly has caused disquiet to China.” Indian official Palaniappan Chidambaram (now Home Minister), citing China’s position within the NSG, said that, “From time to time, China takes unpredictable positions that raise a number of questions about its attitude toward the rise of India.”

Tensions over Separatists and Islamist Extremists

One source of tension between Beijing and Islamabad that has surfaced has been the issue of Chinese Uighur separatists receiving sanctuary and training on Pakistani territory. The Chinese province of Xinjiang is home to 8 million Muslim Uighurs, many of whom resent the growing presence and economic grip on the region of the Han Chinese. Some have agitated for an independent “East Turkestan.” To mollify China’s concerns, Pakistan in recent years has begun to clamp down on Uighur settlements and on religious schools used as training grounds for militants.⁵⁰ Media reports indicate that Pakistan may have extradited as many as nine Uighurs to China in April after accusing them of involvement in terrorist activities.⁵¹

Tension has also surfaced over Islamist extremism in Pakistan. It came to a head in the summer of 2007 when vigilantes kidnapped several Chinese citizens whom they accused of running a brothel in Islamabad. China was incensed by this incident, and its complaints to Pakistani authorities likely contributed to Pakistan’s decision to finally launch a military operation at the Red Mosque in Islamabad, where the militants had been holed up since January 2007. Around the same timeframe as the Red Mosque episode, three Chinese officials were killed in Peshawar in July 2007. Several days later, a suicide bomber attacked a group of Chinese engineers in Baluchistan. Last August, Islamist extremists abducted Chinese engineer, Long Ziaowei, in Pakistan’s Swat Valley. The Chinese protested vehemently to the Pakistani government and Ziaowei was released unharmed in February.

Security concerns about Pakistan could move the Chinese in the direction of working more closely with the international community to help stabilize the country. During

⁴⁹Bhaskar Roy, “China Unmasked—What Next?” *South Asia Analysis Group Paper* No. 2840, September 12, 2008.

⁵⁰Ziad Haider, “Clearing Clouds Over the Karakoram Pass,” *YaleGlobal Online*, March 29, 2004, at <http://yaleglobal.yale.edu/display.article?id=3603&page=2> (May 14, 2009).

⁵¹Press release, “Freedom House Condemns Pakistan, China for Uighur Extraditions,” Freedom House, May 7, 2009 at <http://www.freedomhouse.org/template.cfm?page=70&release=815> (May 14, 2009).

President Zardari's visit to Beijing in October 2008, Beijing resisted providing Pakistan a large-scale bailout from its economic crisis, thus forcing Islamabad to accept an International Monetary Fund program with stringent conditions for economic reform. Beijing did come through with a soft loan of about \$500 million, though. China is part of the 11-member "Friends of Democratic Pakistan" grouping that was formed last September and met in April in Tokyo. The grouping has pledged to lend collective support to Pakistan in consolidating its democratic institutions, the rule of law, good governance, socio-economic advancement, economic reform, and progress in meeting the challenge of terrorism.

In another sign that China feels increasingly compelled to pressure Pakistan to adopt more responsible counterterrorism policies, Beijing dropped its resistance to banning the Jamaat-ud-Dawa (JuD—a front organization for the Pakistan-based Lashkar-e-Tayyiba, responsible for the November terrorist attacks in Mumbai) in the United Nations Security Council (UNSC) last December. China had previously vetoed UNSC resolutions seeking to ban the JuD over the last several years.

Recommendations for U.S. Policy

Given that China, Pakistan, and India are nuclear-armed states and that border disputes continue to bedevil both India–Pakistan and India–China relations, the U.S. must pay close attention to the security dynamics of the region and seek opportunities to reduce military tensions and discourage further nuclear proliferation.

China's apparent growing concern over Islamist extremism in Pakistan may provide opportunities for Washington to work more closely with Beijing in encouraging more effective Pakistani counterterrorism policies. Pakistan's reliance on both the U.S. and China for aid and diplomatic support means that coordinated approaches from Washington and Beijing provide the best chance for impacting Pakistani policies in a way that encourages regional stability. Conversely, the more Pakistan believes it can play the U.S. and China off one another, the less likely it will be to take necessary economic and political reforms and to rein in extremists. China's involvement in the "Friends of Democratic Pakistan" grouping is a positive sign that it may be willing to contribute to a multilateral effort aimed at stabilizing the situation in Pakistan.

The U.S. should also seek to convince China to play a responsible role with regard to its nuclear cooperation with Pakistan, emphasizing the need to discourage nuclear-weapons stockpiling in a country facing the specter of further instability. China and the U.S. share the goal of preventing Pakistan's nuclear weapons from falling into the wrong hands—China perhaps even more so, given its geographic proximity to Pakistan. Recent encroachments by the Taliban into parts of northwest Pakistan have added a more dangerous dimension to nuclear proliferation in Pakistan and require new thinking among stakeholders in the region for avoiding a nightmare scenario in which al-Qaeda gains access to Pakistan's nuclear weapons. There is little reason to panic about the safety and security of Pakistan's nuclear weapons at the moment since the Pakistan military is a

professional and unified force that has adopted security procedures to avoid such a worst-case scenario. Even so, recent developments in the country should add new impetus to regional efforts to control nuclear proliferation.

The U.S. should involve China in efforts to encourage greater South Asia regional economic integration and cooperation. Chinese financial aid to Pakistan has been valuable in maintaining economic stability there both before and during the global financial crisis. Chinese direct investment, such as China Mobile's acquisition of Paktel, and assisting Afghan and Pakistani companies to tap the potentially huge Chinese market would be helpful in the creation of a more prosperous region. Trade flows are relatively undeveloped and would be particularly promising if transport links can be improved. Washington should encourage the Chinese to take part in economic and trade ventures that involve bringing Afghanistan and Pakistan together for mutual economic benefit. This would fit with China's interest in accessing Middle East markets through Afghanistan and Pakistan and help provide each country with a vested interest in promoting regional stability.

Conclusion

To date China's pursuit of relations with Pakistan has been aimed primarily at containing Indian power in the region. With rising instability in nuclear-armed Pakistan and the threat of Taliban forces gaining influence there, both China and the U.S. must take responsibility for encouraging greater stability and coherence among Pakistan's leadership. China's handling of the current crisis in Pakistan is a true test of its credentials as a responsible global player.

Panel II: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you all very much for very interesting testimony.

Dr. Phares, you painted a very interesting picture of a classic blow back scenario where the Chinese are supporting certain countries and certain regimes that then support terrorists and then add to the jihadi problem along China's own borders or within China itself.

We just returned from China. I don't want to characterize any other commissioners' impressions, but I sense a distinct sense of relaxation about this issue in China. Every time we pressed on the possibilities for the kind of scenario you painted with respect to the Talibanization of Afghanistan or Pakistan and how that might pour into their own borders, we got what I would characterize as kind of a "shrug-off."

So, I wonder--same thing with respect to support for Iran and its support for terrorist organizations--I wonder if it's your assessment, in fact, that there is just a lack of realization of how destabilizing this kind of behavior is, this kind of support is, or a lack of belief that this could actually come back to bite China, if you will, inside of China?

Or what would explain China's, shall we say, relaxed approach to the kind of blow back scenarios that I think you well painted?

And any one of you can weigh in on that question.

DR. PHARES: Thank you.

There is the one main answer and then there's a series of smaller comparative answers. The main one is historical, is that China is, as probably other countries, in a pre-9/11 mood for themselves. That would remind us of our debate. Reading the 400 pages of 9/11 Commission, our debates about the rise of al-Qaeda threat against us including our national security, is somewhat reminiscent of what the Chinese would have if they have a debate. The problem is they have no debate in China. There's one-party rule.

So, unfortunately, I say that unless there is a significant threat and strike against Chinese mainland and urban zones, as could have been the case last summer when these movements have targeted Chinese institutions and places, I don't think the reaction will be that, yes, we see an imminent danger.

But as important is the fact that the Chinese government, reminding us also of a parallel situation with the Russian government, do not like to project the idea that there is a jihadi threat on the inside, unlike in the West, Western Europe and United States, because that also implicates ethnic claims and ethnic secession.

A further investigation of the terror threat inside Xinjiang will open up the question of the minority and all these questions. That's the second reason.

Third, I do say, however, that a pressing by the United States, by the Obama administration, for a bilateral discussion of that joint threat with the Chinese, raising all these issues, would be something that the Chinese would respond to. They may not respond to in their press; they may not respond to in their media; but certainly in their negotiations, knowing certainly that we are present in Afghanistan and we may be financially or otherwise present in Pakistan, and they know that there are 700 kilometers of borders, if the Taliban takes over in Afghanistan and Pakistan, they know that there will be a direct threat. They are not ready yet to admit it.

HEARING COCHAIR BLUMENTHAL: Anyone else on that? Thank you.

MS. CURTIS: Yes, I'd like to say a few words, if I could. I

wouldn't necessarily take at face value their downplaying the situation in Pakistan. Many Pakistanis have been saying over the last several weeks privately that they are receiving pressure from the Chinese, particularly when the Taliban moved into Buner district from the Swat Valley, and I think that it is possible that Pakistan's recent efforts to confront the Taliban militarily in these areas could perhaps have been spurred by Chinese pressure.

So I think the Chinese are concerned by what they see as the increased Talibanization, particularly near the border areas with China, and so I think they are concerned, but they do take sort of pride in the fact that they don't embarrass the Pakistanis publicly.

They like to deal privately with the Pakistanis, and they use that to sort of differentiate how they say the Americans deal with Pakistan in terms of making public statements or public references to some of the problems and challenges we see there.

So this may be another reason for them not expressing forthrightly the concerns they have about Pakistan.

HEARING COCHAIR BLUMENTHAL: Thank you.

MR. DENMARK: If I could add very briefly.

HEARING COCHAIR BLUMENTHAL: Sure. Yes.

MR. DENMARK: Very briefly. Excuse me. In 2001 and 2002, China very strongly tried to tie especially ETIM to al-Qaeda in an effort to try to get China on the U.S. side in the global war on terrorism. They saw it as in their interest in trying to tie that. Some people think they might have even overemphasized the ties between ETIM and al-Qaeda.

I think the idea of trying to tie the relationship with Iran and Sudan to this issue is very interesting, but I think Dr. Phares' characterization of a pre-9/11 mind-set is very good. In fact, I would say it's a pre-pre-9/11 mind-set, in that they're very focused on maintaining their access to Middle Eastern resources, maintaining their image as a leader of the developing world. And that is very strong in terms of motivating their foreign policy, and getting them to focus on Pakistani instability, Pakistani insurgents, through their relationship with Iran, I think may be overly indirect.

I think, as Ms. Curtis specifically discussed, concerns about instability right on their border is very much in their interest and something that they have discussed internally in their own publications. And I think it's something that, as I say in my testimony, and the other witnesses seem to agree, that engaging with China on this issue, the threat of Pakistani instability towards the greater South

Asian security architecture, is something that I think is a good avenue for U.S. to engage China on.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman.

I have two questions I would direct to Mr. Denmark, and then invite the others to comment. Commissioner Shea earlier raised the issue of the Shanghai Cooperation Organization. Just a quick one. Did the United States try to get into that organization and get rebuffed? Two, do we have observer status in that organization? If you can give me a quick answer on that, and then I'll come back to a larger question.

MR. DENMARK: The quick answer is no to both questions, as far as I know. I think we have attempted at times to be observers in specific SCO exercises, but we don't have official SCO status as far as I'm aware.

COMMISSIONER MULLOY: Anyone want to add anything on that? Okay.

In the White Paper that the Obama administration put out on the U.S. policy toward Afghanistan and Pakistan, they state, quote:

"The core goal of the U.S. must be to disrupt, dismantle and defeat al-Qaeda in its safe havens in Pakistan and prevent their return to Pakistan or Afghanistan."

My understanding--I'm not an expert in these matters at all--but al-Qaeda was the group that attacked us and we didn't recognize the Taliban government in Afghanistan. I think we recognized the Northern Alliance as still the legitimate government of Afghanistan.

But we asked the Taliban to release the al-Qaeda members to us, and when they didn't, that's when we invaded Afghanistan, and NATO went with us.

What is the relationship between al-Qaeda and the Taliban, and who are we really after? Are they related? I just need some sense of all of this, and you guys are experts. If you can help me out, I'd appreciate it, Mr. Denmark, and then go across.

MR. DENMARK: In terms of the relationship between the Taliban and al-Qaeda, Dr. Phares is much more of an expert on that issue than I am.

Basically what I would say, when you ask who our enemy is, according to the Obama administration, our enemies are personified in al-Qaeda and insurgent groups such as the Taliban. More broadly, our enemy is instability.

If you look at their strategy, they go beyond just capturing and killing bad guys and into how to make Afghanistan and Pakistan more

stable, how to strengthen their governments, how to strengthen their security services, so that not only do we defeat the specific insurgents but also we address the conditions that create these insurgencies.

DR. PHARES: If I may summarize it quickly, you have the legal aspect of it and then the strategic historical aspect, the legal and the historical strategic aspect. The legal part of it is that when, regardless of what was our consideration of who attacked us on 9/11, what we practically did was to remove the Taliban because they protected al-Qaeda.

So after Tora Bora on, we are in a state of war with the Taliban, and they are in a state of war with us in statements and in action.

But, ideologically and historically, we need to refer to what that foe is saying about us and about this war as an important ingredient of how we should see it as well. The al-Qaeda group which took refuge in Afghanistan in the '90s and Osama bin Laden himself do recognize the Taliban and Umar Mullah, as the supreme leader of the "believers"-quote-unquote--which means ideologically speaking that this is the highest international authority for them.

Now, the Taliban themselves recognize Al Qaeda as the international arm of the so-called--quote-unquote--"Jihad movement." So, in a sense, even if the Taliban are ethnically Pashtun or local Afghan and even if al-Qaeda is made of international membership coming from various countries, they consider themselves as one body of struggle.

The international organization works in a variety of places around the world. There is an Al Qaeda Maghreb, al-Qaeda Sunni Triangle, al-Qaeda in Syria-Levant, an Al Qaeda in Afghanistan and now, of course, even in the West.

And the Taliban are the jihadists of the region, of Afghanistan, of Pakistan. The partners of al-Qaeda in Algeria would be another group. The partners of Al Qaeda in Sudan would be another group. So we have to see it as Al Qaeda being the mother ship international organization, and these are--quote-unquote--"the national jihadi organizations," responsible for action on their own soil.

MS. CURTIS: I'd like to just build on what Dr. Phares just said. I completely agree with everything that he has said, and you have to go back through the history and the U.S. tried to deal with the Taliban diplomatically throughout the 1990s to get them to turn over Osama bin Laden. He, of course, took refuge in Afghanistan in 1996 from Sudan when he was kicked out of the Sudan.

I would say they have a closer relationship now than ever. Basically Al Qaeda provides the ideological inspiration, the training, the connection to the international jihad for the Taliban, while the

Taliban provides a safe haven for Al Qaeda because they have the Pashtun links. They're Pashtun so they have the ethnic identification with the region so they can provide Al Qaeda with the safe haven in these border regions of Afghanistan and Pakistan. Of course, now Pakistan.

So I think it's clear that there is a very close relationship there, and that is why, yes, the goal is to disrupt al-Qaeda, but you could argue that if we allow the Taliban leadership to regain influence in Afghanistan, we're giving Al Qaeda even a stronger safe haven than they had before 9/11.

COMMISSIONER MULLOY: That's very helpful and I appreciate it very much.

HEARING COCHAIR FIEDLER: Commissioner Cleveland.

COMMISSIONER CLEVELAND: Thank you.

Ms. Curtis, you talked in your testimony about the Chinese resisting in October of 2008 any inclination to provide Pakistan with a bailout in their economic crisis, but that they subsequently went on to provide \$500 million in a soft loan. Can you talk a little bit about what that loan was for and what the terms of financing were, if you know?

And then perhaps the rest of the panel may want to comment on what other kinds of assistance the Chinese have provided to Pakistan, either lending or grants?

MS. CURTIS: I don't know the exact terms of the grant, but I'm sure they were, it was more of a grant support, budgetary support for Pakistan. Of course, the U.S. has provided budgetary support to Pakistan throughout, over the last several years, but not to this extent.

But I think the point I'm making is President Zardari when he went there in September of 2008, Pakistan was in economic dire straits, was close to defaulting, and I think he expected to get more along the lines of, four to five billion so that Pakistan would not have to go to the IMF. They were trying to avoid going to the IMF. So I think the point is, at least in this one case, we saw China resisting a complete bailout of the Pakistan economy.

But, I would agree with some of the other witnesses, that the role that China is playing with this "Friends of Democratic Pakistan" isn't entirely clear. They are part of the organization, but at the same time, they seem to want to keep somewhat of a distance from it, and I think, as Mr. Denmark pointed out, they want to provide assistance bilaterally rather than through this international mechanism. So I think that's telling.

COMMISSIONER CLEVELAND: Mr. Denmark, do you want to comment on that?

MR. DENMARK: I think Ms. Curtis laid it out very well. The only thing I would add is just to reemphasize that China's relationship with Pakistan is almost purely strategic. Economically, Pakistan doesn't really register for China. They set a goal for 2011 of trade of \$15 billion by 2011, which would be four percent of China's trade with the U.S. today. So it's not even on the radar economically.

HEARING COCHAIR FIEDLER: Commissioner Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you very much and thank you to all of our witnesses.

This is very interesting. Earlier with Mr. Schiffer here, I asked about the stability question and whether a stable extremist government would be better than instability from China's perspective, and Dr. Phares, you pretty much repudiated that.

But during the 1990s, the Chinese government had a relationship. They recognized the Taliban. They had a relationship and there were suspicions that they had cut a deal with Pakistan also, which was essentially we'll provide you missile technology, we'll provide you a bunch of stuff, and in exchange, particularly through the ISI, which was connected to the Taliban, in exchange, you guys keep hands off of the Xinjiang province and what's going on with the Muslims out there.

And, in fact, the concerns of the Muslims stayed pretty much below the radar screen and it was fairly low level. So I'm wondering what changed about this dynamic? Al Qaeda would be an easy answer, but, Ms. Curtis, you note that the tensions about Islamist extremism came to a head in the summer of 2007. That's six years after 9/11 2001, and I just wondered if you could explore a little bit about has this dynamic fundamentally shifted so that indeed the Chinese wouldn't tolerate an extremist government in Pakistan or Afghanistan?

DR. PHARES: Thank you very much. First, there's a factor of time, chronology. The Taliban came to power in 1996 so the Chinese policy after 1996 obviously and realistically was to try to cut a deal with the Taliban so they do not, will not project a jihadi policy within Xinjiang. So China is on the defensive trying to contain the Taliban by striking deals, by making sure that they will ensure some of their interests, and at the same time the Taliban would not cross the border and influence and create madrasahs and later on jihadists.

Despite that, the Taliban had a deal with the Chinese on the one hand, yet al-Qaeda which is protected by the Taliban inside Afghanistan from '96 to 2001, and we learned about it in 2001, have hosted a team or jihadi separatists from Xinjiang inside Afghanistan.

So the Taliban inside Afghanistan are the ones who are in control of their strategies with regard China. It was in their interests to make sure that the Chinese are not going to put pressure on them

because they were still a young regime. They are still fighting the Northern Alliance. They did not want the Chinese who had borders with the Northern Alliance, by the way, to pour in weapons and support the Northern Alliance because the Northern Alliance could have done what it has done in 2001 much earlier.

So it would be like a Stalinist realist approach. The Afghani Taliban would say we want to maintain China where it is; we're going to grow our strength; we're going to win the civil war against the Northern Alliance.

Their second priority was not China because there is a long-range aim in the jihadist strategies. It's not to engage just to engage. It's to make sure to protect the regime. And then move to Pakistan in the Waziristan areas, which they are doing right now, and only after they secure their goal in Pakistan, should it be part of it or all of it, then they will focus on China.

Now, if the question is does the Chinese leadership know about that? I believe that their experts know about that. That brings us to the previous question of are they willing to engage us in a dual strategy to stop the Taliban? That's a different question.

But my belief is that the Chinese know eventually what the Taliban wants from Xinjiang five years from now, ten years from now.

MS. CURTIS: Yes. I would just add that I think what's changed from the '90s when perhaps the Chinese have struck some kind of deal was Pakistani control over the Taliban. At that time, Pakistan had relations with the Taliban; the military very much had the upper hand. There was no Talibanization of Pakistan.

So what's changed is now the Taliban are starting to get the upper hand within Pakistan itself. So I think the Chinese would not want a Taliban type of regime led by people who have taken over the Swat Valley and who are now fighting the Pakistan military, but probably what they would accept is Pakistani military regime that had close ties with extremists so long as they weren't threatening China itself.

So I think the major difference here is they see certain loss of control by the Pakistani establishment towards the militants. So that is perhaps why their policies are changing.

I just wanted to add to that, there is some reporting that Chinese Communist Party leaders have met with the Jamaat-e-Islami in Pakistan, which is an Islamist political party in Pakistan, which is quite interesting, showing that they're trying to keep relations with all political parties in Pakistan.

CHAIRMAN BARTHOLOMEW: Mr. Denmark.

MR. DENMARK: I would add two other changes from Beijing's

perspective since 1996 and 2001. The first being a change in China's perception of its interests, is that China is profoundly focused on maintaining access to foreign resources, maintaining access to foreign markets, and their behavior now shows that they're not really concerned about the character of a state that they're dealing with per se as long as whatever regime is in place is stable and allows business to be done.

I would argue that it's their calculation that a regime in Pakistan controlled by the Taliban or some extremist group is inherently unstable because of their jihadist ties but also because of--which ties into the second point that I would have was perceptions of the changes of China's strategic environment.

The United States is much more profoundly focused on the Taliban and al-Qaeda than we were in 1996. And this change, China cannot be seen as supporting any government with ties to terrorism because its primary relationship is with the United States and nothing can get in the way of that relationship including having some sort of arrangement with some supposed future Pakistani extremist government.

CHAIRMAN BARTHOLOMEW: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Slane.

COMMISSIONER SLANE: Can you give us your assessment of the stability in Pakistan?

CHAIRMAN BARTHOLOMEW: Boy, everybody is jumping on that question.

MS. CURTIS: Sir, I think things have changed dramatically in the last few weeks. What we saw previously was a very confused population. We saw a government that had struck peace deals with the Taliban and was unwilling to confront Taliban elements who had taken over the Swat Valley region in northern Pakistan.

But what we saw one week after President Asif Ali Zardari signed on to the demands of the Taliban in Swat Valley to implement Sharia courts, Islamic courts in the region. Only one week later, the Taliban moved into neighboring Buner district, and I think that raised concern both within the Pakistan military and among the populace, as well as statements by the Taliban leader in Swat Valley saying that Pakistan's entire court system was illegitimate, it wasn't adhering to Sharia, demonstrated the larger Taliban goal of trying to undermine democracy throughout Pakistan.

So what we've seen is a sea-change in civilian leadership statements now supporting the military confronting the Taliban; the military leadership saying they will not allow the Taliban to jeopardize Pakistani civil society and to force Pakistanis into a way of life that is

foreign to them.

I think this bodes well in terms of catalyzing Pakistani public opinion against the Talibanization of their own country, but the question is how long it will last because we already see a humanitarian situation developing with 1.5 million internally displaced people starting to flee Swat. So what we've seen is the Pakistanis hitting the Taliban hard, civilians getting caught in the crossfire, so I think we're at a turning point in a way in a Pakistan, but it's also a very fragile situation.

And that's why I think the commitment of 110 million in humanitarian aid from the Obama administration, which was announced yesterday, I believe, is very important to help the civilians who are in crisis and to take some responsibility for these civilians who are suffering for Pakistan military operations that not only are benefiting Pakistan but are benefiting world security.

So I think it is still a fragile situation, but I just note that we've seen a sea-change in the Pakistani's leadership attitude toward confronting the Taliban, which I think has helped provide the possibility that this situation can be brought under control.

DR. PHARES: If I may, I agree with Ms. Curtis, of course, and I would like to add three parameters quick. One is about influence; the other is about geography; and the third is the nukes.

Influence. There are zones of influence in Pakistan that are not really changing. It's the rise of those who have not spoken before, in this case, the People's Party, their supporters and those who are in government today. The influence of the Taliban and the other jihadist components is known. It's in those areas of the tribal areas. It's in some urban areas in those big cities and it's on the Indian-Kashmir-Pakistani border.

The geography is very important. Until the Buner move, the unspoken or undeclared agreement between the Taliban leadership and the previous and current Pakistani government was you will not go beyond the areas where you have always had control. That would be Waziristan in the south and Swat Valley. Buner was the no-go zone for both.

Now once the Taliban obtained an agreement on Sharia in their own Swat Valley, what they tried to do was to test ability of the Pakistani Army to move if they go into Buner. They went into Buner. This time there was a different cabinet in Islamabad and the international community also moved.

The nuke situation was very high on the international radar. They responded because they were at 60 kilometers from downtown Islamabad.

My assessment is, and I agree with my colleague, that the Pakistani Army made the decision, informed the government that we are going to take out the Taliban until the zones of the Swat but not engage them and reverse them completely. So what we see today is a counter offensive by the Pakistani government to send a message to the Taliban that you're not changing the regime; the Army will protect the regime.

But it is not yet what we had hoped for, that the Pakistani Army will go full-fledged yet against the Taliban. So that's my estimate on the issue.

COMMISSIONER SLANE: Do you agree, Mr. Denmark?

MR. DENMARK: I have absolutely no expertise in this issue so I endorse and extend.

HEARING COCHAIR BLUMENTHAL: That usually does not stop people.

HEARING COCHAIR FIEDLER: Commissioner Videnieks.

COMMISSIONER VIDENIEKS: You mentioned the term AFPAK. Is the border between the two countries an artificial line drawn over a glass of cognac or is it really a national border?

And the second thing on which I'd like to have a little discussion by the panel is--it is my understanding, as a panelist stated, that al-Qaeda is an international, global organization, and the Taliban is more or less national, or maybe in a couple of countries.

It was my understanding that Afghanistan does not like foreigners and the panel seemed to say that a lot of support comes from al-Qaeda to the Taliban. Please expand on those two areas.

DR. PHARES: Then the three quick points. With regard to AFPAK, this is a term that was coined here in Washington, in Brussels, more so than in the region. If you ask the two governments, the Kabul and Islamabad government, every inch of that border is historic and will be defended to the last soldier.

Reality is this is a national border that does not correspond to the ethnic boundaries between the various groups. It's not just between Pakistan and Afghanistan. Inside Afghanistan you have the mostly southern areas of Pashtun majority, then the Hazara, then the northern various ethnic groups, and inside Pakistan, there's another cocktail out there. You have the Pashtun in the northwestern parts, but then you have the various other ethnicities.

So if you ask the question from an academic perspective, is that border really between two nations, well, it depends. It's in the eyes of who you are asking. The Pashtun will say, well, this is Pashtun land that stretches from Afghanistan to Pakistan. That would be the same question as about the Kurds between Turkey and Iraq and Iran.

With regard to al-Qaeda, local or international, and the exceptions by the Afghani, that's a very good question because indeed the psychology of the Afghani people as a whole in terms of opposing British in the past and Russians and, of course, even NATO at this point in time is well imbedded in the culture we don't like the foreigners, and that would be the same for many other places.

The difference is that the Taliban are not reacting to al-Qaeda as Afghan versus foreigners. To them, the members of al-Qaeda are part of what they call the Ummah. The Ummah is the greater bigger nation. So they are not foreigners if they come as international brigades, fight with them.

You could make the case the Comintern in the '30s and '40s in the Soviet Union, and the Soviet Union fighters from Chile could come and help the Communist Party of the Soviet Union when it was fighting the Nazis and others.

In this case, the jihadists of al-Qaeda are seen as the international brigade that would come and help them if needed. They would go to Somalia and help them if needed, and as you just said, the al-Qaeda is the international body. Taliban is the local. Could be national, could be regional, and it could be very local.

COMMISSIONER VIDENIEKS: But they're Ummah; right?

DR. PHARES: Yes, the concept of Ummah makes a member of al-Qaeda local wherever they are, in Chechnya, in Kashmir or in Pakistan.

COMMISSIONER VIDENIEKS: Thank you.

Anybody else?

MS. CURTIS: Yes. So Afghanistan and Pakistan, they're separated by the Durand line, which was established by the Brits in 1893, but as Dr. Phares was saying, the Pashtun population straddles the border and, in fact, you have more Pashtuns in Pakistan, but they make up a larger proportion of the Afghan population. So this is a very important point to keep in mind.

Pakistan is worried about sort of ethnic separatist tendencies or a revival of what's called Pashtunistan. So this is something that they have to consider when they're dealing with this area.

And then in terms of the Taliban and their support within Afghanistan, I would just note that most polling shows that there's still broad support for the Coalition forces remaining in Afghanistan. The people do not support the Taliban.

They don't support their policies, but they're intimidated by their efforts, and so I think this is important to keep in mind, that the ideology that the Taliban is espousing, as Dr. Phares said, is more connected to the international jihad and it's not something that is sort

of part of the average Afghan's traditional way of life.

COMMISSIONER VIDENIEKS: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Shea.

COMMISSIONER SHEA: Following up on Commissioner Videnieks' question, my understanding of Pakistan, it's basically a combination of four or five ethnic groups, Pashtun, Punjabi, Sindhi, Balochis. Are certain ethnic groups more predisposed to have a friendlier relationship with the Chinese than others? Is there an ethnic component to the PRC-Pakistan relationship?

DR. PHARES: Very powerful question. Little research about that. The little we know says that the farther the ethnicities are from those who have already been infiltrated by the jihadists, the more they feel close to the Chinese and the Chinese will close to them. It's a chess game. It's a very simple chess game.

The Pashtun tribes/communities in the Northwest haven't been infiltrated by the Taliban. Being under the Taliban would constitute more pressure and reasons to worry about in China than, let's say, the Baloch who are in the South.

Now if the future, the Baloch will be infiltrated by the jihadists, then that would change. So for this analysis, the measurement is how deep is the infiltration of the jihadist of these ethnicities will give you an answer of how worried should the Chinese or as a matter of fact the Indians or others as well.

COMMISSIONER SHEA: Thank you.

Just another question. Pakistan and PRC have a very close relationship. We know that. Pakistan and the United States have a growing relationship centered around the fight against terrorism.

Does the relationship between--if at all, does the relationship between Pakistan and China bleed into the U.S.-Pakistan relationship, particularly with respect to Pakistan support of U.S. operations in Afghanistan? Or is Pakistan able to compartmentalize these two relationships?

DR. PHARES: Well, that's geopolitics. There was before 9/11 and after 9/11. That's how I see them. Before 9/11 there was, and certainly under the Cold War, the balance of power between India and Pakistan was the most important element of Pakistan choosing its alliances and strategic relationships, China and India being part of a balance of power by themselves that facilitated the Chinese-Pakistani sort of understanding to make sure that there will be a balance with India.

At the same time, Pakistan being in the known Soviet bloc in the past, we had, as the U.S., a special relationship with the Pakistanis.

Now what has changed after 9/11, there is a new player on the

ground that are the Taliban, the jihadi forces. When that happened, certainly Pakistan's government and secular elites and masses, who are very concerned about the offense of the Taliban, naturally see in the United States an ally which they would like to establish good relations with, but not overwhelming relations.

What the previous president used to tell us, and even this government is trying to tell us, is we want to have a strategic relationship with you but don't show it too much because some of our constituencies are not going to accept that.

With regard to China, Pakistan doesn't have that psychological American issue with China because the Taliban are not at war with China. They're not going to go in their chat rooms and the media and Al-Jazeera and accuse Pakistan of having good relations with China. Actually, the international jihadist network would say we'd rather you have relationship with China than with the United States. They would like to keep China and the United States apart.

So, the answer, the suggestion here, is that a trilateral discussion of a containment of the Taliban would be the best thing we can do. First, the bilateral talk with the Chinese is one thing we should do regardless of what's happening in Pakistan. But then the Pakistanis would love, I guess, the idea that U.S. and China and Pakistan and probably bring in, as I suggested in my testimony, other players, including India and Afghanistan. Isolating the Taliban should be the name of the game in the region including with the U.S. and with China.

Everybody has interests in it.

COMMISSIONER SHEA: Thank you.

MS. CURTIS: I would just add, you referred to the Pakistan-U.S. relationship as driven by the counterterrorism issue, but I would say that Pakistan-U.S. bilateral relations go back much further than the counterterrorism relationship, the Cold War era, and if anything, I would say the 1990s when Pakistan was sanctioned was more of an aberration.

However, it still stings very much in the Pakistani mind, and of course that's why we're trying to demonstrate that we're interested in a long-term partnership that goes above and beyond just the counterterrorism partnership.

In terms of China's role there, I think Pakistan does to a certain extent try to play China and the U.S. off each other. You know tries to threaten, well, we can always go to China, et cetera, and that's why I pointed out earlier that it was helpful that China did not fully bail Pakistan's economy out and allow Pakistan to avoid going to the IMF.

So it's that kind of coordination that I believe is necessary. It's not always going to be easy, but I think the U.S. should try to work

toward that kind of coordination in the interests of Pakistani stability and just to point out that in terms of India-Pakistan relations, China has also played a very interesting role.

Of course, it maintains its relationship with Pakistan to offset Indian power. Even a certain amount of tension actually plays to China's interests, Indo-Pakistani tension, because it bogs India down in South Asia, and it doesn't allow them the resources, the time to extend themselves internationally or compete internationally with China, but at the same time, China does not want to see war between India, Pakistan, and particularly if it could go nuclear.

And it has played a somewhat helpful role during periods of very high tension between India and Pakistan. So I think that's also something just to note.

MR. DENMARK: I'd like to extend, if I could, off of Ms. Curtis' comments. China does not want to see war between India and Pakistan. I think that the questions that have recently been asked by some of the commissioners about stability inside Pakistan and the status of that, I think is very central to the future of the U.S.-China approach to Afghanistan and Pakistan.

The traditional strategic architecture of South Asia has, speaking very broadly, has been China making sure, playing a very Bismarckian role to make sure that India and Pakistan conflict remains somewhat brewing but it doesn't come up too much, does not destabilize the region.

And what I think China needs to realize, what some Americans have begun to realize, is that stability within Pakistan has become the key to regional stability, to the regional stability architecture, that if you look at Mumbai, you had tensions increase very quickly and very unexpectedly because of instability within Pakistan bleeding into the India-Pakistan conflict.

I think the key approach to moving forward with China to engage this is to convince China, convince Pakistan, that the key to the future strategic architecture for South Asia is maintaining stability within Pakistan, addressing those issues, that the U.S. has already signed on to.

And I think that's how the U.S.-Pakistan relationship will bleed into the U.S.-China relationship in the future.

COMMISSIONER SHEA: Thank you.

HEARING COCHAIR FIEDLER: I would like to take us away from the geopolitical for a moment to your testimony, Dr. Phares, where you describe or you began to describe activity in Xinjiang that resembled what I would characterize, as a layman, as grassroots organizing over the long term, and with a plan, though.

Historically, Saudi Arabia, Turkey to some extent, have assisted the Uighurs abroad in financing. Explain a little more about the content of the plan and what international support Uighurs are receiving inside China for that organizing that you described.

DR. PHARES: Thank you for the question.

Let me make a distinction, Mr. Commissioner, between two things, between the actual legitimate ethnic cultural claim of any minority including the Uighurs and the others because there are other non-Uighur, non-Chinese groups, on the one hand, and the rise of an ideological movement within the Uighur community, which is jihadists Salafis or non-Salafis.

So having made that distinction, let me dive into who has been supportive of the rise of such a movement. The Wahhabi network, part of which is in Saudi Arabia, but there are other parts outside Saudi Arabia that are in exile, and the general Salafis, what we call the Salafis network, which is influenced by the Wahhabi, have been very active under the Cold War and since the collapse of the Soviet Union in making sure that a large pool of indoctrinated people is going to be very influential including in the Xinjiang, in that part of China.

I suggest to take advantage of the answer to say that what we need to communicate probably better to the Chinese, including the Chinese experts, is what we know about the intentions of the jihadists including Wahhabi, Salafi and others. Yes, they could say they are in control of the Xinjiang. Yes, they are. They could put in more divisions. 40 percent are not Uighur, and the jihadists are only probably five to ten percent to the maximum. But they should think in terms of what is the future projection.

As we speak right now, underground madrasahs are being established in Xinjiang. Madrasahs for exiled Uighurs who have been indoctrinated in a variety of places, in Afghanistan, in Central Asia, in Pakistan, and also as far as the West, are now making progress.

So the Chinese need to look and project into the future. In the next five years, it may double, it may triple, the numbers of these individuals.

Two, they are being trained, not just indoctrinated ideologically, but trained for the use of laptops, trained for the use of technologies. Some of them are infiltrating and penetrating the Chinese security systems. Let's keep in mind that there is a big program. Some of the programs, the components of the Chinese nuclear programs are stationed in that part.

Some of the ballistic missiles, some of the weaponry systems, so they need, I guess the Chinese need to better understand the speed and the width and the depth of the jihadization of the Uighur community.

It's not just an issue of what kind of claims the ethnicity wants to establish. It's what is happening actually as strategy by these groups.

As I mentioned in my testimony, not to be very long, they have stages, and we've been reading about it in chat rooms and we've been listening to them making, the jihadists of China, statements in a variety of places, and they are not going to be doing something so different from what they have tried to do in a variety of other places including in the Philippines, the southern Philippines, in Chechnya, and in Kashmir.

That is to increase the number of the jihadists, to engage, strike against the Chinese, create Sharia-only valleys in Xinjiang. If in the future, they'll be successful, they will create those Taliban-like enclaves. They aren't going to call them the Taliban. They call them something else.

And from there on, they will follow the model of the Taliban. So, in my estimate, it's a question of five to ten years before the Uighur jihadi components supported by, in the beginning, petrodollars, not always to the end, will establish enclaves in that part of China.

HEARING COCHAIR FIEDLER: Thank you very much.

Chairman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you. That's interesting, Dr. Phares. Thank you also for making the distinction between the Uighurs who are legitimately and peacefully trying to fight for their own--"fight" is the wrong word--but work for their own self-determination and those who might be engaged in other things.

One of the concerns has always been that the fight against terrorism has been used as an excuse by the Chinese government to crack down on a self-determination movement. Similarly, the way that they look at the Tibetans is disputed by outside of China.

But I'd like to take us in a different direction, and the Chinese government has provided military and assistance to Sri Lanka in its recent success over the LTTE, and frankly I think a lot of people believe that that assistance has made the difference in that military success at significant humanitarian costs.

But is the Chinese government providing military assistance and arms to Pakistan in its current offensive? And if it isn't, why not?

MS. CURTIS: Well, China, as we mentioned, is Pakistan's biggest defense supplier. It has provided fighter aircraft, tanks, ammunition, arms, so it is likely that Chinese arms are being used in the offensive against the Taliban.

But I think you also raised Sri Lanka and that military relationship is more recent. I would say in the last five or so years, we have seen a definite uptick in the provision of Chinese military

assistance to Sri Lanka. It probably did help in terms of the confrontation against the LTTE, but to what extent I can't really say.

So I guess the short answer is, because China is one of Pakistan's biggest military suppliers, it is likely they are using weaponry supplied by the Chinese against the Taliban that they're fighting, but I don't know exactly. I can't give you specifics on that, but perhaps somebody else can.

DR. PHARES: I will just address quickly a couple points. Chinese support for Sri Lanka against the separatists is logical because China feels the success of separatists in any other spot will inflame its own separatists. That's on the political level.

With regard Pakistan, what the Chinese can and have and could provide assistance with to the Pakistanis would be the whatever the Pakistani's Eastern kind of weapons they have, meaning former Soviet or taken from the Taliban or others. But the Chinese and the Pakistanis do not have a strategic relationship in terms of equipping the Pakistani Army, et cetera.

The third point is that what we've noticed is as of August 2008, there was an increase in statements made by Chinese and Pakistani authorities about Pakistan and China having agreed to coordinate and help closely with each other in the fight against terrorism.

So, in counterterrorism measures, Chinese and Pakistanis are talking to each other, most likely sharing intelligence, possibly going to training, but I haven't seen any information about official Chinese support to Pakistan in terms of that training.

CHAIRMAN BARTHOLOMEW: Mr. Denmark.

MR. DENMARK: A significant part of China's military assistance to Pakistan is the JF-17 multi-role fighter and really to production facilities that Pakistan could produce its own.

This fighter is fairly advanced, fourth generation fighter, and to be honest has very little utility in a counterinsurgency operation.

One of the issues I think we--it's not a primary issue, but it may be a secondary issue, when talking to the Chinese about resolving internal Pakistani security issues is looking at how the weapons they give to Pakistan, the weapons they sell to Pakistan, and looking at whether or not that helps them focus on internal insurgency issues or focus on deterrence against India.

To me the JF-17 is very much an India-focused platform for the Pakistanis, and I think that's something that not right away but as we get into the issue is something that the U.S. and China should look at.

CHAIRMAN BARTHOLOMEW: Thanks.

Dr. Phares, I'd just note that the separatist movement that had been going on inside of Sri Lanka has been going on for the past 20 or

25 years, at least, and it's been essentially since the Chinese have become interested in building its port in Hambantota that the assistance, the military assistance, seems to have been taking place, and I was just wondering about surge capacity.

MS. CURTIS: I think another issue here is, from India's perspective, it sees the increased relations with Sri Lanka, as well as the investment in the port in Bangladesh, and the increased relations between China and Bangladesh, as China trying to make inroads into South Asia surrounding India.

So that would be the Indian's perspective on why so recently has China taken interest in supporting Sri Lanka in the ethnic war.

DR. PHARES: And to add to it quickly, let's look at the war as between Sri Lanka and India as separating the Tamil ethnicity in the same way the AFPAC separates the Pashtun. The larger group of Tamil exists inside India so Chinese support to the central government of Sri Lanka is, in a sense, and I agree, sort of containment of India.

CHAIRMAN BARTHOLOMEW: Geopolitics again.

DR. PHARES: In a sense.

CHAIRMAN BARTHOLOMEW: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Thank you very much.

My question is the following: we sometimes get from the Chinese raising the specter of suspicion about what our--quote--unquote--"real" intentions are in South and Central Asia with our ongoing operations and basing and so forth. We got that again last week.

To some degree, they're right. We have all kinds of intentions. Our first intention obviously is to win the war against al-Qaeda and the Taliban. But have any of you seen Chinese concerns with us actually being victorious in Afghanistan and Pakistan and staying in the region, in Central Asia, because we would have ongoing interests there including interests with respect to China's growth and power?

And how stable do you think those relationships and basing agreements we have in Central Asia are for operations after, presuming a victory in Afghanistan and Pakistan?

DR. PHARES: I'll begin with a couple points here. The political psychology of the Chinese leadership knowing what China's regime is--it's a one party--so the debate is not that high in the media in China as is in liberal democracies. Having said that, the Chinese leadership feels that they are projecting power as far as Sudan, as far as many other places in the Middle East, probably projecting economic power in Latin America.

So it is a grand design of a grand power. To have another grand power sitting at the southern and western borders of China is an issue of debate and discussion within the Party and, of course, within the government.

Number two, what can mitigate this and make it more acceptable probably for the Chinese so that international forces, U.S.-led, NATO or probably others would-be presence across from the borders is a multilateral agreement, is that the Chinese will be involved in at least the discussion and the design of the counter threat, in a sense.

We may invite the Chinese to come to Afghanistan. We may invite them to sit down and discuss a regional strategy against the Taliban. They may come and discuss it internationally, and then project it as they have been solicited, and so it would go for the Russians or the Indians.

But they may not actually send troops, but we are now below the level of what can secure the Chinese psychologically, meaning they see it as we are unilateral. We go there even with our NATO allies, even if we are accepted by the local governments, they feel that there has not been enough international framework/fora where they can sit with us, discussing it, even if they do not actually commit to send forces.

HEARING COCHAIR BLUMENTHAL: To put a finer point on this, my point is that we have interests inside Central Asia in terms of checking China's rise--okay. And that's just a fact, I think. And my question then is are the Chinese concerned actually about us winning and staying rather than losing and having an Islamic extremist government on their borders?

MR. DENMARK: An issue that I tried to get to in my testimony, I think the Chinese are of very split minds about this issue. On the one hand, they, of course, they're very concerned about the plan to contain China's rise and surround China, et cetera.

Yet, they also realize that they need the U.S. to maintain stability along China's periphery. Right now they're free-riding--U.S. providing stability along its periphery. And this is a very problematic situation for them in that they can't provide security themselves. They need the U.S. to provide the security. Yet, they also see this as part of a broader, more strategic plan to contain China's rise.

Are they concerned about the long-term? I think it's possible that they're concerned. The U.S. has bases in Japan and Korea. Yet, this hasn't stopped China from having a robust diplomatic and economic relationship with these countries.

In the future, if the U.S. does decide to maintain bases in Central Asia, including in Afghanistan, this shouldn't prevent China from also

having robust diplomatic and economic relationships with these countries as well. I don't see why Japan and Korea would be different than Central Asia from that perspective.

DR. PHARES: I may add one point here. The tipping point is going to be Chinese perception of their national security in Xinjiang. That's the tipping point. If they feel--and I understand from your discussions that they feel they are in control or so their message is--if they feel that there is no threat over the next five to ten years, then they'd rather see U.S. and NATO out and local stable countries which won't have any influence inside the Chinese borders.

But if their analysis is along what I've just mentioned, that if we fail, U.S. and our allies, in both countries, in Afghanistan and in Pakistan, this is going to lead necessarily to a huge instability inside Xinjiang. Then probably this would be the point where they would consider our presence, as my colleague mentioned, as utile, as acceptable, but the "save face" strategy is very important. Even in that case, they would like to be appearing in front of their own Party and in front of their own citizens as part of the agreement for why these forces are staying.

HEARING COCHAIR FIEDLER: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman.

Mr. Denmark, in your testimony, you point out that the U.S. economy continues to flounder, and that that will constrain the ability of the U.S. government to continue to support military operations in Afghanistan and Pakistan, and you point out the U.S. military is constrained by two ongoing wars, and it's unclear how much longer the American people will support continued deployment overseas.

With that, and I remember, I think Congressman Obey, who is the chairman of the House Appropriations Committee, made some comments about the appropriation for the war and how much longer there would be support.

How much are we spending on the Afghanistan/Pakistan war? Where do we get that money? Are we borrowing that money from the Chinese? And should we seek Chinese help in funding this if it? Why should we be borrowing? If it's in their interests and our interests, why don't we get them to fund it, rather than borrow it to help us fund it, because I think there's a lot of concern in this country about our budget deficit and how quick it's growing, et cetera. So just help me think through those issues a little bit.

You're welcome to comment, Dr. Phares or Ms. Curtis.

MR. DENMARK: I'm sure my co-witnesses can give you a much more exact figure on how much the war costs per month or per year than I could.

In terms of how we're paying for it, of course, money is fungible. I think that you can tie increased debt, increase--the Chinese purchasing of U.S. debt towards increased war costs. I think that's a pretty easy case to make.

Why do the Chinese purchase these? I think part of it is increasing the ties of our economic relationship. But more importantly, the U.S. is a good investment, and I think the Chinese recognize that the U.S. is a good investment over the long term, and that's why they buy our debt.

In terms of getting the Chinese to start paying for some of this, I think that is what is in part behind the White Paper that has been referred to before that came out by the Obama administration that calls for international assistance in paying for reconstruction in Afghanistan, paying for reconstruction in Pakistan, and improving the economies and the governance in both of those countries.

I think that's where that comes from, is that it's not just a U.S. problem, it's an international problem, and what I argued in my testimony, and my co-witnesses also seem to be arguing, is that China has an important stake in maintaining stability in these countries and should therefore contribute to international economic efforts to rebuild these countries.

DR. PHARES: From public information, we are going to be spending \$95 billion a year on--

COMMISSIONER MULLOY: \$95 billion?

DR. PHARES: \$95 on Afghanistan. And we are going to be spending \$1.5 billion on Pakistan for the next five years more or less.

I don't know the origin. I'm not expert on what's the origin of the cash that we're going to be spending, but I can make one point here, is that it's an open field. Engaging the Chinese, asking them to come forward, spending money or working with us on counterterrorism is something that we can do, and there is no risk in doing it. And we should increasingly do so because at some point in time, there will be a breaking point.

Because of the growth and the rise of that threat within their own borders, they're going to weigh in the situation and see that the United States is asking them, the two countries. We can also work, we need to work with Kabul and Islamabad to have this triangular approach to China, and call on China to spend more and to do more, and at some point there will be a breaking point.

The only thing I'm sure about is that if we don't do it, they'll be very happy that we are spending. If we don't ask our partners around the world to spend dollars or euros or whatever, they're going to be happy. So I think the Obama administration has a good opportunity to

approach aggressively China and the other partners, and tell them why don't you come in. But we have to make sure that they understand that there is a threat.

It's not just a why don't you pay? It's there is a threat and if you don't, we're going to explain to them in the next five and ten years, this is going to happen, and when it will happen, we'll have the luxury of telling them we told you so.

COMMISSIONER MULLOY: China, of course, by keeping its currency underpriced is able to accumulate the big cash from us, which they then reinvest. They got the dollars so they help reinvest them in our Treasuries to help finance our budgets because that's an investment for them. They're also going to put more money into other things and resources around the world and other things.

So I just think it would be very helpful for us to get them to, rather than us borrowing the money, that they help fund these efforts because it seems to be the consensus here that they gain from this whole effort that we're making in Afghanistan and Pakistan.

Ms. Curtis, do you have any?

MS. CURTIS: No, I agree completely that the Chinese have basically been free-riding. They want us to do the heavy lifting. Yes, they want stable borders, but we're the ones that suffer from anti-Americanism. The Chinese come in, they do investments, economic support, so we definitely have to get them to pull their weight more in these two countries.

And just in terms of the assistance of Pakistan, it was 12 billion in military and economic assistance from 2001 to 2007, and in addition to the 1.5 billion that Dr. Phares talked about--that's economic assistance--there will probably be at least another billion in military assistance going to Pakistan. So you're looking upwards of two billion per year to Pakistan over the next five years.

But, yes, absolutely, I agree. But the freeloading is not only coming from the Chinese. I'd just mention that our European partners, even though most of the terrorist plots that have either been wrapped up or that have been carried out have been towards Europe, yet we don't see the commitment that we should from those countries as well going into Afghanistan and Pakistan.

COMMISSIONER MULLOY: Thank you all very much. Very helpful.

HEARING COCHAIR BLUMENTHAL: Well, thank you all very much.

We're going to wrap up, and this was a very enriching session. So thank you all for your testimony and coming out here today.

DR. PHARES: Thank you.

HEARING COCHAIR BLUMENTHAL: We're going to break for lunch, so we'll be back at 1:15.

[Whereupon at 12:15 p.m., the hearing recessed, to reconvene at 1:15 p.m., this same day.]

A F T E R N O O N S E S S I O N

PANEL III: CONTINENTAL ASIA IN CHINA'S ENERGY STRATEGY

HEARING COCHAIR BLUMENTHAL: Welcome back to our third panel. This afternoon we're going to focus on continental Asia and China's global energy strategy, and we have two very well-known and respected experts to cover those issues for us.

Ms. Nanay is a Senior Director for PFC Energy's Country Strategies practice. She heads the firm's Russia and Caspian Service, where she provides clients with risk analysis for investment in the oil and gas industry, concentrating on Russia and the Caspian region.

Dr. Blank has served at the Strategic Studies Institute. He has been an expert on the Soviet bloc and the post-Soviet bloc since 1989.

I suppose you couldn't be an expert before that on the post-Soviet bloc. He also has written many articles and conference papers on Russia, the Commonwealth of Independent States, and Eastern Europe.

His current research deals with proliferation, the revolution in military affairs, and energy and security in Eurasia.

Thank you for joining us. We look forward to your testimony, and we'll begin with Ms. Nanay.

STATEMENT OF MS. JULIA NANAY SENIOR DIRECTOR, PFC ENERGY, WASHINGTON, DC

MS. NANAY: Thank you.

You all have the paper in front of you or you have had it in advance, but I will summarize some of the points from my paper. I work on the bigger Caspian region, Russia, Kazakhstan--the Central Asian countries, and I have also done a fair amount of work on Iran.

I think the issues that are actually quite important right now for the Chinese role in this region is that particularly with the financial

crisis that governments including Russia have been reaching out to the Chinese because they have money, and Kazakhstan has done the same very recently, and there's been a number of loans for oil deals concluded. I think the interesting element in all of this is that for Kazakhstan, there has been a pretty long relationship with China.

The Chinese companies have been active there since the 1990s, working in various ways in the western part of the country, but until very recently, there was a sort of concern by the Kazakh government that perhaps the Chinese companies were getting too great a role.

Now, that worry or fear perhaps remains to some extent, but it's been whittled away by the fact that China is able to help Kazakhstan in two very important ways. One is that Kazakhstan needs money and China is able to help on that front, but also Kazakhstan sits in a landlocked position in Central Asia. It's a vast country with large resources of both oil, gas, and also uranium, and the Chinese provide access across the border.

They share a very long border and China is able to come in and build pipelines. It creates an option for Kazakhstan. It creates an option for Turkmenistan in the sense that prior to the break up of the former Soviet Union, everything was oriented from South to North. Everything went to Russia and that created a sort of monopoly hold on the energy sector in these countries that it is really the Chinese that have helped to create optionality, and optionality is good for everyone.

It's also good for the U.S. We like to diversify our sources of imports and access and China has allowed the Central Asians diversification.

The Chinese, of course, have a strategic goal in the region. It's neighbor countries, it's easy access to energy resources, and you know the Chinese companies are state companies. They can deal on a government-to-government level. And currently at a time where really if you're working in the oil industry, you see the importance of state companies that are basically dominating in the oil and gas sectors. So Chinese state companies deal with other state companies in this region, and they're able to work together.

As I said, these deals are government-to-government, and it's very different than the international oil industry.

So while in a country like Kazakhstan, clearly Chevron and ExxonMobil, two U.S. companies, which have dominant roles there and will obviously have dominant roles there--they're important companies to Kazakhstan and the Kazakh government-- there is this new element where in fact the Chinese are able to spend the money to buy up smaller assets that the international oil industry would not likely be interested in.

And then they're able to connect all of this up with the pipelines that they're building and start orienting these assets to some degree towards China. For now it's been oil, but as China rapidly builds up its need for natural gas, also because there is a climate change element, the need to reduce coal use, gas is a logical fuel for that. It's also sitting there next door. I think Kazakhstan presents potential opportunities for gas, but it's Turkmenistan that is the major player in that as we all know.

I've been to Turkmenistan a number of times in the last few months, and it is really quite striking to see the inroads that China has been able to make there and it's not recent. The Chinese, as in Kazakhstan, have been in Turkmenistan since the 1990s, and they've been working with the government on a number of projects, Chinese state companies. Again, they operate under different constraints than an international oil company.

Their needs are more strategic than it is profit maximization. It's less immediate. It's long term. So they are building a pipeline now from Turkmenistan to carry gas across Uzbekistan, Kazakhstan into China. These are very long-distance pipelines, and a few short years ago, no one would have imagined that such long distance pipelines would make any sense, but for the Chinese they make strategic and political sense, and again for Turkmenistan, which is a country that has been so highly dependent on shipping the majority of gas exports to Russia, China presents another option.

So it's optionality, and I have to also make the comment, is that the markets for oil and gas in the future, if you look at where the demand growth has been really since the year 2000 for oil, it's really in the Asian markets where we see the largest growth, and I think in the future when the demand growth picks up again, the orientation will be more Asia than it is the OECD and the West.

And for these landlocked countries of Central Asia where the U.S. has essentially made it more difficult for them to orient towards Iran, really China is the country that then moved into capture the opportunity to carry resources to Asia because originally Iran could have been the country that basically captured more of this, and then it would have been shipped out to Asia from the Iranian ports.

But, ultimately, I think the Chinese presence brings benefits. I see it as, yes, it is competition, certainly for the West, and it is resources that potentially the West would like to see a lot more of oriented in another direction. But sitting where these countries sit in Central Asia, I think the Chinese direction does make a whole lot of sense, and we'll see whether eventually as these pipelines are up and running, these very long distance pipelines, if even Western companies

don't find a way to feed some of their resources into these pipelines.

I'm trying to think whether there are other points. The Chinese also have been very active in Iran, which is another country that I know to some extent probably there is some interest in, and again it's because while others have been isolated from this country, the Chinese have been able to fill a need, and I think there are ties throughout this region that are there and I think they're going to continue to grow.

Thank you.

[The statement follows:]

**Prepared Statement of Ms. Julia Nanay
Senior Director, PFC Energy, Washington, DC**

China's growing appetite for oil and natural gas imports is reshaping geopolitical relationships in its neighborhood and has implications for U.S. foreign policy. China became a net oil importer in 1993 and since then has worked assiduously to build its ties and assets (including upstream and pipelines) in Russia and Central Asia and has extended its interests into Iran. Chinese state companies have begun to eclipse the output of U.S. firms Chevron and ExxonMobil in Kazakhstan, and Chinese firms are challenging the U.S. in Turkmenistan, Uzbekistan and in Iran, where they are getting access to important exploration and production opportunities while U.S. companies remain sidelined. China concludes its business deals on a government to government basis, a process of entry for its state firms that is very different from the way private U.S. companies do business.

Chinese companies are partnered with regional state entities in oil and gas pipelines in Kazakhstan and in a gas pipeline from Turkmenistan that crosses Uzbekistan and Kazakhstan. China's status as a cash rich economic powerhouse needing energy to fuel its industries, and with money to pay for it, makes it a magnet for Central Asian suppliers that will serve to draw their resources to the East. It is proving particularly attractive to these landlocked producers. Kazakhstan shares a 1,700 kilometer border with China.

With countries to its north, west and southwest that have major resources, China has embarked on a course of getting on the ground in all these places and it is gaining leverage over considerable energy wealth. This can be seen as a win-win situation for China and for the Central Asians. China strengthens its energy security, while Central Asian countries diversify their export options and get investments and cash. By extending its reach into Central Asia, China also helps to develop its western Xinjiang Province, where the Muslim Uighur minority poses a risk of separatism. Thus, oil and gas supplies from Central Asia help fuel the Chinese economy and contribute to both its energy and political security. Central Asian gas links will tie Turkmenistan, Uzbekistan and Kazakhstan to China giving them all a stake in this infrastructure's security and making it more likely that these countries will cooperate with China on other security and anti-terrorist measures.

While some governments and state companies, most notably in Kazakhstan and Russia, are suffering the fallout from the financial crisis and lower oil prices, China is primed to take advantage of the opportunities this offers for coming to the rescue of its resource rich neighbors. What's more, China's economy, along with other Asians like India, will be future drivers of both oil and gas demand. In earlier days, it was thought that Iran would be the best conduit for accessing Asian energy markets from the Caspian but once Iran's role was limited by U.S. and multilateral sanctions, it was clear that another route to Asia would need to be found. A decade ago it was difficult to imagine such long distance pipelines like the ones China

is now constructing as being the solution but this has become the means to reach energy hungry eastern markets. Clearly, China's inevitable demand uptick over the next years will exert an important influence on global oil markets.

After the United States, China has become the world's second largest consumer and importer of oil (buying about 3.5 million barrels per day on world markets) and relying on the Middle East (including Saudi Arabia, Oman, Iran and Kuwait) for about 45% of its imports. While its oil production from Central Asia is minor, about 10% of its import demand, China's expanding pipeline connections will support access to growing oil and gas volumes from Central Asia and Russia, in addition to volumes it produces in these areas. China may then be able to at least diversify its supplies away from Middle East oil, although this reliance is bound to remain significant. Eventually, competition could result between the West and China for the Caspian region's supplies.

In terms of natural gas, China's consumption has been rising at a more modest pace than oil. Until 2007, it was able to meet its needs largely from domestic production. But its gas import requirements are starting to take off, which is why China now pays as much attention to building gas pipelines from Central Asia as it does to oil. In fact, the gas connections to Central Asia may eclipse the importance of oil in the years ahead, as China tries to increase the clean fuel component of its energy mix and mitigate the impact of its heavy dependence on coal.

The most active Chinese company investing in Iran, Kazakhstan, Turkmenistan and Uzbekistan is China National Petroleum Corporation (CNPC), with Sinopec and other smaller players also taking stakes. CNPC is also increasing its ties with Russian state company Rosneft, with which it has an exploration JV in East Siberia and is looking to cooperate in refining in China. CNPC is the pipeline construction expert among Chinese companies and this makes its regional role a natural phenomenon as China seeks to deepen its energy ties with infrastructure links.

CNPC is the provider of the latest loans for oil deals in both Russia and Kazakhstan. As a result of the arrangement with Russia, by 2011 CNPC will import 300,000 barrels per day of oil through a new pipeline from Skovorodino in East Siberia, a project that has been on the drawing boards for a number of years. It was only with the conclusion of a \$25 billion loan in February (\$15 billion to Russian state company Rosneft and \$10 billion to pipeline monopoly Transneft) that China was finally able to secure this 20-year, 300,000 b/d oil flow to its northeast. How much oil CNPC draws away from West Siberia and other export routes for the new pipeline will depend on the level of oil produced by Russian companies by 2011 in East Siberia. Eventually, CNPC may also produce oil in East Siberia. There are plans to expand the Russia-China pipeline to 600,000 b/d at some undefined future date.

With the breakthrough oil for loan deal of February, there has been a thaw in tensions between Moscow and Beijing and the precedent has been set for further energy cooperation between these two historical rivals. Still, longer term, the competitive nature of the Russian-Chinese relationship in Central Asia could emerge as a problem between these two powers and cause frictions in their energy ties with each other. This may be borne out particularly when Chinese gas purchases from Central Asia begin to escalate. Eventually, however, once Russia begins to develop its own gas resources in East Siberia, China will be a natural export destination for this gas from Russia.

Another loan-for-oil deal was concluded with Kazakhstan in April, with CNPC providing \$5 billion to Kazakhstan's state company KazMunaiGaz (KMG), money it needs to purchase the country's fourth largest producer, MangistauMunaiGaz (MMG), from private owners. KMG will then give CNPC 50% of MMG, a transaction valued at \$1.4 billion, probably calculated against the loan amount. In Kazakhstan, CNPC (since the 1990s) along with Sinopec and CITIC (more recently) have been building up producing

assets which, when the purchase of MMG is completed in July, will reach 355,000 b/d. This level of production will be equal to the output of KMG and larger than the combined output of Chevron and ExxonMobil in Kazakhstan.

Chinese company activities in Kazakhstan are substantial and wide-ranging. These involve everything from producing oil and gas to building gas processing plants and oil and gas pipelines. By 2011, a 400,000 b/d oil pipeline will extend from the western oil fields of Kazakhstan, 3,000 kilometers across the country, to the Chinese border. CNPC already owns 50% of one of Kazakhstan's 3 refineries, in Shymkent. It is the only foreign company to have a stake in a Kazakh refinery. In addition, there are plans for CNPC to build a new joint refinery with Kazakhstan near the Chinese border. China is also providing money and participating with Kazakhstan in the construction of a gas pipeline from western Kazakhstan to the east, where it will meet up with a new pipeline China is helping to build from Turkmenistan across Uzbekistan and Kazakhstan to China. Chinese companies have recently signed a JV to produce uranium in Kazakhstan while also getting Kazakh participation in the construction of nuclear plants in China to be supplied with Kazakh uranium production. In addition to oil and gas, Kazakhstan is rich in uranium and is seeking to become the world's largest uranium producer by 2010. Because the Kazakh government is short of money, it has opened up to Chinese participation in uranium production.

In Turkmenistan, CNPC is the only foreign company to have signed a Production Sharing Agreement (PSA) to develop gas fields in the prolific Amu Darya Basin in the east near the Uzbek border. Over the next years, Chinese imports of Turkmen gas will rival the volumes currently under contract to Russia. As China moves this year to finish off construction of the 2,000 kilometer gas pipeline to its border from its Turkmen gas fields, it will create a major competitor to Russia for Turkmen gas supplies and will provide Turkmenistan with leverage to negotiate attractive gas sales prices with all its customers.

Turkmenistan's large gas reserves have attracted interest from many international companies, including U.S. firms, but since Chinese companies have been working with the Turkmen government since the mid-1990s, providing drilling rigs and services, they have succeeded in moving to the front of the queue. They are already drilling wells in the giant South Iolatan field, which UK firm Gaffney Cline and Associates (GCA) estimated in October 2008 to hold up to 14 trillion cubic meters (tcm) of gas reserves. An Iranian company is also negotiating a contract to drill in South Iolatan. This field is being eyed by our own industry as a major source of gas supplies, possibly even for a western route but U.S. companies have so far been unable to access opportunities in Turkmenistan's onshore. One reason may be the proximity of Turkmenistan's resources to Iran. In addition to exports through an existing system to Russia, a smaller pipeline was built in 1997 to export natural gas to Iran. For Turkmenistan, which values supply diversification, Russia, Iran and China are all important and more immediate export options than a western route for gas exports, which is still just in the planning stages for the future.

In Uzbekistan, CNPC has partnered in four exploration projects and is involved in constructing the gas pipeline which crosses from Turkmenistan to Kazakhstan and China. Finally, Chinese companies have either received stakes or continue to negotiate positions in some of Iran's largest oil and gas fields. For China, Iran may represent another piece of the Caspian puzzle. Its resources can be accessed by sea in the south and maybe eventually even by pipelines to the north. Piece by piece, China is building vast pipeline networks that tie this bigger region to the East.

As China's energy ties grow with Iran, Kazakhstan, Russia, Turkmenistan and Uzbekistan, these countries will develop deeper political and geopolitical ties with their eastern neighbor. U.S. leverage for various goals, whether in democratization, human rights or commercial concerns, will diminish. China's ties to Iran are a more immediate case in point. They have been forged over many years while the U.S. isolated itself from this country. These ties are deepening even as we speak. For China, this whole area is

considered to be in its neighborhood and when any of these countries come calling for money and assistance, China can provide it.

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

**STATEMENT OF PROF. STEPHEN J. BLANK
STRATEGIC STUDIES INSTITUTE, U.S. ARMY WAR COLLEGE
CARLISLE BARRACKS, PENNSYLVANIA**

DR. BLANK: Thank you, Mr. Blumenthal. I'd like to thank the committee for inviting me. It's a great honor to testify before you.

Since I am an employee of the U.S. Army, I need to reiterate that my testimony does not reflect the views of the Army, Defense Department or the U.S. government. I will also try to summarize the written statement that you have before you.

China has exploited its relatively stronger position due to the current global financial economic crisis to buy up energy positions throughout Asia, and I may add that the committee asked me specifically to look at the recent deals with regard to Russia, Kazakhstan, Myanmar and broadly Iran.

In doing so, China is essentially continuing the strategy that it had developed before the crisis began last year of coming into energy-producing areas and buying up access to energy production at above-market prices.

Now that the energy price has fallen by a factor of about 70 percent from its high last year, China is able to buy up distressed firms and access to their energy products. Often these are state firms, as Dr. Nanay pointed out, and to do so at prices that are quite reasonable from its point of view, and it is able to do so because of its huge cash reserves.

China, I believe, is also buying up access to pipelines for both oil and natural gas and for that matter uranium, and potentially electric power as well, as part of a broader strategy of enormous expansion of China's overall infrastructure throughout Asia. If you look at what China has been doing in its interior and to the South and West, in terms of its overall infrastructure, these pipelines fit in very nicely with the overall attempt to build up a huge Asian interior infrastructure encompassing China and its neighbors.

As Dr. Nanay said, the neighbors benefit because, particularly at a time of crisis, they get economic relief, they get cash, and they have an option of a second customer or a third customer other than Russia who was breathing down their neck and putting a lot of pressure on

them.

But beyond that, China's overall strategy, and I do believe it is a strategy, given the presence of state banks and state corporations working together to buy up distressed energy firms or access to energy fields, is to gain what it considers to be energy security.

As I see it, energy security for China is essentially having a secure pipeline network overland that does not have to depend on maritime transport. In peacetime, China's main customer or main export source for energy is the Gulf and the Middle East and its purchases of Middle Eastern oil have actually increased through 2008.

However, the Chinese government is quite anxious about the possibility of their being more conflict either in the Middle East or in and around the Indian Ocean or in the oft-cited Taiwan scenario in which the U.S. or perhaps Indian Navy could close the Straits of Malacca or the Indian Ocean to Chinese maritime transport.

In that case, China would then have no independent source of energy except what it could get overland. And I would submit that the strategy we see today of buying up these firms is connected to this Malacca Straits anxiety or what the Chinese call the Malacca question in order to obtain economic strategic security for China and also to develop its own interior like Xinjiang and Tibet in order to prevent more uprisings like those we saw last year because China believes that economic development is the answer to ethnic unrest in its country.

Finally, and this is, I think, of critical importance, we see a pattern as well by which China is able to leverage its superior economic power vis-a-vis these states in order to induce them to change their previous policy preferences on key questions relating to the sale and distribution of their energy, which suggests that in broader terms, China is beginning to be able to leverage its economic power in order to induce Asian states into a pattern of accommodation with China's preferences.

Now, they benefit from those preferences and sales, as we have pointed out, especially at a time of crisis, but nonetheless, it is clear that China is able to influence their policies in a direction that suits China more than it might have suited those states in other times.

Thank you.

[The statement follows:]

**Prepared Statement of Prof. Stephen J. Blank
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Chinese Energy Policy in Central and South Asia

Testimony of Professor Stephen J. Blank
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Before the US-China Economic and Security Review Commission,
The Impact of China's Economic and Security Interests in Continental Asia on the
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China has exploited the current global economic crisis to intensify and accelerate its previous strategy for obtaining energy security and political influence abroad. This strategy's tactics are quite straightforward. Exploiting other countries' and firms' distress, using its enormous cash reserves, and benefitting from the fact that its economy appears to be less adversely affected than others have been, China, through its oil companies CNOOC, CNPC, Petro China, SINOPEC, or through governmental agencies, is either lending afflicted firms and countries (often the same since we are dealing with state energy firms) money to obtain long-term contracts, access to energy, and other commodities at below market prices if possible, and at the current low market prices where necessary. However, these are not new tactics specially crafted for the current crisis. Rather they are the same tactics that China employed earlier. But now they have much greater effect given the current crisis and the availability of so many properties from countries and firms afflicted by it.

China's economic activities abroad during this crisis are also not tied to energy alone. China is making strenuous efforts to buy into Australia's minerals sector in copper, gold, and aluminum.⁵² It also recently offered a \$15 Billion credit to ASEAN members and is seeking to establish a \$10 Billion investment fund for Southeast Asian countries for projects connected with construction, infrastructure, energy, resources, information, and communications.⁵³ Beyond those projects,

China also planned to offer 270 million Yuan (\$39.7 M) in special aid to Cambodia, Laos, and Myanmar to meet urgent needs, inject \$5M into the China-ASEAN cooperation Fund, and donate \$900,000 to the cooperation fund of ASEAN Plus-3, the side grouping of ASEAN plus China, Japan, and South Korea.⁵⁴

Chinese scholars are also discussing a free trade zone and vastly enhanced mutual Chinese-Southeast Asian investments in each other's country, a strategy that can only

⁵² Banyan, "Australia's Chinese Entanglement," *The Economist*, May 2, 2009, p. 46

⁵³ "China Offers Funds to Boost ASEAN," *BBC News*, April 13, 2009, www.news.bbc.co.uk

⁵⁴ *Ibid.*

enhance China's presence in Southeast Asia's economies.⁵⁵ Furthermore, because of China's relative strength and large cash reserves Asian countries like Vietnam are, according to David Pilling of the Financial times, "humbly beseeching China" for almost \$15 billion of investments in Vietnam's bauxite.⁵⁶ In other words China both seeks such investment opportunities and is being solicited to make them by governments who either have a large trade debt to China like Vietnam, or are economically distressed due to the current global crisis. These far-ranging investments outline a global strategy that is at work not only in Southeast or Central Asia, but also in Latin America and Africa. Across the globe China deliberately complements its economic assistance and energy acquisitions with arms sales, military support, political support in the UN and other fora like the Shanghai Cooperation Organization, conducts other investments to build up infrastructure, provides economic aid, and buys up massive amounts of agricultural and industrial raw materials.⁵⁷

Thus China secures the long-term access to energy and commodities it wants at low prices, gains equity access to those energy fields or pipelines, and also obtains considerable influence and political leverage over the host government. In return it allows these distressed firms to gain capital and access to China's consumer market whose energy demand remains robust.⁵⁸ Indeed, China's total oil imports hit a one year high in March 2009, indicating continuing strong demand. China thereby engenders a mutually profitable but dependency-inducing long-term relationship with these energy providers and their governments. The instruments of China's energy strategy are its major energy firms, banks, and state lending agencies and they clearly work together given the size and scope of recent acquisitions across the globe.

China's actions also bear all the earmarks of a global strategic plan of action as the opportunity for China to use its economic power to secure unchallengeable positions in Eurasia and elsewhere presents itself.⁵⁹ Even though China's national oil and energy companies do not always see eye to eye with the government and even though much of the oil fields they buy produce oil that does not go to China, the confluence of energy buyouts of foreign assets and state lending to those governments as well as the breadth and duration of China's actions over time clearly indicates a considered policy and strategy.⁶⁰ China's global shopping spree also reflects its persisting belief that it cannot

⁵⁵ Zhu Yifan, Fan Xi, and Chen Yin, "Do Not Let Your Neighbor Collapse, --emerging Asian Economies Seek Internal Support," Beijing, *Xinhua*, in English, April 17, 2009, "Open Source Center, Foreign Broadcast Information Service Central Eurasia (Henceforth FBIS SOV), April 17, 2009

⁵⁶ David Pilling, "Asia Pays Tribute to Its New Superpower," *Financial Times*, May 7, 2009, p. 15

⁵⁷ Simon Romero and Alexei Barrionuevo, "Deals Help China Expand Sway in Latin America," *New York Times*, April 15, 2009, www.nytimes.com for examples from Latin America; Arianna Eunjung Cha, "China Uses Global Crisis To Assert Its Influence," *Washington Post*, April 23, 2009, www.washingtonpost.com

⁵⁸ "China's Energy Consumption Rises By 3.04 PCT Last Year-on-Year in Q1-NBS," *Interfax*, April 30, 2009

⁵⁹ Romero and Barrionuevo; Cha

⁶⁰ Trevor Houser, "The Roots of Chinese Oil investment Abroad," *Asia Policy*, Number 5 January 2008, 141-66; *The Rise of Asia's National Oil Companies*, energy Security Survey 2007, Special Report, NO. 14, 2007, National Bureau of Research Asia, www.nbr.org

ultimately rely upon the market to deliver energy, its determination to strike now while the iron is hot in terms of acquiring distressed properties, and its efforts to implement its concept of energy security. That concept is simple. Energy security means having reliable, long-term, and diverse supply sources that cannot be interdicted, particularly in the Straits of Malacca, and tying suppliers to China both economically and politically through long-term deals.

China is merely extending its earlier strategy that was launched about a decade ago and that has continued despite unprecedented high energy prices through 2008. That strategy and ambivalence about relying on markets reflected the fundamental security orientation of China's thinking about energy supplies. Despite widespread concern then that China was locking up long-term assets, in fact it was buying assets that were then excluded from other competitors. Actually China's previous sprees only got it about 2% of the global energy market in oil.⁶¹ However, today, as energy prices have collapsed and many major state-owned producers are in a crisis mode, China has huge cash reserves and remains relatively unhurt by the crisis. Therefore it can exploit this downturn with great alacrity to further its strategy under more auspicious conditions. Given low energy prices and widespread economic suffering in key countries, China has recently concluded major energy deals with Russia, Kazakhstan, Brazil, Venezuela, and can be expected to continue along this path. Indeed, China's recent global investment activities show that China uses its economic power to lend money to distressed governments and/or firms and then uses that economic power and the dependency it generates to secure political influence with those states. And it does this all over the world, e.g. Latin America.⁶²

Central and South Asia

China's strategy is clear. In conditions where Far Eastern infrastructure is only beginning to appear; where the Middle East remains as volatile as ever; and China's Straits of Malacca dilemma remains unabated, it must define energy security as having diverse suppliers, at least some of whom cannot be interdicted in the Indian Ocean by the US, Indian or other navies or other hostile forces. Yet as the Middle East remains its largest source of energy, China's strategy is clearly both one of hedging against the future and of extending its energy and other security links abroad through economic power.

Second, China also seeks to tie Central Asian producers to it to deter them from supporting their cousins and coreligionists, Muslim rebels in Xinjiang, its own largest energy producing province. Third, to the extent that China can gain leverage over both

⁶¹ International Crisis Group, *China's Thirst for Oil*, Asia Report No. 153, June 9, 2008, <http://www.crisisgroup.org/home/index.cfm?id=5478>

⁶² Cha; Romero and Barrioneuvo,

Russia and Central Asian countries, it forestalls a Russian monopoly over Central Asia that could also be used to deprive it of energy or threaten its interests in Xinjiang as happened during the Sino-Soviet split of the period 1956-90 when Moscow sought to exploit Han-Muslim tensions there.⁶³ Therefore for geostrategic reasons it also seeks to avoid excessive dependence upon Middle Eastern and African producers even as it buys ever more energy from them, seeking producers as far away as Iran who can then ship gas and oil to it overland through new pipelines that China is helping to build in Kazakhstan, Turkmenistan, and Uzbekistan and which could ultimately connect to Iran. Beyond that China ties loans to energy because it not only gets back the loans plus interest it can now tie up energy assets in long-term contracts at reduced prices for exclusive access.

Central Asia is one of the links in this chain for China clearly invests its economic resources in countries with which it has a political affinity and which enjoy a dubious reputation abroad because of their authoritarianism. We find China replicating this approach in Africa, Latin America, and in Southeast Asia where it is Myanmar's staunchest foreign supporter. China also invests in these countries for two other reasons. Many other fields in producer states that were opened earlier are not available for sale and when China has sought to buy in major countries, e.g. its efforts to buy into UNOCAL in 2005, that action has raised a storm of disapproval from host states. But even bearing these things in mind, China's strategy began before 2005 and works remarkably well with its geopolitical strategy. This is unlikely to be a coincidence or fortuitous event. This political dimension is another reason why China's energy strategy is also connected to its overall foreign policy and defense strategy and may be thought of as mutually reinforcing aspects of its overall grand strategy.⁶⁴

For example China's Export-Import Bank is lending the state-owned Development Bank of Kazakhstan \$5 Billion, and CNPC is lending Kazmunaigaz, Kazakhstan's state-run gas company, another \$5 Billion. Moreover, CNPC is buying a 49% minority holding in Kazakhstan's company AO MangistauMunaigaz from KazMunaiGaz National Co.⁶⁵ This deal enables Kazakhstan to continue its robust pace of exploration for oil, which finances its overall development plan whose long-range aim is its comprehensive economic diversification and modernization. Having received an estimated \$21.1 Billion in 2008 in investment for exploration and production, it needs to keep that up during this crisis to prevent an even more severe economic contraction. Kazakhstan's state news agency Kazinform said the \$5 Billion loan would help pay for the MangistauMunaiGaz deal and the construction of the Beineu-Bozoi-Akbulak gas pipeline, which will serve southern Kazakhstan.⁶⁶ Thus Kazakhstan's need for capital

⁶³ Lowell Tillet, "The National Minorities Factor in the Sino-Soviet Dispute," *Orbis*, XXI, No. 2, 241-260.

⁶⁴ Michael Swaine and Ashley J. Tellis, *Interpreting China's Grand Strategy: Past, Present, and Future*, Santa Monica, CA: Rand Corporation, 1996

⁶⁵ M.K. Bhadrakumar, "Cash-Rich China Courts the Caspian," *Asia Times Online*, April 18, 2009, www.atimes.com

⁶⁶ *Ibid.*; "Kazakhstan: A Chinese Energy Loan," www.stratfor.com Analysis, April 17, 2009; Joanna Lillis, "Kazakhstan:

and reliable export markets plays into China's strategy and China's victory was clearly facilitated by its deep pockets and cash reserves.⁶⁷ But China's actions do not break with past Sino-Kazakh relations. Indeed, according to Kazakhstan's President Nursultan Nazarbayev, at least since 2006, "economic cooperation has become the major motivation for pushing the overall development of the Kazakhstan-China relationship."⁶⁸

Nevertheless this deal exemplifies the way in which China can now exploit the stricken condition of countries like Kazakhstan whose banking system is all but insolvent and where foreign investment has fallen by half since 2008. Indeed this deal gives China control over about 15 percent of Kazakhstan's total oil output and other Chinese firms have already been there for some time. Furthermore Kazakhstan's national nuclear power company Kazatomprom has begun mining uranium fields in southern Kazakhstan in a joint venture with Chinese nuclear power companies.⁶⁹ Terms of the deal also call for Kazakhstan to provide China with more than 24,000 tons of uranium by 2020. More recently, the China Guangdong Nuclear Power Group (CGNPG) and Kazakhstan's state nuclear agency, Kazatomprom, have agreed to form a joint enterprise that would build atomic energy stations in China.⁷⁰ Thus Chinese Prime Minister Wen Jiabao recently outlined a four point proposal for enhancing bilateral partnership that emphasized first of all maintaining the growth of bilateral trade, and second, fulfilling previous agreements and giving priority to cooperation in the energy and resource sectors. Then comes cooperation in investment and finances to ensure smooth implementation of construction projects. Finally both sides should promote cooperation in infrastructure.⁷¹

This strategy of gaining critical access to Central Asian energy neither occurs exclusively in Kazakhstan, or even Central Asia nor only in regard to hydrocarbons. Apart from lending Kazakhstan money China is also building power plants in Tajikistan and Kyrgyzstan and pipelines in Turkmenistan that will then go on to Uzbekistan so that it can buy gas from these countries at lower than normal prices. It also is mining iron ore in Kyrgyzstan from what is apparently Asia's largest source of iron. Not surprisingly the Kyrgyz government is encouraging further Chinese investment in its coal mining, non-ferrous metals, precious metals, and infrastructure sectors.⁷² Kyrgyz officials also want China to import electricity from the Kambarata power station that Russia is building to prevent surplus capacity and under production. Buying hydropower makes sense for China which has increasingly been pledging infrastructure assistance and cash to Central

China's Deep Pockets Make Beijing a Potent Player in Central Asia," *Eurasia Insight*, April 20, 2009;

⁶⁷ *Ibidem*

⁶⁸ "Interview With President Nursultan Nazarbayev of Kazakhstan,"

Beijing, *Xinhua Domestic Service in Chinese*, June 8, 2006, *FBIS SOV*, June 8, 2006

⁶⁹ John C.K. Daly, "Analysis: China Increases Stake in Kazakh Energy Assets," *UPI.com*, www.upi.com, April 28, 2009

⁷⁰ "China, Kazakhstan: Nuclear Power Deal Agreed," www.stratfor.com, April 30, 2009

⁷¹ "Chinese Premier Raises Four-Point Proposal. For china-Kazakhstan Cooperation," Beijing, *Xinhua* in English, April 17, 2009, *FBIS SOV*, April 17, 2009

⁷² "China Reform Monitor," April 15, 2009 from the American Foreign Policy Council, www.afpc.org, citing Interfax, April 15, 2009

Asian states through the SCO, e.g. helping Tajikistan build dams and roads. Moreover, China can become a handler or middleman, e.g. wiring Central Asia into Pakistan and Afghanistan and picking up huge transit and construction fees.⁷³ Likewise, in the past few years China has invested heavily in Afghanistan's energy and mineral resources, which have been found to be abundant, with a view to building pipelines either directly to China or possibly through the port of Gwadar and Pakistan to China.⁷⁴ As many analyses suggest, China ultimately hopes to ship Persian Gulf oil from Gwadar overland through Pakistan to Xinjiang in China.

Beyond that oil pipeline it is also considering a major infrastructural investment there to make it into an overall energy corridor where it sets up an oil refinery and Gwadar Port Energy zone that also accommodates other energy industries, and creates the basis for oil and gas exploration projects in Pakistan from which the latter will benefit as well.⁷⁵ Indeed, a comprehensive examination of Pakistan-China relations underscores the trend to deepen what had been essentially a security and geopolitically driven relationship with a strong energy and economic component comprising energy, trade, and investment by China in Pakistan.⁷⁶ Despite enormous Indian concern about China's naval strategy of using Gwadar or Myanmar's ports for military purposes, that task appears to be beyond the Chinese Navy's current and foreseeable capabilities as the PLAN admits, and the main purpose of Gwadar and other similar port projects appears to be for energy transmission and infrastructure.⁷⁷

Thus much of its investment in energy and infrastructure abroad in Central Asia seems to be connected or could easily be connected with its efforts to open up the port of Gwadar. Were this port to be established as a hub it could spare China the necessity of going through the Straits of Malacca and become the hub of a network of pipelines from Iran and the Middle East, if not also South and Central Asia, to China.⁷⁸ Indeed, China's so called string of pearls strategy in the Indian Ocean that combines large infrastructural

⁷³ Jian Yang, "Beyond Energy: China's Energy Relations With Japan and India," Paper Presented to the Annual convention of the International Studies Association, New York, 2009

⁷⁴ "Mining Boom Boosting Economics of Afghanistan," www.sananaews.com.pk, April 22, 2009; Ian McWilliam, "China Wins Major Afghan Project," *BBC News South Asia*, November 20, 2007; "Afghanistan Looking Mining Companies To Explore Iron Ore Mine," <http://paguntaka.org>, April 5, 2009; Niklas Norling, "The emerging China-Afghanistan Relationship," *Central Asia Caucasus Analyst*, May 14, 2008; Kevin Slaten, "China's Bigger role in Pakistan, Afghanistan," *South China Morning Post*, February 12, 2009, www.scmp.com; Ron Synovitz, "China: Afghan Investment Reveals Larger Strategy," *Radio Free Europe Radio Liberty*, May 29, 2008; Tariq Mahmud Ashraf, "Afghanistan in Chinese Strategy Toward South and Central Asia," *Jamestown China Brief*, VII, BNO 10, May 13, 2008; Jeremy Page, "Afghanistan Copper Deposits Worth \$88 Billion Attract Chinese Investors," *Timesonline*, May 15, 2008, www.timesonline.co.uk;

⁷⁵ "Chinese Mulling \$13B Investment in Gwadar," *Pakistan Real Estate Now*, May 9, 2008,

www.livenreal.com/news/index.php/chinese-mulling-13b-investment-in-gwadar; Sumita Kumar, "The China-Pakistan Relationship: Trade, Investment, Energy, and Infrastructure," *Strategic Analysis*, XXXI, NO. 5, 2007, pp. 757-790

⁷⁶ *Ibid.*

⁷⁷ Andrew Erickson and Lyle Goldstein, "Gunboats for China's New "Grand Canals",?" *Naval War College Review*, LXII, NO. 2, Spring, 2009, pp. 43-76

⁷⁸ Kumar, pp. 757-790

developments in and around Myanmar and Pakistan with military construction of what appears to be potential naval bases, not only is viewed as an effort to project naval power into that Ocean through available ports or bases, but also as a way of bypassing the Straits of Malacca and creating strongholds of economic and political influence tying these areas to China through energy and infrastructural investments.⁷⁹ When and if the infrastructure tying these ports to China is completed these projects could create long-lasting economic and political relationships dominated by China and that ensure that Middle Eastern and African energy supplies need not be at risk in the Straits of Malacca.

In another example in early 2007 China loaned Tajikistan several million dollars without interest. In return the Tajik government then signed a political or cooperation agreement with China foregoing recognition of Taiwan, tightening security linkages, and postulating an identity of interests with China on a bilateral basis outside of existing linkages between them through the SCO.⁸⁰ Similarly once the loan to Kazakhstan was announced, Chinese Vice Premier Wang Qishan indicated that it should lead to further bilateral cooperation in business and politics while President Nazarbayev of Kazakhstan indicated his support for Chinese investment in Kazakhstan and entrepreneurial activity that carried out mutually beneficial cooperation.⁸¹ The different nuances in these remarks indicate what is at stake here, i.e. Central Asia's economic independence. Although these are only a few of many such examples in Central Asia and elsewhere, they underscore the tactics by which China is advancing its overall strategy for Central Asia in energy and other domains.

CNPC's Future Plans

CNPC, in its own words, has been making acquisitions in Eurasia non-stop. Indeed, it recently announced a detailed plan to "strive to build five cooperation zones covering Central Asia, Africa, South America, the Middle East, and the Asia Pacific region within eight to ten years." Ultimately its overseas oil and gas business would amount to 200 million tons of oil and gas annually.⁸² As this plan does not include the loans for oil plans that have already started so it represents a new campaign.⁸³ Indeed, Central Asia is the most important zone for foreign energy cooperation, another sign of the intertwined nature of energy, strategic, and political considerations in China's energy

⁷⁹ Erickson and Goldstein, pp. 43-76; Shebonti Ray Dadwal, "China's Search for Energy Security: Emerging Dilemmas," *Strategic Analysis*, XXXI, NO. 6, 2007, pp. 889-914; You Ji, "Dealing with the Malacca Dilemma: China's Effort to Protect Its Energy Supply," *Strategic Analysis*, XXXI, NO. 3, 2007, pp. 467-489; Gupreet S. Khurana, "China's 'String of Pearls' In the Indian Ocean and Its Security implications," *Strategic Analysis*, XXXII, No. 1, 2008, pp. 1-39

⁸⁰ Beijing, *Xinhua*, in English, January 15, 2007, *FBIS SOV*, January 15, 2007; Dushanbe, *Asia-Plus Internet Version*, in Russian, January 16, 2007, *FBIS SOV*, January 16, 2007; Beijing, *China Daily (Hong Kong Edition) Internet Version*, in English, January 16, 2007, *FBIS SOV*, January 16, 2007

⁸¹ Beijing, *Xinhua*, in English, April 16, 2009, *FBIS SOV*, April 16, 2009

⁸² Ming Quan, "CNPC's Expansion Blueprint: Oil and Gas Capacity To Reach 200 Million Tons in 10 Years," Guangzhou, *Shiji Jingji Baodao Online*, in Chinese, March 19, 2009, *FBIS SOV*, April 16, 2009

⁸³ *Ibid.*

policies.⁸⁴ Apart from expanding holdings in Africa and Latin America, the efforts in the Middle East should be strengthened to make it the company's future key development zone. Meanwhile efforts should also be made in the Asia-Pacific for producing both natural gas and Liquefied Natural Gas (LNG).⁸⁵ That last point has particular relevance for China's energy ties to Myanmar, a major gas and oil supplier.

CNPC has also indicated that this is an auspicious time for such bold plans since energy demand will grow while China already imports most of its oil. Moreover, CNPC aims to become an integrated international energy company with six oil and gas business centers in Asia, America, and Europe. Meanwhile the value of investment becomes more apparent as global economic growth slows down and both energy and assets decline in price.⁸⁶ CNPC estimates that Central Asia has 8% of world oil and 5% of world gas and that negotiations are not that tricky since states like Turkmenistan are approaching China.⁸⁷ Thus in Central Asia CNPC emphasizes the need for going beyond the already estimated 40BCM of gas to be transported through pipelines from there to 50-60BCM annually and transmitting 20 million tons of oil annually through the pipeline from Kazakhstan. Apart from the oil pipeline from Russia discussed below, CNPC wants to finish a pipeline that annually transmits 30BCM of natural gas from Russia. This means a priority on finishing pipeline deals, wrapping up their financing, and their construction from Central Asia and Russia. Therefore we can expect an even greater Chinese energy drive and footprint in these areas, for example, CNPC also wants to establish a heavy oil and LNG shipping company to control those products from the wellhead to China itself.⁸⁸

CNPC also believes that with the breakthrough in Sino-Russian talks there are no longer strategic obstacles to getting oil and gas from all four of these major strategic routes (Central Asia and Russia, South America, Africa, Asia-Pacific) and also expects breakthroughs on the Sino-Burmese pipeline this year.⁸⁹ CNPC also announced its tactics, i.e. merger and acquisition efforts with closely monitored and selected targeted oil and gas companies and assets, i.e. small to medium sized independent oil companies suffering from financial difficulties but with future potential, as well as sophisticated oil and gas assets. Second, it will also target larger oil and gas firms for mergers and acquisitions to expand its overseas oil and gas business.⁹⁰

Although most of China's energy imports still come from the Middle East; Beijing is clearly and rapidly seeking to diversify its suppliers on a global basis: Venezuela, other Latin American countries, Africa, Russia, and Central Asia. Neither will China slacken the pace of acquisitions anytime soon. As noted above, CNPC's

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

program will not stop. It recently announced its intention to invest up to \$44 Billion in oil and gas projects in 2009, especially in core projects like the ongoing Kazakhstan-China oil pipeline that will send China 15 billion tons of oil a year from 2011-2034. We can expect that other projects in Central Asia, e.g. the gas pipeline from Turkmenistan, will also be moved further to completion and that Chinese firms and the government will continue searching for distressed energy firms that they can acquire at cut-rate prices to gain global and regional leverage among suppliers and governments.

Russia

Other Chinese companies are equally active, PetroChina, which holds CNPC's non-politically sensitive assets, will soon start building to build a pipeline from its terminal in Daqing to the Russian border that will connect to the pipeline Transneft is building to ship Rosneft's oil to China. The pipeline will cost China 10 Billion Yuan (\$11.34 Billion Hong Kong dollars). and represents China's contribution to the Russo-Chinese oil project announced in February and completed in April, 2009 where China loaned Rosneft and Transneft, two immensely leveraged firms, \$25 billion to commit them to build the pipeline from Taishet to Skovorodiono in Eastern Siberia from whence the oil will then go to Daqing. From 2011-2034 China will receive 15 million tons annually from Russia which is now tied, against Russia's past preference, to a single consumer at the end of its pipeline, a situation that it has successfully blocked everywhere else.

Both sides claim that this agreement represents a win-win deal for them. Moscow now argues that the conclusion of this deal will create a reliable, stable sales market for oil from eastern Siberia to the Asia-Pacific region and that the rest of Russia's pipeline to the Pacific Ocean, the East Siberian Pacific Ocean (ESPO) pipeline will soon open and start selling gas from the terminal at Kozmino Bay.⁹¹ While this pipeline will start carrying 30 million tons of oil annually it ultimately will carry 80 million tons of oil annually.⁹²

However China now possesses ample opportunity to gain equity assets in both Kazakh and Russian firms and influence state policy directly in these petro-states. Worse yet, according to Western analysts, Moscow is actually selling the oil to China, when all the costs, including the loans and interests are calculated, at a price that is estimated as being between \$11.40. to \$22 a barrel.⁹³ Formally the two governments announced that the price of this oil would be based on a formula based on the floating price of Brent

⁹¹ Robert J. Saiget, "PRC FM Spokesman Says China, Russia Finalize Oil Pipeline, Supply Deal," *AFP* in English, April 21, 2009, *FBIS SOV*, April 22, 2009; Rong Yan, "Vice Premier Li Keqiang Meets Russian Deputy Prime Minister Sechin," Beijing, *Xinhua Domestic Service*, in Chinese, April 21, 2009, *FBIS SOV*, April 22, 2009

⁹² Moscow, *ITAR-TASS*, in English, April 13, 2009, *FBIS SOV*, April 13, 2009

⁹³ "The Collaborative View: Transforming Chaos Into Opportunity," <http://collaboration360.blogspot.com/2009/02/transforming-chaos-into-opportunities.html>; Robert Cutler, "China On Buying and Lending Spree," *Asia Times Online*, March 5, 2009, www.atimes.com

crude oil when it arrives at the projected Kozmino Bay terminal.⁹⁴ But there is no pipeline to Kozmino Bay and no clear idea who will pay for it. Despite Russian optimism, it is quite unclear whether or not Japan will make the huge investment necessary for this pipeline to materialize. Thus for now energy flows to Kozmino Bay will be only those carried by the Russian railway system, a grossly overpriced and inefficient way of transporting oil. However, given the absence of financing for that pipeline, the greed, mismanagement, high labor costs, and endemic corruption of the Russian energy industry and the failure to announce a price for the oil being shipped to China let alone that which will be shipped to Kozmino Bay, skepticism about such announcements is warranted.⁹⁵

While Chinese analysts may not be happy about this pricing arrangement, we can be relatively sure one or another side will seek to renegotiate it once prices move dramatically up or down. Russia may think that it got a stable market and the first major step in its efforts to diversify its energy supplies eastwards, but in fact this deal was made out of Russian weakness and not only will China gain access to upstream Russian energy assets, it also evidently was able to induce Moscow to reorganize its organizational process for negotiating energy deals with China, a sure sign of its superior leverage.⁹⁶ Moreover, China certainly intends that this deal will remain stable and lead Moscow to provide it with even more oil, gas, and electricity.⁹⁷

In other words, despite Russian satisfaction that it has a stable market that Rosneft and Transneft were saved, and that it can now ship oil to China; it appears that China got and will get more and more out of this deal than Russia and has increased its leverage over Russia. China has essentially effectuated a major victory over Russia and will gain access to equity in hitherto excluded Russian firms apart from its leverage over Russia.⁹⁸ Russia may proclaim that it could become China's largest oil supplier in 15 years (a prospect this author finds to be unlikely), but in fact Moscow and Astana must accept not only Chinese equity positions in their energy firms, Russia also must accept outcomes that it has successfully rejected everywhere else and get less for its products than the market now charges.⁹⁹ Russia also must find financing to build oil and gas pipelines from Siberia to the Pacific Coast, and given its own shoddy record of construction and the games it has played with Japan, this is by no means a certain proposition.

Since many of Russia's decisions here represent a reversal of past Russian

⁹⁴ Gaye Christoffersen, *The Multiple Levels of Sino-Russian Energy Relations*, Paper Presented to the Conference "Sino-Russian Relations: Old Patterns, New Realities", Central Asia-Caucasus Institute, Washington, D.C., May 6-7, 2009

⁹⁵ For an analysis of Russian energy failures in Asia to date see Stephen Blank, "At a Dead End: Russian Policy and the Russian Far East," Forthcoming, *Demokratizatsiia*

⁹⁶ *Ibid.*

⁹⁷ Rong Yan, *FBIS SOV*, April 22, 2009; Saiget, *FBIS SOV*, April 22, 2009

⁹⁸ John Helmer, "China Loan Turns Russian Oil East," *Asia Times Online*, February 24, 2009, www.atimes.com

⁹⁹ Moscow, *Interfax*, in English, March 27, 2009, *FBIS SOV*, March 27, 2009

priorities, i.e. building a pipeline to one Asian party alone and not to the Pacific where it could supply all of Northeast Asia and the US, the Sino-Russian deal is impressive testimony to China's heightened power as a result of its past growth and the current crisis and to Russia's decline due to its leadership's unrelenting cupidity and mismanagement. Apart from ensuring large oil shipments through the pipeline to itself, China is abetting Russia's reorientation of its energy strategy away from Europe if that materializes and has clearly induced Moscow to approach it again concerning the project of a gas pipeline from the Altai to China for 40BCM a year of gas. Gazprom has now repented of its past decision to abandon this pipeline and has approached CNPC to participate in retail gas sales in China as a quid pro quo for favorable pricing.¹⁰⁰

Iran

Since 2004 China has signed several major oil and gas deals with Iran which is already supplying over 15% of China's energy needs. The most recent deal for \$3.2 Billion was signed on March 15 where China will help develop the South Pars field, part of what is believed to be the world's largest natural gas reservoir.¹⁰¹ But beyond energy considerations these deals meet China and Iran's overall foreign policy objectives. These deals are not only instrumental in ensuring China's continuing receipt of large quantities of oil and gas, they also meet Iran's desire to replace Japan with China as its main Asian energy importer. Thus Iran has warned Japan in the past that if it backed out of energy deals due to Western pressure it would turn to China.¹⁰² Iran's foreign policy since 2001 has also been driven mainly by Tehran's "Ostpolitik", a policy placing primary emphasis on securing Russian, Chinese, and Asian support for its programs. Indeed, Iran seeks broader cooperation with Russia not only on nuclear issues but on a gas cartel and on all security issues in the CIS, or at least so it claims.¹⁰³ And it clearly seeks to be a major supplier to China to earn its political support and help break Western sanctions. Indeed, Iran points to such deals as signs that US claims that foreign energy firms are shunning Iran are baseless and that US opposition to energy deals with Iran can be overcome.¹⁰⁴

Therefore these deals compromise the unity of the P-5 (permanent members of the Security Council) and the negotiations between the EU and Iran that include China and Russia in forging a strong united front to arrest or reverse Iran's ever more open quest for nuclear weapons. Thanks to these deals Iran not only gains strong supporters in the East,

¹⁰⁰ Bhadrakumar,

¹⁰¹ Borzou Daragahi, "Iran Signs \$3.2 Billion Natural Gas Deal With China," *Los Angeles Times*, March 16, 2009, www.latimes.com

¹⁰² "Iran Eyes Russia, China If Japan Stalls On oil Deal," *The Japan Times*, August 29, 2006, <http://search.japantimes.co.jp/print/nb20060829a1.html>; F. William Engdahl, "China Lays Down Gauntlet in Energy War," *Asia Times Online*, December 21, 2005, www.atimes.com

¹⁰³ Andrei Kolesnikov, "Vladimir Putin Includes Iran in Sextet," *Moscow, Kommersant*, in Russian, June 16, 2006, *FBIS SOV*, June 16, 2006

¹⁰⁴ Wang Ying and Dinakar Sethuraman, "China, Iran Sign \$2Billion Oil Production Agreement," *Bloomberg*, December 10, 2007

it gains capital to develop its energy systems and evade or mitigate at least some of the impact of UN and US sanctions. Indeed, according to a report from the CIA, “Chinese entities – which include private companies, individuals, and state-owned military export firms – continue to engage in WMD-related proliferation activities “ to Iran. And even though Beijing has tightened regulations on sensitive equipment exports, “enforcement continues to fall short.”¹⁰⁵ China not only hampers the US and deflects its attention away from China’s growing power, putting it in the status of a demandeur vis-à-vis China as regards Iran. China also gets an enormous source of reliable energy supplies and by forging these deals it has already begun to create a basis for enhancing the viability of any projected pipeline linking it through Pakistan and Central Asia (either Kazakhstan or Uzbekistan, Afghanistan and/or Pakistan) directly to Iran. Here again China would thus be in a position to realize its ultimate dream of diverse supply lines that cannot be cut off by the US Navy or in this case by Russia or India, all potential rivals.

Thus China’s energy deals with Iran for oil and gas parallel its energy deals with Russia and Kazakhstan in that they consolidate a community of interests binding China to its suppliers. But these deals also enable China to attack U.S. objectives, attain lasting partnerships with important energy suppliers and generally strategically important states, gain secure and reliable energy supplies, deflect Washington’s attention and energy away from it and its growth, and to do so at relatively little political cost. At the same time the current economic crisis offers China hitherto undreamt of opportunities to pursue its energy strategy at knock-down prices, for example in the Russian case, where it can obtain its goal of getting energy wherever possible at below market prices.

South and Southeast Asia

China’s energy strategy that aims to ensure its energy security in times of peace and crisis if not war, inevitably entails a strong global rivalry with other key consumers like India. In 2006 India initiated efforts to forge a truce so that India and China would not overbid for energy supplies in the Middle East, Central Asia, and Africa. But that agreement has either broken down or been discontinued and it is clear that China is outpacing India in Central Asia and elsewhere by virtue of its greater aggressiveness and enormous cash reserves. In particular China has trounced India in the rivalry for access to Myanmar’s gas fields. Here again the energy rivalry parallels the strategic rivalry perceived by Indian and other observers stemming from what they regard as China’s efforts to implement the string of pearls strategy and project naval power into the Indian Ocean.¹⁰⁶ But China’s support for Pakistan, infrastructural projects there, and programs with Myanmar also support its larger strategic objective of frustrating India’s capacity to play a major role in world politics beyond the Subcontinent and particularly in Central

¹⁰⁵ “Iranian nuclear Work Unhindered By Sanctions, CIA Report Says,” *Global Security Newswire*, May 8, 2009, Nuclear Threat Initiative, www.nti.org, or <http://gsn.nti.org>

¹⁰⁶ Walter C. Ludwig III, “Delhi’s Pacific Ambition: Naval Power, “Look East,” and India’s Emerging Influence in the Asia-Pacific,” Forthcoming, *Asian Security*, V, No. 2, 2009

and Southeast Asia. That India seeks such a role is not open to doubt.¹⁰⁷ But as the discussion of the rivalry between it and China for energy access in Myanmar indicates, China is equally determined to thwart its attainment of those objectives.

Myanmar's location at the Northwestern portal of the Straits of Malacca and into the Indian Ocean, and the possibility of using its ports and associated infrastructure to bypass the Straits gives the area strategic maritime significance for both India and China. But as China has staked enormous resources on building its Southwest Yunnan province and holding onto Tibet, and given Myanmar's oil and gas holdings, economic influence and access have become very important to both China and India. India covets Myanmar's gas which could do much for its energy starved and insurgent Northeast provinces and regards China's naval and energy activity there as potentially threatening to it.¹⁰⁸ Thus it is hardly surprising that a robust economic-energy-naval rivalry is occurring with regard to Myanmar.

Myanmar possesses Southeast Asia's largest natural gas reserves of at least 88 Trillion Cubic Feet (TCF) and oil reserves of around 600 million barrels. Although India was the preferential buyer for Myanmar in its gas fields called A1 and A3 off the Rakhine Coast (the site is called Shwe) in 2006-07; China stole a march on India and won Myanmar's support to develop both ports and associated infrastructure as well as an oil pipeline linking Myanmar's deep-water port at Sitwe to Kunming, a pipeline that would again bypass the Straits of Malacca.¹⁰⁹ Much of this was due to the tensions in the relationship between India and Bangla Desh through which this gas would have to go from Myanmar. Bangla Desh resents India's efforts to dominate South Asia, is plagued by strong anti-Indian feelings stemming from the Hindu-Muslim clash on the subcontinent, and has also become a major target of Chinese investment as China seeks to constrain Indian strategic opportunities. These factors, combined with some inept Indian diplomacy led Bangla Desh to veto shipments of Myanmar's gas through its territory to India and Myanmar, now having no outlet for its product was naturally susceptible to Chinese blandishments, the influence of China in the Security Council, and Beijing's growing military and economic investments there.¹¹⁰

More recently China signed a contract with Myanmar to build cross-border oil and gas pipelines for the gas from those blocks and gas fields. The gas pipeline runs over 1240 miles from Sitwe through Rullu and Kunming in Yunnan to Chongqing in Southwest China.¹¹¹ In return China will provide Myanmar with help in building a big

¹⁰⁷ Stephen Blank, *Natural Allies?: Regional Security in Asia and Prospects for Indo-American Strategic Cooperation*, Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2005

¹⁰⁸ Zhao Hong, "China and India's Competitive Relations With Myanmar," *ICS Working Paper Series No. 7, 2008*, Institute of China Studies University Of Malaya, 2008; Jian Yang,

¹⁰⁹ Zhao Hong, pp. 9-12, Jian Yang, pp. 6-7

¹¹⁰ *Ibidem*; Ashild Kolas, "Burma in the Balance: the Geopolitics of Gas," *Strategic Analysis*, XXXI, No. 4, 2007, pp. 625-643

¹¹¹ "Myanmar Gets China's Help For Hydropower Project," *Asian Energy*, <http://asianenergy.blogspot.com>, March 31,

hydropower project in Northern Myanmar, continuing its assistance to Myanmar with these projects.¹¹² China's position in the Security Council where it can block unpalatable UN resolutions against Myanmar undoubtedly is a factor in that country's government's thinking.¹¹³ Similarly China has offered to assist Bangla Desh in providing foreign investment for its energy holdings that it desires, as well as power generation, hydro and solar energy, military assistance, and even nuclear power. Not surprisingly, its relationship with Bangla Desh has improved at India's expense.¹¹⁴

Here again we see how energy, geopolitics, naval and maritime ambitions, and support for authoritarian regimes, particularly those near China's poorer and potentially volatile Western regions, all come together to foster an aggressive strategy of economic and energy investment, leading to the acquisition of a preferential position in the host country's energy equation if not overall policies. These trends suggest that in Myanmar as well as Russia Chinese economic power is reaching a point where it can persuade regimes to adopt policies that they might not otherwise have done, e.g. in Myanmar's case, reverse its intention to ship gas to India and instead sell it to China.

Such cases indicate the ongoing nature of the Indo-Chinese energy rivalry in Asia as well as across the globe. For example, in October, 2008 Pakistan warned that if India kept delaying the projected Iran-Pakistan-India pipeline (IPI) it might lose out and be replaced by China.¹¹⁵ Interestingly enough China's Ambassador to India in 2006, Sun Yuxi, said that China has no objections to the IPI, finding it a very good idea, while India's minister for State Planning, M.V. Rajashekar, also said that once the pipeline is completed it could be extended to China.¹¹⁶ Indeed, if one correlates China's recent moves in Central Asia regarding energy with its deals with Iran, it is hard to escape the notion that China is contemplating a pipeline network running from Iran either through Central Asia, or prospectively through Pakistan and/or India to China.¹¹⁷

For all the talk that China is wasting money and paying for long-term contracts at top of the market prices, it is securing lodgments and presumably influence in places that

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¹¹² *Ibid.*

¹¹³ Sudha Ramachandran, "China Secures Myanmar Energy Route," *Asia Times Online*, April 3, 2009, www.atimes.com

¹¹⁴ "China For improved Tech for Power Generation in Bangladesh," www.energybangla.com, April 21, 2009; "Bangladesh to Seek Foreign Help In Offshore Gas Exploration," www.energybangla.com April 8, 2009; "China Offers Bangladesh More Military Aid, Nuclear Tech (Roundup)," *South Asia News*, April 25, 2008, www.monstersandcritics.com, accessed on May 4, 2009; Srinjoy Bose, *energy Politics: India-Bangladesh-Myanmar Relations*, Institute of Peace and conflict Studies IPCS Special Report, No, 45, 2007

¹¹⁵ "Pakistan: India May Lose Iran Gas Pipeline Project," *FARS News Agency*, October 19, 2008, www.english.farsnews.com

¹¹⁶ "The Energy Game," *Heartland: Eurasian Review of Geopolitics*, November, 2005, www.heartland.it

¹¹⁷ Stephen Blank, "China's Recent Energy Gains in Central Asia: What Do They Portend?," *Central Asia Caucasus Analyst*, September 19, 2007

India cannot yet do. Since China is the benchmark against which India now measures itself, this must be highly disturbing to Indian elites and the government. China, for example, is far ahead of India in gaining access to Central Asian pipelines and in making or completing deals to begin construction of them. Similarly the dates by when it should be obtaining Central Asian energy are much earlier than those when India hopes to be able to obtain energy from Central Asia. Again ironically, due to U.S. pressure upon Iran, China, not India is the main Asian beneficiary of Iran's energy. The pressure from China and the sense of being unable to compete with it may provide another motive for greater reliance upon nuclear energy and for turning to Russia to fill up its shortfalls. And, to the extent that Indo-Chinese competition for energy is unregulated (against the efforts by former Indian Energy Minister Aiyar to find a cooperative solution to the problem), Indo-Chinese rivalry in Asia could grow over time as well.

Implications

These cases, along with Chinese actions beyond Eurasia, exemplify China's so called "peaceful rise". There is no force or threat of it other than the pressures of the market in today's economy. Companies and governments who cannot meet their debts or are short of cash will generally look for lenders who offer the most favorable terms. And in the current climate China, sitting atop enormous cash reserves, is more than willing to offer such terms in return for exclusive access to the product, below-market prices, and opportunities for further equity access in those firms and countries. While these borrowers get their cash they also suffer, as debtors habitually do, from a loss of freedom of action. To a considerably greater degree than before they are tied to China's economic chariot and to its economic-political preferences.

Moreover, these investments and the accompanying strategy behind them are coming to be seen both in China and abroad as portending a new level in China's rise to power and the development of the so called "Beijing consensus."¹¹⁸ South Korea's Ministry of Strategy and Finance recently sounded the alarm over China's investment and loan strategy in a report bearing this title. It warned that China's energy investments might "put Korea's diplomatic efforts to secure natural resources in peril."¹¹⁹ It also warned that developing countries that accept these loans and investments might gravitate toward a Chinese-style economic model.¹²⁰ Some foreign commentators warn that this strategy might compromise Taiwan's independence and that through this strategy China is clearly eclipsing Japan which has failed to translate its economic power into political advantage.¹²¹ Others disagree as do some political leaders who claim that they are not surrendering their political independence to China or adopting a Chinese-style economic

¹¹⁸ Joshua Cooper Ramo, *The Beijing Consensus*, London: The Foreign Policy Centre, 2004

¹¹⁹ Pilling, p. 15

¹²⁰ Arianna Eunjung Cha, "China Uses Global Crisis To Assert Its Influence," *The China Post*, April 25, 2009, www.chinapost.com.tw

¹²¹ Pilling, p. 15

model.¹²² But some Chinese scholars claim that this model is coming to replace the previous “Washington model” of economic development.

For example, Chi Zhiyuan, a professor at Tsinghua University who recently wrote a book on this subject, claims that the financial crisis has caused the world to lose confidence in Washington. Similarly, Cheng Enfu, an economics researcher at the Chinese Academy of Social Sciences, a government–affiliated think tank, defines the Beijing Consensus as,

Promotion of economies in which public ownership remains dominant; gradual reform is preferred to “shock therapy,” the country is open to foreign trade but remains largely self-reliant; and large-scale market reform takes place first, followed by political and cultural change.¹²³

It is hardly coincidental that Russia’s economy under Putin and Medvedev broadly resembles this paradigm in many aspects. But nonetheless it is failing to keep pace with China. In this context it is hardly a surprise that for years Russian leaders have been publicly warning that if Russia did not get its house in order that China would gain a commanding economic position in Russian Asia or warning against the rise of China as exporter, importer, and now lender in Central Asia. For example, Russian officials have repeatedly reiterated their opposition to being merely China’s source for raw materials and demand equal status in economic-technological exchanges with China.¹²⁴ Russian leaders also know that if they fail to be competitive economic players in East Asia they will also be at a serious disadvantage at home and in Central Asia. For, if Russia fails to become “a worthy economic partner” for Asia and the Pacific rim, Deputy Prime Minister and Finance Minister Aleksei Kudrin warned that, “China and the Southeast Asian countries will steamroll Siberia and the Far East.”¹²⁵ China would then also steamroll Russia in Central Asia too. Certainly Russian energy policy therefore betrayed a definite reserve, if not something stronger, about ceding too much influence in Russia or Central Asia to China.¹²⁶ Yet now we see Russia accepting its debts to China and reversing past energy policies regarding both oil and gas.

¹²² Cha

¹²³ *Ibid.*

¹²⁴ Sergei Blagov, “Russia Wants to Be More than China’s Source for Raw Materials,” *Eurasia Daily Monitor*, September 30, 2005

¹²⁵ Moscow, *Interfax*, Presidential Bulletin, in English, August 21, 2001, *FBIS SOV*, August 21, 2001, “Asia and the Russian far East: The Dream of Economic Integration,” *AsiaInt Special Reports*, November, 2002, pp. 3-6, www.Asiaint.com

¹²⁶ Michael Lelyveld, “Russia: Moscow’s Oil Pipeline Plan to China Stalls,” *Radio Free Europe Radio Liberty* (Henceforth RFERL), *Newsline*, December 10, 2002, on Slavneft see, Le-Min Lim, “China Sees Russian Barrier to Slavneft,” *International Herald Tribune*, December 17, 2002, “Anti-China Sentiment Plays Into Duma vote,” www.stratfor.com, December 16, 2002, “Chinese Drop Plans to Bid for Slavneft,” *Rosbusiness consulting*, December 17, 2002, www.top.rbc.ru, Peter Wonacott and Jeanne Whalen, “China and Russia Prepare to Sign Pipeline Agreement,” *Wall Street Journal*, December 2, 2002, “Japan, Russia Discussing Pipeline Construction,” *Moscow Times*, December 28, 2002

The situation in Central Asia also shows similar signs of rising Chinese power. For some time it has been apparent that China has had the power to influence at least some Central Asian states' policies, e.g. prodding Kyrgyzstan to enact an "anti-extremism law in 2004 because it may have believed that Uyghur underground parties existed there and in Kazakhstan.¹²⁷ In like manner Kazakhstan may have sacrificed some of its own interests in 2005 to China to get it to make its first energy purchase there of Petrokazakhstan.¹²⁸ More recently a study of Central Asian perceptions of China concluded that local governments perceive China as a uniquely powerful regime that could substantially injure their interests and therefore make fulsome statements about friendship with it.¹²⁹ Thus they too are being forced into accommodating China.

Similarly we see in Myanmar that Chinese investment helped turn that government away from India to Beijing. In other words China is beginning to have other states accommodate themselves to its preferences. Some have discerned even a similar trend in Australia though others deny it.¹³⁰ Others argue this is happening in East Asia, particularly Southeast Asia, but also possibly in South Korea.¹³¹ The evidence submitted here suggests that we can begin to discern such patterns of accommodation, particularly in the face of the current crisis, backed up by the unstated but always present specter of China's power, especially in neighboring areas like Central Asia. Indeed, several writers not only point to the growth of that power in Central or Southeast Asia, they openly herald the advent of a new order that is gradually becoming based on an increasing accommodation to China's preferences, often manifested through such soft economic power as we have seen here.¹³² Thus Thomas Rawski and William Keller openly warn that "the balance of influence between China and the United States in Asia is shifting decidedly in China's favor."¹³³

While this is by no means a scholarly or analytical consensus view; it does testify to the vigor of China's current policies. Not surprisingly China sees in this crisis an opportunity (as the Chinese characters for crisis suggest). In the last major economic

¹²⁷ Igor Rotar, "Kyrgyzstan Bans "Extremism" With Prodding From Beijing" September 21, 2004

¹²⁸ Marat Yermukanov, "Astana May Sacrifice National Interests To Save China Oil Deal," *Eurasia Daily Monitor*, September 7, 2005; Vladimir Socor, "Implications of China's Takeover of Petrokazakhstan," *Eurasia Daily Monitor*, September 7, 2005

¹²⁹ Marlene Laruelle and Sebastian Peyrouse, *China As a Neighbor: Central Asian Perspectives and Strategies*, Stockholm: Institute for Security, Development and Policy, 2009, p. 170

¹³⁰ James Manicom and Andrew O'Neil, "Accommodation, Realignment, or Business as Usual?: Australia's Response to a Rising China" Paper Presented to the Annual Convention of the International Studies Association, New York, 2009; "Australia's Chinese Entanglement," p. 46

¹³¹ Robert S. Ross, "Balance of Power Politics and the Rise of China: Accommodation and Balancing in East Asia," William W. Keller and Thomas G. Rawski, Eds., *China's Rise and the Balance Of Influence in Asia*, Pittsburgh: University of Pittsburgh Press, 2007, pp. 121-145

¹³² *Ibid.* and the essays contained throughout the book; Manicom and O'Neil; David C. Kang, *China Rising: Peace Power and Order in East Asia*, New York: Columbia Press, 2008.

¹³³ William W. Keller and Thomas G. Rawski, "Asia's Shifting Strategic and Economic Landscape," *Ibid.*, p. 7

crisis a decade ago China acted not just to secure Southeast Asian stability but also benefited immensely from the perception of its role and from the emergence of its economic power as the anchor of Asian stability and one of the anchors of global stability as is also now the case. Much has been written about China's economic and energy policies in Asia that have been devised to ensure its maximum energy security. But now we may begin to see the fruition of those policies in Central Asia and elsewhere. While many will undoubtedly benefit, somebody may well lose and the results from that perspective will not be pretty.

Panel III: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you very much. Let's start with Commissioner Slane.

COMMISSIONER SLANE: Ms. Nanay, one of the concerns that we have with the economy next year is inflation, and we have benefitted this year from low prices in oil and gas. Do you see the demand for oil and gas going up substantially next year?

MS. NANAY: My company, when we look at this, we think next year may still be a year of less demand than maybe by 2012. If you see what's happened between last year and this year, oil demand has really collapsed worldwide from 85 million barrels a day last year to 83 this year.

I don't see it picking back up to capture the lower demand that we see now within the next year, but probably by 2012, I think there will be a growth and demand again that's going to be more substantial.

COMMISSIONER SLANE: And would you predict \$100 barrel oil in 2012?

MS. NANAY: No. The oil price is a difficult one to predict, and it could actually go back down from where it is now, which is closer to \$60 a barrel. But that \$100 a barrel price appears to have been an anomaly, and I don't see in 2012 that we're going to come back to that price. On the other hand, predicting oil prices is basically very difficult.

HEARING COCHAIR FIEDLER: Commissioner Shea.

COMMISSIONER SHEA: Ms. Nanay, you point out that the Chinese energy companies acting in Central Asia are state owned, and that they have objectives beyond profit maximization. And I was wondering if you could just give us a sense of the U.S. energy companies that are players in Central Asia, and if you could give us some sort of on-the-ground anecdotes about how Chinese companies may be advantaged in their negotiations with the Central Asian governments regarding access to these resources over U.S. companies?

MS. NANAY: Well, the resources, other than I think

Turkmenistan is an interesting issue there because in fact China's CNPC has gained access to a production sharing agreement in one of the most prolific gas basins in the world, and, I know that U.S. companies would like to access similar opportunities in Turkmenistan.

On the other hand, Chinese companies for the last ten years have been helping the Turkmen with drilling rigs, drilling activities, potentially with minor infrastructure projects. They've just been able to do the sorts of things that international oil companies don't spend a decade doing in order to get access to resources in a country.

So the differences are quite remarkable in the sense that, even in Kazakhstan, when you have the Chinese companies that are active in a project, if the government asks for a gas processing facility, it's not a question of is this going to be profitable? It just gets done.

Same thing with pipelines. They just get built. And so it's a different cost structure, a different, just different--what companies are trying to access is different. For a U.S. company, you need to have access to reserves so you can book the reserves. You have more short-term motivations because your shareholders want to see results every quarter. It's just very different from the way a state company generally operates and certainly the Chinese are no exception.

COMMISSIONER SHEA: Dr. Blank, do you have anything to add? Do you have anything to add or?

DR. BLANK: I would also add that the Chinese have certain advantages compared to us. Central Asian governments are notoriously corrupt. We have laws about that kind of thing. Chevron, for example, cannot come to the IRS and say we're taking a deduction of \$5 million for bribes to Central Asian leaders. But the Chinese and the Russians can easily pay those kinds of things without any questions asked.

They also have the great advantage of proximity and the fact that they are a major power that borders all these states, and if you look at Central Asian government perceptions of China, and there is some excellent recent work about this, it's clear that these governments see China as a state that has a great capability to injure them and with which they must deal very cautiously and warily.

So if the Chinese come to them and offer them or negotiate with them reasonable terms, it's quite likely the pipeline will be built or the refinery or whatever we're talking about.

The Turkmen case is illustrative. Up until 2006, Turkmenistan had no option but to ship its gas to Russia. And the Russians were able to get this gas at a ridiculously low price and then arbitrage it throughout Europe, which was the source of their profit.

The Chinese came along and actually offered to pay a higher price for gas, and the minute that happened, once the Turkmen-China

deal was signed in 2006, we see a steady rise in Turkmenistan and Central Asia's ability overall to compel the Russians to give them a higher price for their gas and oil to the point whereas the Times reported last week, Russia is now paying more for the gas than the gas is worth on the open market because of the contracts it has signed.

So this is again optionality as Julia has said. It benefits the Central Asians so it's a kind of a win-win solution, but also there is an undercurrent of apprehension. What will happen to assets that we have sold to the Chinese? Will we lose control of them? Will other people be working there and not our people? And so on.

COMMISSIONER SHEA: Thank you.

HEARING COCHAIR FIEDLER: I have a question. You made reference earlier to Chinese strategy to lower dependence on maritime received oil, if you will. So if they could corner the market in Central Asia, what percentage of their needs would be satisfied, even in the most extreme, which would be cornering the market?

DR. BLANK: I don't have the figures on that, but I really think that it would be impossible for China to corner the market in Central Asia.

HEARING COCHAIR FIEDLER: Oh, okay. That's actually not my point. My point was not whether they could corner it, but what percentage of their need would be satisfied overland through pipelines with the contracts they have now?

I'm trying to determine whether or not the strategy is meaningful. Can they get enough oil from Central Asia to make a difference? They can get oil, but can they get enough to make a difference?

DR. BLANK: I don't think at present you can because many of these pipeline deals are recent deals and the pipelines haven't been built. I think this is a long-term strategy over time, and frankly it looks to be like a strategy that ultimately encompasses the idea of getting Iranian energy piped in overland to China if you look at the way the network is taking shape.

But right now in terms of pipeline construction, we're at a very early stage so pipelines are not completed. So if this was to become a strategy right now, they would get very little out of it. I can't give you an exact number, but it's, I think, in the long-term, this is what they're aiming at.

MS. NANAY: What the Chinese can get out of the pipeline they're building for oil will be 400,000 barrels a day. Very possible that they'll try to move up towards that volume by 2011, 2012. Right now they're only taking 100,000 barrels a day through their pipeline. Their total production in Kazakhstan of Chinese companies right now

is about 355,000 barrels a day after they complete this most recent acquisition.

I think it's important to understand that what the Chinese are acquiring in Kazakhstan is really assets that the IOCs have not targeted, the international oil companies. So they're not taking assets there necessarily away from our companies. Our companies are important to Kazakhstan.

They're in the biggest projects. The reason that you can say that Exxon and Chevron don't have the level of production that the Chinese have is because they're part of consortium projects and these consortiums produce sizable volumes of oil, but when you take out the per company production, it's, of course, less is allocated per company.

But Chevron and Exxon in the Tengiz project produce over 500,000 barrels a day now. There's another big oil and gas project, Karachaganak, which is another backbone of the Kazakh energy sector that produces over 200,000 barrels a day, and there are no Chinese companies in either one of these projects.

For the future, I think what you can say is that, look, Chinese oil imports, 3.5 million barrels a day, they will grow, so the Kazakh share, which is ten percent now, is probably never going to be a whole lot more than ten to 15 percent of whatever that total volume is. But it's going to be important, and the Russian share of oil is going to grow since a project is being built, a pipeline now from East Siberia into China.

So they're piecing together volumes that individually from each country may not be huge volumes. There is certainly not the level of the CPC pipeline in which our companies operate from the Tengiz field in Kazakhstan to the Black Sea coast or the Baku-Ceyhan pipeline on the other side of the Caspian. But for the Chinese, these smaller volumes eventually will all add up, and it will be Russia, it will be Kazakhstan, it will be gas from Turkmenistan, and it will have an impact, but it's not going to be the be all or end all for their energy requirements.

HEARING COCHAIR FIEDLER: Thank you. Yes, Dr. Blank.

DR. BLANK: I might add also that until last year, there was a lot of concern about Chinese firms buying up energy properties all over the world, not just in Asia, but going to Latin America and Africa, and so on, and I counted at that point that really the Chinese had only bought up about two percent of the overall global oil supply.

So this is not a figure that in and of itself is a challenge to U.S. companies seeking to do business in these areas, and these are fields that had been left out in a sense or that had been ignored by the oil majors in their quest for access to new fields, but, as Dr. Nanay said,

the point is to put together a mosaic, if you like, or a jigsaw puzzle of gas and oil from here and there and everywhere else that if necessary, as a kind of hedge, against bad times--that is a military situation--China would then not have to worry about being dependent on the 7th Fleet for the security of its energy.

HEARING COCHAIR FIEDLER: That was my original question. So you're coming back to that their strategy is overland pipelines to hedge in a military conflict, to have sufficient oil, and then we just got done, I thought, hearing testimony that it wouldn't be a sufficient amount.

DR. BLANK: No, we're not saying it wouldn't be a sufficient amount. Right now, today, it's not a sufficient amount. But if you look at the deals and the pipelines that are going to be built, for example, the pipeline from Russia, that pipeline is supposed to open in two years, in 2011, and it is supposed to send China 15 million tons of oil annually for the 20 years after that.

So that would be a significant increase in China's imports from a land source other than going through the Indian Ocean. But today there's nothing there. Today all you have is construction sites, but in two years, the expectation is that this pipeline will be finished and China then will be obtaining the oil.

The same is true for other gas pipeline deals or oil pipeline deals being negotiated with Central Asia and Myanmar and so on.

HEARING COCHAIR FIEDLER: Thank you.

Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Thank you both.

Could you give me some sense of the scope of the planned pipeline builds? In both of your testimonies, you talk about the kind of the mileage of what Dr. Blank says is the Chinese dream to actually have a pipeline that goes all the way from Iran to the west of China. Roughly, how many miles are we talking about there, miles of pipeline? That's a lot of space; isn't it?

DR. BLANK: Yes, it certainly is.

HEARING COCHAIR BLUMENTHAL: How would that work exactly geographically?

DR. BLANK: I don't have the exact miles, but the idea is to put together a network, say, that Iranian oil and gas where China has access or which is to be sold to China could go either overland all the way from Iran to China, of course, if all the intervening countries agree, or it could be sent to a port in Iran, and then to the port of Gwadar, for example, off Pakistan's Indian Ocean, on the Indian Ocean coast of Pakistan.

And China is building a very large infrastructure that is going to

connect Gwadar ultimately to western China. Terminals, refineries, the whole system.

So, for example, Iranian oil and gas that could then go from Gwadar to China and not have to go through the rest of the Indian Ocean and not run the risk of interdiction. So we're talking about several thousand miles and through several sovereign states.

But unless one assumes that the Chinese are simply building infrastructure without any strategic reason, it makes no sense to spend all this money building infrastructure throughout the south and west of China to all these countries unless there is some strategic design there.

HEARING COCHAIR FIEDLER: Let me make a comment on what you said before. They may have a strategic design. That's not the question. The question is, is their strategic design viable?

DR. BLANK: I believe they think it is. I believe that they think that they will have very few options other than that in case of a conflict where the Indian Ocean route is closed. So this is their hedge.

This is why they are building not just pipelines and railways into inner-Asia or Central Asia but also establishing naval logistical bases, port infrastructures, and so on, that can then ship goods and supplies from those ports, either in Myanmar or in Pakistan, to China and avoid that whole journey through the Indian Ocean.

We won't know for sure if it's viable, but I don't know that they think they have another alternative.

MS. NANAY: I think there is a point that Dr. Blank makes that probably there is a broader strategy to connect up this whole region from Iran onwards. For now, what you're talking about from Russia is 300,000 barrels a day; Kazakhstan, 400,000 barrels a day; one-fifth of their imports, current imports.

So it's true that for now the situation if you just look at the static picture, by 2011-2012 isn't a huge amount, but eventually that will grow, and I think there is a broader strategy, and certainly probably on the part of China a view that they do want to grow this and to bring as much energy as possible by these very long distance pipelines.

Kazakhstan is bigger than Western Europe. Then you have a pipeline that China now has managed to build that goes from one part of that country to the Chinese border, and then inside China, they've already built, I think, two legs of this West to East gas pipeline. They're building a third one. These were all pipelines that like I said, a few years ago, no one believed would be viable, and yet they're working.

HEARING COCHAIR BLUMENTHAL: Can I just ask how this works, and pardon my ignorance? Okay. You have that big a pipeline.

What else, what other types of infrastructure? You're in another sovereign country, Kazakhstan in this case, so you're somewhat dependent upon whether or not they will allow full use of it.

What other infrastructure do you need to make it work? Why do they think that it's less vulnerable to interdiction than maritime traffic? This seems to me to be incredibly vulnerable to a host of different actors.

So I'm asking two separate questions. One is what actually goes into this type of infrastructure? Do you need Chinese workers on the ground? Do you need Chinese transport and railroads? Do you need Chinese officers, security officers protecting it? Do you need the agreement of all the sovereign nations to keep piping it?

The second question is or set of questions is what makes them think this is less vulnerable than the maritime?

DR. BLANK: Well, you bring in Chinese management, you bring in Chinese labor. You talked about that. There are pumping stations, compressors, refineries, all the basic infrastructure you need to run a pipeline. In Kazakhstan, I don't think they have been able to bring in Chinese troops. I think that would cause a tremendous uproar if they tried to do it, but they do believe that it is safer for them, despite the risks, which they're well aware of in Central Asia, and for that matter in other places, in Russia and Myanmar, to have these pipelines and infrastructure set up because they believe they have political leverage that they can use to prevent the host country from acting in a way that damages China's interests.

They have been able in many cases to compel Central Asian governments, for example, not to support their ethnic brethren in Xinjiang because of the unrest in Xinjiang. They have been able to bring in their workers even though that has caused some discontent in Kazakhstan, and they are using this economic power in order to rescue Kazakh companies, and the Kazakhs know that to a certain degree there's a certain dependence, therefore, on China and are not willing to provoke China.

So while it may not be an ideal situation from Chinese point of view, again, given the fact that they believe that in any major crisis either the Middle East will be closed because something terrible will happen in the Middle East or that the Indian or American fleets will close the Straits of Malacca and they have no leverage at all on those governments.

So this is the least bad alternative. It's the best of all the available bad alternatives, and they do have, I think they're confident that they have the means to bring in this oil, not just in peacetime, but if things got really bad, that they would be able to get that energy from

Russia and Kazakhstan, perhaps Myanmar as well.

HEARING COCHAIR BLUMENTHAL: Ms. Nanay, real quick.

MS. NANAY: I don't think there is a real security concern between Kazakhstan and China within Kazakhstan, but probably China sees this pipeline as helping to bring economic development in the one part of their country where they have a concern, which is Xinjiang, with the Uighur minority where there's been friction between the Chinese government and this minority.

But I think this pipeline for the Chinese is seen as probably reducing the worries about separatism that exist with this region, and frankly in all of this area, the security services are very strong, and within countries themselves, I think even in Turkmenistan, I see reduced risks although there you're sitting near Afghanistan. You have other concerns because you have the risk of the drug trade, of Islamic movements.

So probably I suppose in the South, Uzbekistan, Turkmenistan, I might see more of the security concerns than I would see in Kazakhstan itself, and--but look, there are problems everywhere. There are chances that energy gets disrupted everywhere for whatever reason. Right now the Chinese depend to such a large degree on the Middle East. This is the other issue that concerns them. That is a major area for their own source of energy as it is for other countries and, we also depend on the Middle East, so this is a diversification opportunity for them.

HEARING COCHAIR FIEDLER: Chairman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thanks very much, and thank you to both of our witnesses.

It's very interesting testimony and interesting discussion. I want to switch it a little bit to the geopolitics. You both have mentioned that China's acquisition of these resources has provided a counterbalance to Russia's lock-hold on those resources, but it seems to me that would be a double-edged sword also for the countries, for Kazakhstan, Turkmenistan, in that now they have to juggle two rather large countries, neither of which have been very shy about using their economic power in order to achieve other possible ends.

How do you see this unfolding? Are these countries going to be able to continue to do some sort of a balance? Are they worried about losing that balance and what impact does China's acquisition of some of these energy resources have on China's relationships with Russia?

DR. BLANK: You've asked several questions. Let me try to give you an answer. In Central Asia, the extent of the balancing act varies from country to country. Some have greater independence than others. I think Kazakhstan, for example, has more freedom of

maneuver than say Tajikistan, just to give you an example, but all of those states are conducting what you might call a multi-vector foreign policy, attempt to omni-balancing, balancing against all sides. And they've been doing this since 1991.

This energy deal, if anything, makes their situation a little bit easier because it gave them more options vis-a-vis Russia, which was able to compel them to sell energy at below market prices until 2006 in many cases.

Now, Russia actually is paying more than the market price rather for these goods because of the leverage that these states gained in the last three years, thanks to China. So China helps balance out Russia.

Secondly, they have means of influencing or at least inducing Russia and China to help them. Central Asian states, to a considerable degree, each varying, depend on Russia and China to provide them with material resources for their security. Again, Tajikistan is the most outstanding example, but even Kazakhstan does, and they have a mechanism such as the Shanghai Cooperation Organization whereby they can make their voice felt, and they did last summer when the SCO refused to support the recognition of Abkhazia and South Ossetia, for an example.

Russia was not happy with this, but it accepted that verdict and tried to make the decision through another venue which it controlled, the Collective Security Treaty Organization.

So all these states are balancing constantly between Russia, China, and among other states or organizations like the United States and the EU. These deals actually to some degree help them, and particularly in a time of economic crisis.

For example, Kazakhstan's banking system is in very serious danger. The recent deal with China gave them \$10 billion cash which they clearly needed and which is enabling them to continue their modernization program and making the country attractive to worldwide investment.

Now, in terms of the relationship of Russia, Russia was not thrilled to have China come in and be a competitor in Central Asia, but again there was nothing it can do about it. Russia's power over Central Asia is considerable, but it's not all encompassing, and Russia for that matter needs a partner in China, and this would be true of any Russian government, from a Jeffersonian democracy to Stalinism. Given the power relationship, they need to have a normal friendly relationship with China.

We see now, for example, in the Russo-Chinese deal, that I believe the Chinese got the better of the deal, although the Russians think it was a win-win deal because Rosneft and Mr. Sechin, who

controls Rosneft, were bailed out, and the Russians now will be able to finally have a stable market for their oil in the Far East.

On the other hand, China was able to persuade Russia to change a fundamental point of Russian policy. Russian policy regarding energy shipments in the Far East was clearly aiming to build a pipeline all the way to the Pacific Ocean at Kozmino Bay, and from there sell to everybody--U.S., South Korea, Japan, China, other states, maybe eventually even North Korea, if that came to pass.

Instead, Russia was persuaded or induced, given the economic crisis and the debts Rosneft and Transneft had accumulated, to build a pipeline to one customer and everybody who knows the energy business will tell you that if you have a pipeline to one customer, the customer controls the pipeline, not you. Even if the Russians got a price that they think is a good price, I still think China very much got the better of the deal.

CHAIRMAN BARTHOLOMEW: Ms. Nanay, do you agree?

MS. NANAY: Well, yes, I think there is one important point there that is useful to follow up on, is that China is a customer, it's not a market, whereas, if you go out through the pipelines that go from Kazakhstan out to the West you're reaching markets, and I think that's an important distinction.

Russia will always be, I think, the predominant partner for these countries. Kazakhstan ships most all of its oil exports right now through Russia. China is a small piece of it. Some go south. Eventually we're hoping that even more will go out through the Baku-Tbilisi-Ceyhan oil pipeline. There is a lot of work that still needs to be done to make that a reality for Kazakhstan.

Same for Turkmenistan. Turkmenistan, a majority of its gas exports until there was a pipeline explosion in Turkmenistan earlier in April and since then, now over a month, the Turkmen haven't been able to ship their gas exports out to Russia because of dispute disagreement. It's not clear how this all came about, but they're trying to resolve it, and ultimately the Turkmen, at least in this moment in time, are really stuck to the degree that the China pipeline hasn't started up yet, and really their safety valve is Iran.

There is a pipeline to Iran from Turkmenistan that was built in '97, again at a time where the Turkmen were experiencing problems with Russia. Turkmenistan, again sitting where it sits, which is in a terribly difficult corner of the world near Afghanistan and basically Uzbekistan, Kazakhstan, Iran, their neighbors. These are their neighbors.

That's what they're dealing with and they really believe that for their survival because they're so dependent on gas for their revenues,

that they need pipelines in every direction they can get it, and Russia will always be important, but they will even consider--this is the other issue--is that the U.S. has been working actually since the late 1990s on trying to convince the Turkmen to consider a pipeline for gas that would go West.

And they have talked about it. They are looking at it, and this is a country that is determined to diversify, and so neither China nor Russia will be their only directions that they will seek to be going with their resources.

HEARING COCHAIR FIEDLER: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you. Thank you, Mr. Chairman. Thank you both for being here. You've been a terrific panel.

I'm going to quote something from your testimony and ask for a quick question for you and then for Dr. Blank. And then ask another question which we can engage in a broader discussion.

Ms. Nanay, you say, "China's status as a cash rich economic powerhouse needing energy to fuel its industries, and with money to pay for it, makes it a magnet for Central Asian suppliers."

Then you further say, "As China's energy ties grow with Iran, Kazakhstan, Russia, Turkmenistan and Uzbekistan, these countries will develop deeper political and geopolitical ties with their eastern neighbor. U.S. leverage for various goals, whether in democratization, human rights, or commercial concerns, will diminish."

Do you think that trend is in the national security interests of the United States?

MS. NANAY: Frankly speaking, wherever you go now where there is oil and gas, I think that is the trend, and I'll tell you why that is the trend. It's because national oil companies and then potentially other companies that they choose to partner with that are not part of the Western international oil industry, basically they do not come in and press for democratization or human rights.

Whether it's the Chinese or others, this is not the primary motive of these governments. As I said, these are government-to-government deals very often. For the U.S. companies, it's not that they can come and press for these issues; it's that when the U.S. government comes in, then these are the issues that they press on.

COMMISSIONER MULLOY: Do you think that's in the national security interests of the United States, this trend that you talk about in your testimony?

MS. NANAY: Well, it's probably not in the national security interests of the United States. Yes.

COMMISSIONER MULLOY: And then I want to get this one on the table. Dr. Blank, you referred to these same trends and the investment and the markets and other things, and then you say, "Thus Thomas Rawski and William Keller openly warn that the balance of influence between China and the United States in Asia is shifting decidedly in China's favor."

Is that in the national security interests of the United States?

DR. BLANK: Certainly not.

COMMISSIONER MULLOY: Okay. Now, I ask you both, where does China get this money and wealth to do all this investing and acquisition in Asia? Dr. Blank and then Ms. Nanay.

DR. BLANK: Well, it gets it from us and from the EU and from all of its other trading partners.

COMMISSIONER MULLOY: What about you, Ms. Nanay?

MS. NANAY: I think that's exactly correct.

COMMISSIONER MULLOY: Okay. So then the question then, has our trading policy in which we're running these massive trade deficits with China year after year, has that been in the national interests of the United States?

If you would each answer that pretty quickly because then I'll open it up. Dr. Blank?

DR. BLANK: Well, the last two administrations, both the Bush and the Clinton administration, seemed to think that it was. So I'm not in a position to give you a definitive answer on that. I don't have the economic knowledge to say that because they had a broader geostrategic objective in mind of integrating China with the global economy and, therefore, thinking that China would be a status quo actor, and so on.

But I just don't think that large trade deficits are ever in anybody's interests.

COMMISSIONER MULLOY: Dr. Nanay.

MS. NANAY: Large trade deficits are not in anyone's interests, but we've gone down this track and China is an important trading partner.

COMMISSIONER MULLOY: Now, I want to ask you both this question. Since we've now established it's not in the national security interests to run these massive current account deficits with China, or trade deficits, why do you think the U.S. government is doing this year after year? What forces are driving this to do this when people like you come in--and you're not the only ones--come in and say this is not in the national security interests of the United States to let this go on?

Dr. Blank and then Ms. Nanay.

DR. BLANK: Well, I can't speak for the people who made the

policy. They can give you their rationale so I don't know that I can give you an effective answer.

But I'm sure if you were to invite the people who were responsible, for example, for selling U.S. bonds to China for the deficit, they would come up and tell you that they have reason to believe it's in the U.S. interests that China be tied into the United States economy, as it is, in a significant way, and--

COMMISSIONER MULLOY: Hold it. Hold it.

DR. BLANK: And that they have more power to effect a decision than a lowly analyst like me so--

HEARING COCHAIR BLUMENTHAL: Pat, we're going to have to move on.

COMMISSIONER MULLOY: Are we finished? Is my time up? No.

HEARING COCHAIR BLUMENTHAL: Yes.

COMMISSIONER MULLOY: It wasn't up when you interrupted me. It was still going.

HEARING COCHAIR BLUMENTHAL: Yes, it was.

COMMISSIONER MULLOY: Okay. I'll stop. But Ms. Nanay, you may have an answer. What's driving this in your view?

MS. NANAY: Would we like to build up our manufacturing industries again? I don't think this whole China debate started yesterday. I think there's policies the U.S. has pursued that have led to this that now you can say, oh, it's not in our national security interests, but there are things we've done and we're in a situation that is probably moving down a track that is irreversible at this point.

COMMISSIONER MULLOY: Thank you both.

HEARING COCHAIR FIEDLER: Second round. Oh, sorry, Pete. We didn't catch you. Please.

COMMISSIONER VIDENIEKS: A quick question. It's a kind of factual one. To what extent is China's energy trade dollar-denominated? I understand with OPEC it is. Is it dollar-denominated with Kazakhstan and the Central Asia countries? Increasingly China has been trying to advance billions of Yuan to other countries like, for example--

MS. NANAY: My guess is it is. That would be my answer. I can't give you a definitive answer, but the trade in oil is generally dollar denominated so--

COMMISSIONER VIDENIEKS: Okay.

DR. BLANK: To the best of my knowledge, that's the case. But the point here goes to a broader issue. We've seen both China and for that matter Russia raise the issue of setting up exchanges in their national currencies, and there's a lot of talk of either about a ruble

bloc in the Russian case or a Yuan bloc, if you like, or China attempting to assert itself on international financial issues and on the role of the dollar as the reserve currency. So right now, the oil and gas, I suspect, are being paid for in dollars, but there may be some pressure to change that.

COMMISSIONER VIDENIEKS: I have another question. Some analysts have criticized PRC for acquisition of oil at the wellhead as opposed to relying like we do since the '80s or so on the open markets. Thus, our energy security is, in a sense, determined by the role of the market, whereas, they appear to be trying to acquire and secure the supplies at the wellhead.

If that's the case, ca both systems live side by side?

DR. BLANK: Well, the Chinese look at the energy issue in a very different way than we do. We used to have a much more regulated kind of economy before the '80s, but from 1980 through 2008, we had a very market friendly ideology and overall national policy including in energy. So we went down that way.

The Chinese don't fully trust the market. As I suggested, they're not sure that the energy will be there when they need it if there's a major crisis, and therefore the market won't bail them out and won't give them the energy they need. So being a government that is descended from a Leninist world view and is still an authoritarian regime, it is not a fully marketized economy and doesn't trust the market where its national security interests are seen as being in some degree at stake.

COMMISSIONER VIDENIEKS: Okay. Ma'am, are we getting away from the market as a guarantor of security? Is China starting something which we did in the '80s? Or are they doing 50/50 on it?

MS. NANAY: Not necessarily. I imagine if, while we have Canada, they ship oil here. Whatever is next door to us--or gas--we also capture those opportunities for ourselves. So what they're doing in particular in Central Asia is--or Russia--they're able to lock in these resources by pipelines.

They also trade oil on the open market, though, wherever else they produce it. So I don't think that's necessarily the case.

COMMISSIONER VIDENIEKS: Fine. One more quick question, which is basically what resources, proven or unproven, are there in Afghanistan, energy resources in Afghanistan?

DR. BLANK: In Afghanistan, there's copper; there's large natural gas deposits. I don't think there's oil, but there is natural gas, and it was discovered about three years ago.

The Chinese have some sizable investments in Afghanistan. The problem is you can't make anything work there right now given the

war.

COMMISSIONER VIDENIEKS: Right. Any?

MS. NANAY: I don't know exactly what the Chinese have or what Afghanistan has for that matter.

COMMISSIONER VIDENIEKS: What's there underground, assumed to be underground?

MS. NANAY: I've heard that there are resources, but I couldn't give you an estimate of the size of these resources.

COMMISSIONER VIDENIEKS: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Brookes.

MR. BROOKES: Thank you.

Do we have a sense of what percentage of the gas and oil energy that China gets from Central Asia is put on the open market? I know that some of the energy they get elsewhere is put on the open market. They feel like they make a profit of it. Is that true for Central Asia as well or is it all going to the Chinese market?

MS. NANAY: Well, right now because the pipeline in Kazakhstan isn't connected all the way from the West to the East, clearly what they produce in the West goes out on the open market. Now, the Chinese companies are not forced by their government then to ship everything out through these pipelines. It's not as if the government says to them, okay, you produced this here; you got to put it in the pipeline.

They may choose actually when this pipeline is up and running from West to East to still ship some of their commodity out through the open market because maybe they get a better price. That's not clear to me yet.

On the gas side, they're not receiving really any gas right now from Central Asia. I think that's still in the future, and that gas will be tied directly into their markets.

MR. BROOKES: Any thoughts on that?

DR. BLANK: Nothing different than Dr. Nanay.

MR. BROOKES: Thank you.

HEARING COCHAIR FIEDLER: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes. Iran has been touched on briefly, but I'd like to pursue it a bit because it's really where oil and geopolitics meet. Given the Obama administration's stated policies of denuclearization and the talk about crippling sanctions--their words, not mine--in the oil and natural gas sector, in specific, I believe, against Iran should they not comply with the demands of the U.S. and the EU essentially, it looks like China is going the other direction in terms of its oil and gas investments within Iran, and then, as you stated, the centrality in their mind of having

piping capability from Iran outward--how do you think crippling sanctions by the U.S. and a coalition of the willing would affect Chinese oil and gas interests in Iran?

MS. NANAY: Well, I think the Chinese do try to work with the U.S. on these issues to the extent that they're not really large producers of energy right now or even, I don't know what their--I don't even know if they're producing very much in Iran right now.

I think what they look at more is the future of the potential that they're locking up. They have negotiated projects and I see these more as future sources of oil and gas. I don't think they've concluded any major deals, but Iran and China have a long relationship. The Chinese have worked in other areas with the Iranians helping build the Metro, I think, in Tehran. They just have a relationship that's there and I think it's established.

And, on the other hand, the Chinese do work with us, and how they will cooperate if there's going to be crippling sanctions, I guess that's open to question.

DR. BLANK: Well, I would agree that they don't have--that the production from Iran that is going to China right now is not of the very large nature that the deals that have been made are forward looking. At some time in the future, they're supposed to come on line and generate relatively large volumes of oil and gas.

But if you turn the question around, Iran since about 2001 has been following its own kind of Ostpolitik, if you like, where Russia and China are seen as its major partners, and as a counter to the pressure from the West and from the United States in particular.

So they, if crippling sanctions are laid on Iran by the U.N. or the EU and the U.S., I think Tehran would look to Russia and China for support against them. And I, to be honest, well, I've written this about Russia, I am quite skeptical that either Moscow or Beijing is going to do much to come down very hard on Iran to stop enrichment as long as this creates problems for the United States.

HEARING COCHAIR BLUMENTHAL: Thank you.

Are there any more commissioner questions? No.
Let me thank the panel. Thank you very much for your great testimony, and we've really learned a lot.

We're going to take a ten-minute break and then start the final panel at 2:30.

[Whereupon, a short recess was taken.]

**PANEL IV: CHINA'S TRADE AND INVESTMENT IN
CONTINENTAL ASIA**

HEARING COCHAIR FIEDLER: Our final panel today will examine China's trade and investment in Continental Asia. Today will be joined by Mr. Daniel Twining, and currently Dr. Martin Spechler is here.

Dr. Spechler is Professor of Economics University-Purdue University. Dr. Spechler is the only American economist working full time on the economies of post-Soviet Central Asia. He has been a consultant for the World Bank, the Asian Development Bank, the Global Development Network, USAID and other U.S. governmental agencies.

His new book, *The Political Economy of Reform in Central Asia: Uzbekistan and Its Neighbors*, will be published soon in the UK.

Thank you for being here, Dr. Spechler. We'll start with you and I'll introduce Dr. Twining when he arrives.

We will bend the rules a little bit since there's only two of you, but you normally have seven minutes to make a presentation.

**STATEMENT OF DR. MARTIN C. SPECHLER
PROFESSOR OF ECONOMICS, INDIANA UNIVERSITY
INDIANAPOLIS, INDIANA**

DR. SPECHLER: We at Indiana University always appreciate the chance to come to the beautiful capital of our country and to meet people here in Washington. I might tell some of you whom I haven't told already that we now have, thanks to the U.S. government, the largest investment in knowledge about Central Asia of any institution in the world.

I'm the only economist, but we're teaching nearly a dozen of the languages of Central Asia, and I have some very, very fine colleagues in history, philology, history, political science, and I'm proud to be part of that team.

HEARING COCHAIR FIEDLER: Thank you.

DR. SPECHLER: Let me start with a couple of comments about some of the things I heard in the previous panel.

I'm really surprised at my friend Steve Blank, a noted expert on strategic relations when he goes along with the idea that in a national security crisis, the problem would be interrupting the flow of oil and gas to China.

Wars, even fairly protracted wars, are fought on stocks and not on flows. And therefore we would expect China to accumulate flows

of oil in what we call the Strategic Petroleum Reserve. This would obviate the problem of the Straits of Malacca and the Strait of Hormuz in case of a problem.

The Chinese in my experience are intelligent enough to realize that they need stocks of strategic materials in the event of a problem. Of course, Dr. Blank working at the U.S. Army War College, where experts are responsible, and properly so, for investigating capacity of any foreign power, Russia, China or any other foreign power, to undertake actions inimical to U.S. national interests.

But I question whether that is the Chinese intent or the pattern of Chinese activity in recent years. I read it in a different way. I think that since 1978, since Deng Xiaoping ascended to the senior leadership of China, China has not engaged in belligerency although before then, under Mao Zedong, they were at war here and there with all of their neighbors.

The Chinese have become more and more cooperative on many fronts. It's not wrong to consider Chinese capability and their building of that capability. But many of their actions are favorable to American national interests, and we have many, many cooperative interests with the Chinese. We should never forget that. Same thing is true with Russia.

I talked to Commissioner Mulloy about the matter of the Chinese balance of trade, and that's addressed, to some extent, in my paper so we can talk about that as well. But let me spend two or three minutes outlining the main points that I intended to bring to you.

The first is that, aside from pipeline and other infrastructure projects which are financed and constructed by the Chinese and aside from some telecommunication companies and informal trade, China conducts very little significant business and almost no normal business activity in Central Asia. I speak from some years of experience.

I also teach and research about China and I'm prepared to talk about internal reasons on both sides why normal business relations between China and Central Asia are unlikely to prosper in the years ahead, aside from extraction of natural resources through these pipelines. Even there the supply is far from guaranteed. These Central Asian countries have alternatives. There is a widespread predilection to ignore the independent activity of the 60 million people in Central Asia.

The five countries there, especially Uzbekistan and Kazakhstan, have become much more independent, self-confident and aware of their possibilities and their interests over the last nearly 20 years.

So to talk about Central Asian countries as if they're some kind of pawns to be sacrificed on a big chessboard is simply wrong. To

think of a great, new "great game" is a silly anachronism.

Nearly all of China's commercial activity in Central Asia is either, on the one hand, state controlled by state enterprises and run by self-contained Chinese gangs, or it's a kind of informal trade, which I investigated when I was in Central Asia on several occasions. This informal trade comes from the town and village enterprises of China and it's based on low quality goods brought or smuggled into Central Asia; it's not the basis for normal commercial activity.

So I emphasized this in my title, which I intended to be provocative, "Why Does China Have No Business in Central Asia?" because its commercial activity is not normal commercial activity. Nor is it likely to be because, on the whole, China has not shown much ability to mount advanced business even from within China. Perhaps there's some improvement in this area based on reverse engineering and stealing of commercial secrets of other countries, of other firms, but more important, China has been very reluctant and apparently unable to generate multinational companies even in its own neighborhood.

And there are some excellent reasons for this, having to do with the financing arrangements in China, their linguistic inadequacy, their inability to develop the kind of commercial and marketing infrastructure, and so forth.

In short, that my conclusion based on a search of my contacts in the area, all of whom, of course, are anonymous, as well as official and other kinds of contacts. There's not too much normal business activity talk about really.

I don't think that aside from oil and gas there is much of a threat from China in Central Asia. Indeed, I don't think that China's efforts in the oil and gas sector is much of a threat either. In fact, the more oil and gas that China is able to get out of Central Asia, the better it is for us, and certainly the better it is for the countries of Central Asia.

So let me just stop there.

[The statement follows:]

**Prepared Statement of Dr. Martin C. Spechler
Professor of Economics, Indiana University
Indianapolis, Indiana**

May 20, 2009

Testimony before the U.S.-China Economic and Security Review Commission

Hearing on "The Impact of China's Economic and Security Interests

in Continental Asia on the United States”

Why Does China Have No Business in Central Asia?

Martin C. Spechler

Professor of Economics, Indiana University

A search of many current sources and messages from several of my personal contacts in Central Asia indicate, not surprisingly, that People’s Republic of China (PRC) has little significant *normal commercial business* in the five post-Soviet countries of Central Asia.

This does not deny that China is conducting a growing state-to-state trade and investment program. China wants oil and gas more than anything else in Central Asia, aside perhaps from control of Uighur separatists in the Xinjiang-Uighur Autonomous Region (XUAR) in China’s northwest frontier. Chinese energy investments in Kazakhstan, Uzbekistan, and Turkmenistan will be reviewed by another informant.¹³⁴ There is also a large amount of smuggling and informal “shuttle trade” from China’s township and village enterprises (TVE’s) to Kazakhstan and onwards to the bazaars of Kyrgyzstan and Uzbekistan. Organized commercial trade by established Chinese business enterprises, however, must be judged insignificant. There are several structural reasons to expect this situation to continue for years to come.

Total trade

Both the destination and the values of trade between China and the countries of Central Asia are difficult to ascertain. Relevant figures are published by the International Monetary Fund in its quarterly *Directions of Trade Statistics* and by the Asian Development Bank in its *Key Indicators*. The IMF figures are estimated, for the most part, from the so-called “mirror statistics,” i.e., calculations from partners’ statistics,

¹³⁴ In brief, the PRC has been a net oil importer since 1993, and its 8-10% growth rates since then make securing supply a priority objective. China fears that in an armed conflict, its marine shipping lanes from the Middle East through the Strait of Hormuz would be blocked. Piracy and terrorism are also threats in the Straits of Malacca, through which half of all oil bound for China passes. Already a 960 kilometer oil pipeline, constructed by the Chinese Petroleum Company from Atasu, Kazakhstan to the Chinese border, is pumping a modest amount of oil to Xinjiang. Within about two years this network will extend 3000 kilometers to western Kazakhstan. Some more goes by rail. China has bought rights to several Kazakhstani fields and made preliminary agreements for oil (and gas) development in Turkmenistan. In addition, China has made loans to Turkmenistan to rehabilitate wells there. A natural gas pipeline from Turkmenistan through Uzbekistan is under construction. Eventually it will carry 30 billion cubic meters of Turkmen and Kazakh gas yearly to western China. Both China and the EU will be competitors with Russia for the natural gas and oil in the Caspian Sea off Turkmenistan and will likely force Gazprom to pay higher prices for needed supplies. The CNPC has also recently agreed to explore for natural gas near the Aral Sea in a production-sharing arrangement with South Korea’s National Oil Corporation and two other firms. However, it is doubtful that Chinese companies will try to develop these geologically challenging deposits without their accustomed Western partners or skilled national ones. The CNPC has just lent the Kazakhstani state-controlled company, KazMunaiGas, \$5 billion.

probably on a cif basis. The ADB takes national statistics as received. Both are in millions of USD; hence the conversion from other currencies is at issue. The totals for the year 2007 (the last year published as of March, 2009) can be quite different. For example, Kazakhstan's exports are reported by *Directions* as \$46.5 billion and by *Key Indicators* as \$36.6 billion. Tajikistan's imports are reported as \$1.46 billion by the former and \$2.54 by the latter. As for the reported destination, it's obvious that the port of entry is used, not the ultimate customer or consumer country. Otherwise, countries like Bermuda and the Netherlands would not appear so prominent in *Directions!* Hence, trade between China and Kazakhstan will be exaggerated, since much is transshipped from there to Kyrgyzstan, Uzbekistan, and probably the others. This is simply a matter of geography and land routes in the region.

Furthermore, since China's exports of goods assembled there from imported components are registered *gross* and Russia's exports are reported including transit trade from European sources, the net value of both countries' sales may be overstated by an unknown factor. This would apply more to consumer electronics and capital equipment than to oil and gas, though. Finally, much of the low-quality clothing and footwear is brought by informal traders from China without paying duties or registering values, if they can avoid it. Nevertheless, I give the ranges here, as presented in the two available sources.

Kazakhstan sent 12-15% of its 2007 exports to China, 9% to Russia*.¹³⁵ China supplied 25-22% of its imports, Russia 40-34%.

Kyrgyzstan exported 6-8% to China, 21-18% to Russia. Imports came 14-61% from China (!); 14-16% from Russia.

Tajikistan's exports went 1-0% to China, 7-9% to Russia; imports came 11-21%** from China, 32-21% from Russia.

Turkmenistan's gas exports went mostly to Ukraine first; 9-10%** of its imports came from China; 12-8% from Russia.

Uzbekistan sends only 6% of its exports to China, 22% to Russia—not accidental, since Uzbekistan has no gas pipeline to China as yet. Some 13-14%** of its registered imports come from the PRC, 30-26% from Russia.

In short, the Chinese sell a great deal to the states adjoining the XUAR; only Kazakhstan finds China a sizable market (mostly for oil and steel).

Country situations

¹³⁵ The first figure in the range come from *Directions*, the second from ADB. If *Directions* indicates a significant decrease in the distribution for the first nine months of 2008, that is marked by a *; an increase is marked **.

In *Kyrgyzstan* (the Kyrgyz Republic), the nation with the most Chinese penetration in Central Asia, much more its imports come from China than from Russia, formerly the dominant economic partner in this remote and poor country (\$1790 per capita at purchasing power parity in 2006). A couple of small companies exist in Bishkek at the Dordoi bazaar selling ordinary consumer goods or at Kara-Suu, the famous regional bazaar near Osh and the Uzbekistan border (now open without visas). There are also two or three Chinese tour operators in Bishkek. (They also operate down the road in Almaty.) I have observed Kyrgyz at the airport in Urumqi loaded with electronics, clothing, or even build materials waiting for the regular flights to Central Asia. (Railroad or bus connections are very poor.) A Chinese company delivered non-combat equipment to the Kyrgyz military from 1998 to 2001.

There are an estimated 30,000 Chinese now living in the cities and towns of the Kyrgyz Republic, population 5 million. Some 6000 work permits were issued to PRC citizens in 2008. Some run restaurants or work at food stalls. Chinese are said to feel safer in this tolerant atmosphere than in Russia, and quite a few have enrolled in universities after learning Russian, a potentially valuable skill, rather than Kyrgyz, a Turkic language. These choices indicate that the Chinese intend to return to the PRC. Young Kyrgyz who are able to learn Chinese may find jobs with brick-making, plastic window, or other companies in the Chinese section of the Dordoi bazaar, but career jobs in China itself are hard to break into for ethnic Kyrgyz.¹³⁶

In *Tajikistan*, the other small, fragile economy in the region, the situation is similar. China supplies about 20% of its modest imports, but trade the other way is very small. Aside from declining remittances, a major source of foreign exchange, mountainous Tajikistan's future development is closely tied to its water resources and the electricity which may be generated for its aluminum complex. These could generate exports to China, a neighbor to the east. At present, however, Tajikistan must import a great deal of its fuel from Uzbekistan. China Export-Import Bank is financing a \$300 million hydropower project on the Zeravshan river. The Chinese National Corporation for Heavy Machinery has agreed to build two alumina factories to supply TALCO, the Tajik aluminum combine. While China's credit and infrastructure activity in Tajikistan is growing, Russia and Iran are still more involved in these sectors than are the Chinese. Supposedly, eighty Chinese companies are registered in the country, plus some joint ventures with "Chinese participation."¹³⁷ But my Tajik source could identify only a brickworks in Hissar, a foundry in Dushanbe, and two chemical factories at Yavan and Kurgan-Tiube. The Interior Ministry Migration Service reported all together more than

¹³⁶ Dina Tokbaeva, "The Chinese Connection," *Transition Online*, April 15, 2009.

¹³⁷ Saodat Olimova, "The Multiaceted Chinese Presence in Tajikistan," *China and Eurasia Forum Quarterly*, vol. 7, no. 1 (2008), p. 65.

ten thousand Chinese laborers in Tajikistan, and there may be another one to three thousand illegals there. Most (more than three-quarters young men) are employed in all-Chinese markets or state companies located far from urban areas, often in shabby conditions. In the great majority, these workers know no Tajik or Russian and plan to return to China after a year or so. Thus, most of Chinese involvement appears temporary in nature.

Uzbekistan's trade with the People's Republic of China has grown rapidly in recent years, although ground transportation remains a problem since access must be through Kazakhstan (or Kyrgyzstan, if road projects mature). Total trade exceeded \$900 million in 2006, more than double the figure for 2003.¹³⁸ China Mobile, the giant Hong Kong firm with 223 million subscribers in China itself, is seeking expansion in Uzbekistan, as it has in Yemen and unsuccessfully Pakistan's Telecom. If successful, the Chinese firm would compete with an established Russian one and Huawei Technologies of Shenzhen, a private Chinese company which offers communication services throughout the region, according to my informant from Uzbekistan. Although President Karimov's relations with the Chinese leadership are cordial, he has expressed himself crudely about the quality of imported consumer goods which obviously come from or through China. Karimov's citizens, however, favor the prices.

Since 2000 and up to mid-2008 *Kazakhstan* was the economic star of the region. With growing oil output, a convertible currency, and liberalized financial regulations, Kazakhstan was able to attract several foreign banks. The CNPC and KazMunaiGaz, already mentioned, are both effectively state companies, not normal commercial entities. "Azat," the democratic opposition party in Kazakhstan has recently expressed alarm at the expanded Chinese presence in Kazakhstan's petroleum sector. These dissenters collected 800,000 signatures in support of revising contracts for use of subsoil resources. Long-time President Nursultan Nazarbaev's regime has in fact been sounding notes of resource nationalism recently, yet has allowed China to acquire ownership rights to about one-third of Kazakhstan's oil output.

On a recent trip to Almaty I did not observe any Chinese participation in banking or construction firms. The credit card "China Union Pay" does circulate alongside VISA, American Express, and Diner's Club, though. High freight rates and petty interferences impede Kazakh-Chinese trade. Many Chinese producers prefer to send containers by rail eastward to the Pacific and onwards to Europe rather than utilize shorter routes through Kazakhstan and Russia. Kazakhstan sends steel to China by rail over the Ala pass at Horgos, despite the inconveniences at the border.

In interesting new developments KazAtomProm has signed an joint venture agreement

¹³⁸ Ministry of Commerce of the PRC.

with the Guangdong Nuclear Power Co. to build an atomic power station in China. And Kazakhtelekom has an agreement to develop a wireless network with China's Tietong, financed by the Bank of China.¹³⁹

Turkmenistan has few foreign investors of any origin owing to its tiny market, remote location, and difficulty in obtaining visas. China is supposed to start buying gas this year, if the pipeline is completed on time. The CNPC is also building a gas-processing plant at the Samandepi field. Most of Turkmenistan's limited imports come from neighboring Russia.

Unlike the ex-Soviet Central Asian countries, *Myanmar* appears to be a "satellite" client state of China because the West has tried to isolate that country's military junta. In friendly gestures, China (and Russia) vetoed Security Council sanctions against the regime when it opened fire on protesters. Myanmar is offering a transit route for oil from the Indian Ocean to southern China, avoiding the Straits. It also sells timber and food to China, but overall only 6-14% of the country's \$5-6 billion of exports go there. China does supply a very large and rising share of Myanmar's imports, possibly on concessionary terms. However, both India and Thailand also do business there. The Chinese prime minister, Wen Jiabao, has appealed for democracy in the former Burma, an apparent departure from China's long-held view that foreigners should not interfere in the internal affairs of other countries. This is part of China's more flexible and cooperative stance on a number of problem areas, such as Darfur and North Korea. But Central Asia is different from Myanmar in several respects.

Regional projects

China is also financing and building a strategically important road link from the Kashgar region of the XUAR. This road will traverse mountainous terrain to Kyrgyzstan and Uzbekistan. China is lending \$75 million for that construction. The road from Tajikistan to China over the Kulma Pass (4365 m) was completed three years ago and has reportedly carried traffic of more than 9000 tons.¹⁴⁰ These routes provide land access to Pakistan. There are also railroad projects to improve bulk transport from the XUAR to Kazakhstan, since the railroad gauges differ and require switching the trucks or cargoes at the frontier.

Chinese exports to the region

There are several reasons why Chinese trade, aside from energy and low-quality consumer goods, is unlikely to expand into manufactures and services during the

¹³⁹ www.kt.kz (in Russian), accessed May 6, 2009.

¹⁴⁰ Saodat Olimova, "The Multiaceted Chinese Presence in Tajikistan," *China and Eurasia Forum Quarterly*, vol. 7, no. 1 (2008), p. 64.

foreseeable future.

To take one example, China has become a major producer (second to the USA) of electronic and information technology products, including office equipment, communications equipment, and consumer electronics, such as DVD players, notebook computers, and mobile telephones. These products are assembled in China from components designed and manufactured elsewhere, notably Japan, South Korea, and Taiwan.¹⁴¹ In practice, foreign firms employing cheap Chinese labor in an export platform arrangement. Among the foreign firms are the Taiwanese “Foxconn” brand, owned by the Hon Hai Precision Industry Company, which produces for Sony, Apple, and Nokia. Tech Front of Shanghai is a subsidiary of Quanta Computer, Inc., of Taiwan, the largest leading producer of notebook computers. Taiwan’s Asutec Computer owns China’s Magnificent Brightness, another notebook computer producer. Such products may be attractive to a thin stratum of Central Asian intelligentsia and officials, but they are hardly PRC business exports.

According to some experts, mainland Chinese-owned firms are reluctant to spend on research and development, because of poor protection for their intellectual property. Foreign firms protect their proprietary knowledge from Chinese efforts to reverse-engineer or otherwise steal others’ secrets. Sometimes low-quality Chinese clothing bears Western insignia anyway.

Besides raw materials, China imports considerable quantities of capital goods and equipment. This is good news for Japan, but hardly for Central Asian countries.

China exports huge quantities of footwear, toys, and sporting goods. The higher quality, “branded” types go to markets in Europe and North America—with a VAT rebate-- but lesser quality types are sold by TVE’s located in poorer areas of China (such as the XUAR) and filter across the border, often by Uighur and Kazak traders. At the huge emporium outside Almaty these ordinary wares are sold in wholesale and retail quantities to women and men who come with gigantic bags on buses from Bishkek, Tashkent, and other faraway cities.

Although the states of Central Asia have low formal tariffs, they do engage in non-tariff barriers to prevent competition with their own apparel, food, and other consumer industries. The difficulty and expense of exporting from and importing into Central Asia are truly breathtaking. Kazakhstan requires 11 documents to export and 13 to import; assembling all this takes a reported 89 days! The cost of sending a container to Europe is \$3000. The other three are similar.¹⁴²

¹⁴¹ Lee Branstetter and Nicholas R. Lardy, “China’s Embrace of Globalization,” in Loren Brandt and Thomas G. Rawski, eds., *China’s Great Economic Transformation* (NY: Cambridge University Press, 2008), pp. 661-62.

¹⁴² *Doing Business 2009. Europe and Central Asia*, various tables (Washington, D.C., World Bank, 2009). There are no data for Turkmenistan. The reasonable standard for documents and days would be in the single digits, as indicated by European examples.

Political aspects

China is aware of competition for energy, but has taken the view that normal friction “should be resolved through dialogue on equal footing, consultation and talks.” In its successful negotiations to join the WTO, China argued that existing members should not condition its entry into this worldwide organization on political or economic concessions, as it accused America of doing. So China has adopted a rhetoric favoring normal free trade.

Central Asia is hardly “central” in the view of most Asians. As noted in the London *Economist*, “Central Asia, belying its label, is on the edge of this space [“Asia”] politically as well as physically.”¹⁴³ The East Asia Summit, held this year in Thailand, includes Australia and New Zealand, but not Uzbekistan! ASEAN, the grouping of ten south-eastern nations, is eagerly seeking deals with China, South Korea, and Japan. But a search of ASEAN literature and pronouncements turned up no references to the 60 million Asians in the five countries of Central Asia.¹⁴⁴

China has two crucial foreign policy goals which affect Central Asia. First and foremost, the Chinese wish to suppress any support for separatists in the XUAR who have occasionally resorted to violent attacks on the growing Han population there and its police and military colonists. There are an estimated 210,000 Uighurs in Kazakhstan, some of whom are active in supporting their ethnic kinsmen in the XUAR. A further 46,000 reside in Kyrgyzstan, which borders the most sensitive area (Kashgar city) of the XUAR from this point of view. China calls them “terrorists” likely associated with Al Qaeda, a doubtful connection.¹⁴⁵ But China has received cooperation from all the Central Asian regimes involved in surveilling and controlling these groups. Furthermore, China has succeeded in persuading the Central Asians to adopt the PRC position with regard to Taiwan and Tibet. The neighboring Central Asian states have joined the Shanghai Cooperation Organization, regarded by the Chinese as a key instrument of their regional policy. Originally designed to counter US and NATO military installations and military assistance for these countries, the SCO has had little independent effect, in my opinion. Borders have been demarcated bilaterally. The Uzbekistanis have limited their

¹⁴³ *The Economist*, April 11, 2009, p. 43.

¹⁴⁴ Martin C. Spechler, “Central Asia between East and West,” *The Carl Beck Papers*, no. 1904 (University of Pittsburg, 2008), pp. 22-24.

¹⁴⁵ According to a report to the PRC State Council, “From 1990 to 2001, the ‘East Turkestan’ terrorist forces inside and outside China were responsible for over 200 terrorist incidents in Xinjiang which resulted in the death of 162 people of all ethnic groups, including grassroots officials and religious personnel...” *Beijing Review*, January 31, 2002, quoted by Ramakant Dwivedi, “China’s Central Asia Policy in Recent Times,” *China and Eurasia Forum Quarterly*, vol. 4, no. 4 (2006), p. 143. My own observation and interviews with Uighurs in Urumqi during the late 1990’s indicate these concerns are overblown.

cooperation on military matters and regard the SCO as an economic grouping only. The Chinese, therefore, have little reason to penetrate Central Asian business circles or the political elites, assuming they could do so.

China is limited in its ability to influence Central Asia through business relationships, as compared with Russia, the USA, or the EU. Because of historical accidents, the Sino-Soviet split, and deep cultural and religious differences, the Chinese have few contacts in these countries, as compared with the Koreans, for instance. Central Asians are fearful of the overwhelming Chinese population and even of China's ancient position in the Fergana Valley during the Tang dynasty (618-906 c.e).¹⁴⁶ Chinese traders have expressed dismay to me at the corrupt and disorganized business practices of the Central Asians. Much of exchange is still conducted in cash, not modern credit instruments. As for bulk goods, transportation links are still poor, despite efforts of the Asian Development Bank. Central Asians use Russian as a lingua franca, but that language has long yielded to English as a second language for Chinese.

Central Asian experts are increasingly worried about the region's sources of fresh water. China controls the head waters of the Ili and the Irtysh, which flow into Kazakhstan. The Chinese plans to exploit those rivers for civilian needs, oil field development, power, and irrigation present a latent conflict with Kazakhstan, although the situation at present is not critical, as it is for Amu Darya water entering Afghanistan, Uzbekistan, and Turkmenistan on its way to the much-reduced Aral Sea.

China's increased activity and support of Central Asian governments clearly worries India, which has resumed efforts to expand its strategic depth and influence in this area, close to Afghanistan and Pakistan.¹⁴⁷ Like China, India has friendly relations with all the countries of the region. New Delhi has also obtained their support for India's position on Kashmir. Agreements have recently been signed to allow exploration for energy. India's state-run gas company GAIL agreed to build facilities in Uzbekistan to produce some 100 thousand tons of liquefied petroleum gas at a cost of \$50-60 million each.¹⁴⁸ New Delhi's effort to purchase a share of the Kurmangazy field in Kazakhstan lost out to a Chinese bid, though. Probably India's strength in information technology is more promising for the time being. So we see one result of China's initiatives is to stimulate its natural rivals in the area—Russia, India, and perhaps the USA. India's activity

¹⁴⁶ Murat Auezov, former Kazakh ambassador to China has said: "I know Chinese culture. We should not believe anything the Chinese politicians say. ...I'm telling you that 19th century China, 20th century China, and 21st century China are three different Chinas. But what unites them is a desire to expand their territories." Jeremy Bransten, "Central Asia: China's Mounting Influence." *Eurasia Insight*, November 23, 2004.

¹⁴⁷ Yashwant Sinha, "India and Central Asia in the Emerging Security Environment," in K. Santhanam and Ramakant Dwivedi, eds., *India and Central Asia: Advancing the Common Interest* (New Delhi: IDSA & Anamaya Publishers, 2004), pp. 2-9, quoted in Dwivedi, supra, p. 158.

¹⁴⁸ RFE/RL, May 22, 2006.

increase in the future will also depend on its continued economic and military expansion.¹⁴⁹

Prospects

The basic reason for the insignificance of normal business relations between China and the countries of Central Asia has to do with their present comparative advantages and technical barriers to such relationships. The Central Asian countries have conducted an external policy of “staple globalism,” which involves state trading of exports and selective imports of capital goods.¹⁵⁰ China buys as much staple energy (and some metals) as it can at world prices from Kazakhstan, Turkmenistan, and Uzbekistan, but is hardly interested in the gold¹⁵¹ and cotton which are the main currency earners of these three countries. Kyrgyzstan and Tajikistan have little to offer China besides their labor, though potentially hydropower could be available if the requisite dams can be built or operated efficiently and transmission lines constructed over the mountains to the XUAR. China does not produce the kind of capital goods or high-quality consumer goods the half-Westernized ruling elites in these countries want to purchase with their scarce foreign exchange. Furthermore, potential Chinese businessmen and investors have always worried about the weak enforcement of property rights in all the Central Asian states. According to an authoritative international source, it requires between 177 and 281 days and 32 to 42 procedures to enforce a contract in Central Asia at a cost of 25-30% of the claim—several times worse than in European markets.¹⁵² Lack of financing for foreign ventures would also be a problem. China’s state-owned banks favor large state-owned enterprises and infrastructure projects, with only some 8% of loans going to small and medium-sized enterprises.¹⁵³

The current worldwide slump has severely affected Kazakhstan because of its heavy dependence on oil and gas exports, as well as metals exported to Russia. A huge share of the money Kazakhstan earned went to its active construction sector, which employed more than 500,000 people (in a country of 15 million). With a recall of extensive loans taken in dollars, the government has been forced to expend an estimated \$3 billion to

¹⁴⁹ Stephen Blank, “India’s Rising Presence in Central Asia,” in Ariel Cohen, ed., *Eurasia in Balance* (Aldershot, UK: Ashgate, 2005), pp. 183-201.

¹⁵⁰ Martin C. Spechler, “The Economies of Central Asia: A Survey,” *Comparative Economic Studies*, vol. 50 (2008), pp. 30-52.

¹⁵¹ At present China is buying gold from domestic sources at a discount to diversify its reserves.

¹⁵² *Doing Business 2009*.

¹⁵³ National Bureau of Statistics of the PRC, quoted in *The Wall Street Journal*, May 14, 2009, p. A9. Lack of collateral or other credit guarantees often lead to refusals by banks.

finance some 220 unfinished housing projects in Astana alone.¹⁵⁴

Kyrgyzstan, Tajikistan, and Uzbekistan have lost a tangible share of their GNP's from the return of workers from Russia and elsewhere. Their remittances constituted as much as a third of national income in the first two countries, while Uzbekistan has lost revenue from weak cotton prices. When and if natural gas prices, normally set in state-mediated contracts, fall off, Uzbekistan, Kazakhstan, and Turkmenistan will face budget crises. So far, however, China has not extended open budgetary assistance, as Russia has said it will do.

Conclusion

With regard to China's activity in Central Asia the current United States Administration has little to worry about. Most of PRC direct involvement is temporary and is intended to diversify its sources of fossil fuels. This can reduce world prices slightly, as long-term monopolization of energy is infeasible, and should bother Russia more than the USA. Informal trade with the XUAR is innocuous and beneficial to ordinary Central Asians. Genuine PRC business firms have yet to establish themselves to any significant extent anywhere in Central Asia.

China's suppression of Islamic Uighurs and Buddhist Tibetans is objectionable, of course, but no one can reasonably expect the United States to do more than protest violations of human rights there. A similar lack of feasible instruments affects our position with respect to the malevolent military rule in Burma.

HEARING COCHAIR FIEDLER: Thank you.

DR. SPECHLER: But I'd be delighted to answer questions.

HEARING COCHAIR FIEDLER: Thank you.

Dan Twining is Senior Fellow for Asia at the German Marshall Fund. Mr. Twining previously served as a member of Secretary of State Condoleezza Rice's policy planning staff with responsibility for South Asia and regional issues in East Asia, and also has extensive experience working on the Hill as a Foreign Policy Advisor for Senator McCain.

Welcome.

STATEMENT OF MR. DANIEL TWINING SENIOR FELLOW FOR ASIA, THE GERMAN MARSHALL FUND

¹⁵⁴ Alisher Khamidov, "Kazakhstan: Construction sector still reeling despite government's bail-out package," fergana.ru, April 6, 2009.

OF THE UNITED STATES, WASHINGTON, DC

DR. TWINING: Thanks for having me.

It's very funny to sit on this side of the dais rather than behind Robin Cleveland or someone on the other side. It's great to be here. I have a written statement which I hope you can look at--

HEARING COCHAIR FIEDLER: It will be in the record, yes.

DR. TWINING: --very quickly through some of the key points. I'm going to try to do this at a kind of 30,000 foot level rather than talk about individual Chinese companies or individual investments.

I wanted to talk to you about the strategic implications of Chinese trade in Asia for U.S. interests in terms of five themes.

The first is naval power projection. The second is our counterterrorism objectives. The third is India's rise. The fourth is the question of democracy and human rights. And the fifth is the question of Asian regionalism. And all of these in the context of American interests.

Naval power projection. You're all familiar with the kind of "string of pearls" concept. China has invested, in terms of its trade and investment relationships as well as its foreign assistance strategies, it's invested quite concertedly in South Asia. Deep-water port facilities, as in Pakistan at Gwadar, in Burma, in Bangladesh, in Cambodia; dredging Burma's Irrawaddy River; considering building a canal across the Isthmus of Kra. All of these have quite significant implications for the U.S. footprint in the Indian Ocean and its rim lands.

The interesting thing about this--a lot of this has been commented on quite broadly, but particularly interesting thing to know about what looks like a certain Chinese design here to access the Indian Ocean through all sorts of means, is that all of this Chinese economic penetration, the development of port infrastructure and other things, is occurring in states that are quite weak and fragile. I'll talk a little later about how the U.S. can kind of respond to that.

More broadly, though, as people have been writing with increasing frequency quite recently, it looks like the U.S. is going to need to consider a certain kind of Indian Ocean strategy in the same way that I would argue we've had since the late 1940s quite a coherent East Asia kind of diplomatic, economic, political, military strategy.

I would argue that we don't have anything quite as coherent and systematic in the Indian Ocean, defined as a new region, that I think all American policymakers are still grappling with as a region, and that would be my kind of core recommendation.

On counterterrorism, I know you guys talked about South Asia

this morning, Pakistan particularly. I don't want to talk about it too much except to say that there is this big question mark about Chinese trade and investment in Pakistan in terms of the port facilities along the coast, in terms of the special economic zones, in terms of the kind of manufacturing and energy development facilities that China is investing in.

China has been Pakistan's "all-weather" ally. China has arguably been a much better ally to Pakistan than the United States has, at least in terms of consistency. The U.S.-Pakistan relationship has gone quite up and down since 1954. China has been an "all-weather" ally.

Pakistan's close relationship with China, which hinges in part on China's economic relationship with Pakistan, makes it in some cases harder for the U.S. to pursue its counterterrorist objectives there because Pakistan, although perhaps could be defined as a client state of ours, it's not exclusively a client state of ours, and in fact, it has other options in Saudi Arabia and in China in particular.

So what this means, and this has implications in everything from our relationship with Pakistan's civilian government, which prefers going to Beijing to get blank checks rather than maybe doing hard macro reforms, likes Chinese corporate investments sometimes more than Western investment.

On the military side, the Pakistani military is China's primary arms export destination, and this also creates complications for the U.S. in terms of leveraging our own interests with the Pakistani military to do counterinsurgency and counterterrorism.

At the same time, just to close on Pakistan, China's development of special economic zones, its manufacturing, energy and other interests in the form of trade and investment in Pakistan, gives China quite important leverage, and the U.S. has been encouraging China to use that.

I think our sense, at least when I was in government, is that China prefers a bilateral relationship with Pakistan to a multilateral one. China declined the U.S. suggestion to host the "Friends of Pakistan" donors meeting in April, went to Tokyo instead.

So a big question for the United States, I think, a big way to kind of elevate the issue of Pakistan in our counterterrorism objectives, is going to be make this a diplomatic priority with Beijing.

Again, in part, because of its extensive trade and investment interests in Pakistan.

Third issue area is India's rise, and talk about this as an American with reference to American interests, but successive American administrations and a bipartisan solid majority in Congress have identified India's rise as an important interest to the United

States, to help us maintain a pluralism of power in Asia, to help us kind of do a regional and global strategy in which India is a big and capable democratic partner.

Indians will tell you again and again that China has pursued a strategy to really box them into their region. 90 percent of Chinese arms exports, some private, some public, go to Pakistan, Burma and Bangladesh, all countries immediately around India.

China's infrastructure development is quite extensive, and I think you've heard a lot about it in Pakistan. You've heard about it in Burma. You hear about it a little less, but it exists very heavily, in Bangladesh, in Nepal and elsewhere. A lot of this is justified and is truly done with reference to China's commercial interests in terms of kind of connecting different parts of China to the seas along South Asia, but of course all of these have military applications in terms of troop movements and this sort of thing.

I think the bottom line here is that in terms of China's trade and investment in these countries around South Asia, the most important thing that the United States can do and that India can do as the targeted country is to promote democracy and human rights and good governance in many of these weak South Asian states, and that's my fourth pillar here, which is this point, which of course you know that Chinese trade and investment in continental Asia has not had progressive benefits in terms of good governance, in terms of transparency, in terms of human security, in terms of shared regional security.

In fact, we've seen quite the opposite. We've seen that with Sri Lanka in the latest surge in fighting. China, the primary arms supplier to Sri Lanka, China investing very heavily in the port at Hambantota in Sri Lanka, which is, anyone familiar with the British Empire will tell you is one of the best ports in the Indian Ocean.

This has created a buffer for the Sri Lankan government and military to pursue a policy that I would argue has included crimes of war against Tamil civilians in Sri Lanka with Chinese protection, and the economic piece is a big part of this.

In Burma, I think you're all quite familiar with the infrastructure, the road and rail networks, the energy networks connecting Burma's offshore gas supplies to the mainland, and of course, again, the buffering effect this has had in terms of any ability by the West and partners like Japan to put meaningful pressure on Burma.

And Bangladesh and Nepal, I'll just mention very quickly that, the similar issues. Bangladesh has a closed border to trade with India, which is astonishing given that it's part of India's natural economic

hinterland, sizable and meaningful Indian investments in Bangladesh.

Similarly, in Nepal, big Chinese infrastructure investments, including construction of a rail link to Katmandu, which of course is on the southern slopes of the Himalayas, and Indian national security strategy for about 300 years, including under British India, has been to basically deny Chinese access to the southern slopes of the Himalayas.

Now that you have a or you've had until about ten days ago a Maoist government in Nepal, this has a new twist for India in terms of the China relationship.

All of these countries--Sri Lanka, Burma, Bangladesh, Nepal--suffer from weak governments, weak states, fragile institutions. The best long-term thing that we could be doing is investing in governance and accountability and transparency in these countries to render them less susceptible to the political effects of China's trade and investment regimes.

Finally, fifth point I wanted to raise in this context is the question of Asian regionalism. China has used particular Asian institutions that it has favored to pursue exclusive rather than inclusive economic and political designs. I would single out the Shanghai Cooperation Organization in Central Asia.

I'm not a Central Asia expert. But China has promoted economic and political arrangements through the SCO that are designed to exclude the United States, European countries, privileged China's role along with Russia's.

China's favorite East Asian regional organization is the ASEAN Plus Three organization of the ASEAN states plus China, Japan and Korea. China was very interested in the East Asia Summit when it was stood up in 2005 until it became quite inclusive, and the Southeast Asian states and Japan pulled in India and Australia and other countries.

China lost a lot of interest in it then because it was a reflection of a form of open regionalism rather than a more closed and exclusive regionalism.

On the trade and investment side, we've seen China pursue exclusive economic arrangements in these institutions.

We've also seen though some pushback, and this is what's interesting on this question of in Asia, do economics follow politics or do politics follow economics? If you believe the latter, I think you worry that China's economic magnetism increasingly creates a more Sino centric kind of political sphere in Asia.

In fact, I would say you've seen to some extent the opposite: Southeast Asian states quite concerned about the implications of Chinese trade and investment through things like the Chinese ASEAN

Free Trade Agreement in terms of hollowing out Southeast Asian manufacturing. Because many Southeast Asian countries are in a basically economically competitive relationship with China. Similar stages of development.

You've seen in India, China has moved to India's top trading partner over a period of the last few years, and over a period of the last few years, that same period, you have seen political and military tensions between India and China actually intensify.

So the trade relationship has not created a more fruitful diplomatic and political relationship, I would argue.

You have ASEAN states like Singapore and Vietnam very concerned about China's economic penetration of not only Burma but also Laos and Cambodia. And you see a certain ASEAN cohesion developing around pushing back on this a little bit.

I guess my policy implication for the U.S. would simply be that we should participate in Asian regional institutions more robustly because actually we have a lot of friends and allies who don't want Asia to develop into a closed or a more Sino centric economic and political sphere, who fear the political implications of Chinese trade and investment for their autonomy and their security, and this creates a big opening for us.

Finally, I'll close with just two sentences, which is that the history of the rise of great powers for the last five centuries has shown that great powers, as they rise, define and pursue their interests within an expanding sphere, and this is what China is doing. It's not hugely different in form than what the U.S. did as it rose or what Britain did as it rose. I don't think that means we can be complacent though.

I think it means we shouldn't be emotional. A lot of what China is doing is perfectly in its interests: wanting to develop a blue water navy to project its commercial interests in the Indian Ocean; wanting access to warm water ports in South Asia. All of these are quite natural and logical.

It seems to me the best thing we can do as a country is work with friends and partners and allies to promote high standards for China as it rises in terms of its trade and investment in continental Asia so that trade and investment don't undermine good governance but promote it so that they promote human security rather than undermining it, and so that China increasingly is operating in an international and commercial environment in which kind of rule and law and transparency and accountability characterize its commercial dealings.

Thank you.

[The statement follows:]

**Prepared Statement of Mr. Daniel Twining
Senior Fellow for Asia, The German Marshall Fund of the
United States, Washington, DC**

I am grateful to the Commission for the chance to testify today. I'm going to discuss the strategic implications for the United States of China's trade and investment in continental Asia. I will organize my presentation around five themes: the implications of Chinese trade and investment for (1) naval power projection, (2) counterterrorism, (3) India's rise, (4) democracy and human rights, and (5) Asian regionalism.

Naval power projection

The Pentagon has highlighted Beijing's design to construct a "string of pearls" of naval facilities stretching from Southeast Asia to the Persian Gulf--a project that will help China protect seaborne trade and project its influence in the Indian Ocean. China is constructing deep-water port facilities capable of berthing warships at Gwadar, Pakistan; Rangoon and Kyaukpyu, Burma; Chittagong, Bangladesh; Sihanoukville, Cambodia; and elsewhere. Chinese engineers are dredging Burma's Irrawaddy River to give China a usable waterway connecting Yunnan province to the Bay of Bengal, and China is considering building a canal across the Isthmus of Kra in Thailand.

All of these port construction projects are occurring in countries that enjoy deep economic relationships with China. They welcome investment from China to construct dual-use infrastructure along their coastlines that will expand ocean-going trade and facilitate the processing of energy imports. It should also be noted, as I will discuss more below, that all of these countries are weak states in which Chinese investment is not mediated by strong, democratic institutions and is often less than fully transparent, with implications for public accountability and political corruption.

The United States Navy is used to controlling the Indian ocean sea lanes that carry 70 percent of the world's oil supplies. Freedom of navigation in the Indian Ocean and its rimlands are essential to any U.S. strategy to secure Persian Gulf energy resources, resupply American forces in Afghanistan, contain Iran, project power in the wider Middle East, and conduct antiterrorism operations around the Horn of Africa. China's penetration of the Indian Ocean rimlands and aggressive development of blue-water naval capabilities will transform the balance of power in a region central to American economic and security interests.

The U.S. government needs a combined civilian-military Indian Ocean strategy of the kind we have long had in East Asia, one that invests in strengthening weak states, expanding partnerships with key powers like India, Japan, and Indonesia, and sustaining naval power projection capabilities that enable us to control the balance in some of the world's most strategic waterways.

Counterterrorism

An important strategic question is whether China's close alliance with Pakistan, lubricated by heavy Chinese trade and investment in energy, infrastructure, and

manufacturing, helps or hinders the attainment of American counterterrorism objectives there. Beijing has been selectively helpful in pressuring Islamabad on U.S. counterterrorism priorities, including Pakistan's turn from sponsoring the Taliban in the 1990s to cooperating with the United States in the war in Afghanistan to oust them in 2001. But China has tended to deliver these messages as coming from the Americans, rather than defining them in terms of China's own interests. China's defining interest in Pakistan appears to be to employ it to tie down and contain India, which, if freed from its military contest with Pakistan, would be free to more actively contest and balance Chinese power in Asia.

China's political sponsorship, official assistance, and trade and investment in Pakistan complicate American efforts to pressure Islamabad to take a harder line against Taliban and associated militants. American assistance that comes attached with tough conditionalities has historically led Islamabad to turn to Beijing for extra support, which means that close Sino-Pakistani relations undercut U.S. leverage in advancing our counterterrorism objectives in Pakistan. Pakistan is the top recipient of Chinese military sales, which also complicates American efforts to put pressure on the Pakistani army to reorient from an anti-India force posture to one that emphasizes the counterinsurgency capabilities necessary to defeat Pakistan's internal adversaries. China's economic and security interests in Pakistan have led Beijing to resist U.S. efforts to "multilateralize" diplomatic and aid strategies for Pakistan; China turned down the U.S. offer to host a "Friends of Pakistan" donors meeting in April.

Washington should elevate Pakistan to the top tier of our diplomatic agenda with Beijing and encourage China to use its leverage to advance common objectives there. China has no interest in seeing the Taliban grow stronger and Pakistan more ungovernable. China has important economic equities to protect in Pakistan, including strategic infrastructure investments in Pakistani Kashmir and the port of Gwadar, which in addition to its military applications could become an important conduit for trade from western China to the sea. China has sponsored special economic zones in Pakistan not dissimilar to the Reconstruction Opportunity Zones America has proposed to boost development in the tribal regions of Afghanistan and Pakistan. China's economic interests in Pakistan can be tools Beijing can wield to move forward our common counterterrorism objectives in Pakistan.

India's Rise

The United States has defined an interest in facilitating India's rise as a regional and global power and an important contributor to an Asian equilibrium that is pluralistic rather than hegemonic. China's trade, investment, and foreign assistance to India's South Asian neighbors are perceived by Indian elites to be part of a containment strategy to box India into its subregion and prevent it from playing on the wider global stage in a way that could challenge China's preeminence.

Since the 1990s, the top three recipients of Chinese arms exports have been Pakistan, Burma, and Bangladesh; 90% of Chinese arms exports target India's neighbors in South Asia. In these countries, China has constructed strategic roads and railways along India's

eastern and western flanks. China has also established extensive military supply and exchange relationships with Indian neighbors Nepal and Sri Lanka, countries where Beijing wields disproportionate influence. In 2006, India used its influence with the government of the Maldives to veto a Chinese request for naval access rights just off India's south coast. New Delhi was unsuccessful in pressuring Sri Lanka to prevent Chinese engineers from improving the port at Hambantota, which Indian officials expect to become a port of call for the Chinese navy only miles from India's coastline. Indian military officials believe China's "string of pearls" strategy is designed to contain the Indian Navy's projection of power in what it considers its home seas. Pakistani officials have confirmed those anxieties, saying that China's future naval presence in South Asia will help to frustrate India's control of regional waterways. China's construction of port facilities and transport infrastructure that encircle India is "designed to put India in pincers," in the words of former Indian intelligence director Vikram Sood. To the extent that America pursues a strategy for the Indian Ocean and East Asia that envisions India playing an active leadership role as a country with growing military capabilities and expanding diplomatic horizons, Chinese trade and investment in India's neighbors in ways that box India into its subregion is a complicating factor – one that is perhaps best countered by working with India to promote good governance in its region.

Democracy and human rights

Beyond Pakistan, Chinese trade and investment in and assistance to South Asia has unquestionably undermined political liberalization and accountability. In Sri Lanka, China is investing in the development of Hambantota, one of the best harbors in the Indian Ocean; Beijing gave Colombo a billion dollars in assistance last year, and China is the primary provider of arms to the Sri Lankan military. Its economic ties with China have helped insulate Sri Lanka from international pressure to spare civilian lives in the conflict with the Tamil Tigers, leading not only to the Sri Lankan military's decisive victory over the insurgents but also to the possible commission of crimes of war against innocent Tamil civilians.

In Burma, Chinese investment in and trade in offshore natural gas supplies and extensive road and rail development in Burma's interior have created perhaps the region's most acute economic dependency on China. Beyond its development of harbor facilities with dual-use purposes, China is pursuing a design to connect landlocked Yunnan province to the sea through Burma, leading to extensive Chinese infrastructure investment. Along with sizable military assistance, the political effect of Chinese investment has been to insulate the Burmese junta from international pressure to pursue political liberalization and behave with impunity towards Burma's political and civic opposition. Interestingly, regional experts note a degree of Burmese popular resentment directed at China for its overweening presence in Burma, suggesting that a political transition from a junta dependent on Beijing to more legitimate leaders could threaten China's privileged position there.

Chinese economic penetration has also played an important political role in Bangladesh and Nepal. Chinese investment in Bangladesh's port and energy infrastructure, as well as

extensive Chinese military assistance, has encouraged the country, part of India's natural economic hinterland, to maintain a closed border with India. China is working with a friendly Nepal, until recently led by Maoists with a questionable commitment to democratic norms, to construct railroad infrastructure connecting Katmandu, which sits on the south slope of the Himalayas very close to India's border, with mainland China. Combined with China's construction of road and rail networks just across the Indian border in Tibet, the trade and military implications of this development could transform India's security environment.

Like Pakistan, all of these countries – Sri Lanka, Burma, Bangladesh, and Nepal – suffer from weak governance and underdeveloped state institutions. These have magnified China's economic penetration and the political implications of China's trade and investment in them. Both Washington and New Delhi have a compelling interest in investing for the long term in the infrastructure of good governance and rule of law in these countries, both for intrinsic reasons and because transparency and accountability will render them less susceptible to Chinese political influence.

Asian regionalism

The United States has an interest in strengthening Asian regional institutions that promote regional economic and diplomatic cooperation and sustain a pluralism of power by uniting lesser states that fear falling under the influence of giant neighbors – starting with China. Beijing has employed regional institutions, especially the Shanghai Cooperation Organization (SCO) and the ASEAN Plus Three grouping, to expand its regional influence and promote a form of closed regionalism that excludes the United States.

In the SCO, Beijing has pursued economic agreements that privilege its trade and investment interests in Central Asia, and has worked with Russia to stake out a special claim of influence in a region of immense strategic importance to the United States. China has favored using ASEAN Plus Three as the leading vehicle for Asian economic integration, through special trade, investment, and currency arrangements that privilege a form of closed Asian regionalism at the expense of the open regionalism favored by the United States, Japan, India, and Australia.

Interestingly, however, politics in Asia does not always follow economics. Some Southeast Asian states fear that the China-ASEAN free trade agreement risks hollowing out their manufacturing economies. Leading ASEAN countries, including Singapore and Vietnam, are very worried by China's deep economic penetration of Burma, Laos, and Cambodia and are hedging against it by moving closer to the United States. China has surpassed the United States as India's largest trading partner, but Sino-Indian tensions – over their long-standing border dispute, India's new relationship with Washington, and other issues – have intensified, not diminished, as this has occurred.

Washington should participate actively in Asian regional institutions to give alleviate the concerns of Asian states about the political and military implications of overdependence on China's economic miracle – by giving them equally compelling avenues to partner

with America, Japan, India, and other powers. A continuing U.S. commitment to trade liberalization in APEC, passage of the pending free trade agreement with South Korea, an enhanced U.S. economic partnership with ASEAN, a U.S.-India framework for liberalized trade and investment, and the U.S. move to join the East Asia Summit would all constitute important steps in the direction of balancing the influence China derives from its trade and investment relationships with these countries, and its use of regional forums to advance them, sometimes to the detriment of outside powers.

Conclusion

Great powers as they rise define and pursue their interests within an expanding sphere. This was true of the great power rise of Spain, France, Great Britain, Russia, Germany, Japan, and other nations – including the United States in the 19th and 20th centuries. China is rising in a very different kind of international system than which nurtured the geopolitical ascent of previous great powers. The scale of economic and informational globalization, the widespread embrace of universal norms of democracy and human rights, the continuing preeminence of the United States, and the simultaneous ascent of India and other powers creates important constraints on China's ability to pursue the kind of hegemonic pathways of great power predecessors across modern history.

However, the United States and its partners can only sustain an international system conducive to universal values, economic openness, and cooperative relations between developed and rising powers if we jointly hold China to high standards on these issues. An important test of China's rise as a responsible global power will be its commitment to basic standards on trade and investment that promote rather than undermine good governance and define security in shared rather than zero-sum terms. In the meantime, the United States and other liberal powers should invest in good governance and strong institutions in continental Asia as a bulwark against the political effects of overdependence on Chinese trade and investment, while at the same time aggressively pursuing trade liberalization and foreign assistance strategies that give Asia's lesser states a broad choice of economic partners. Expanding trade and investment relations between China and the United States, and between China and other major powers, should give Beijing an even greater stake in an international system of which it has been a leading beneficiary.

Panel IV: Discussion, Questions and Answers

HEARING COCHAIR FIEDLER: Thank you.

HEARING COCHAIR BLUMENTHAL: Dr. Twining--we forget to mention that he also has a Ph.D. from Oxford and so we didn't mean the demotion. In between government service, he went and got a Ph.D.

Thank you both for your testimony.

I have a question first for Dr. Twining, and if I have time in a second round for Dr. Spechler. But we've heard a lot of testimony today regarding China's interests across continental Asia, the building of pipelines throughout sovereign territory, perhaps having in mind a pipeline that would go from or set of pipelines that would go from Iran back to China's west.

We just heard your testimony regarding the deep-water ports all along the Indian Ocean, and some of Chinese activities in Tibet and the Himalayas have concerned the Indians. Now, India is obviously in its own right a great power with capabilities to, presumably to do something about, to resist some of this encirclement.

When you mentioned that the United States should have an Indian Ocean strategy, it would seem to be that it would be built around what India is going to do, and I wonder what India is going to do?

I've read some Indian writings about a maritime strategy that matches China's, that actually has facilities in places like Qatar and along the Persian Gulf, and so are we going to start seeing a real, let's say, naval competition, for example, between the Indians and the Chinese? Are the Indians getting very serious about this or what has been the response?

DR. TWINING: It's a great question. There are several answers. One of them is the fact that, of course, India's Indian Ocean ambitions, its plans to increasingly secure what it sees as its waters, its historic waters, as China and other countries enter them, are occurring in a different environment. They're occurring in an environment in which the U.S. basically now does have control of the sea lanes.

This is why the U.S.-India strategic relationship is so interesting beyond civ nuke and other issues, is that there's a scenario here where the U.S. and India and Japan, which exercised together only last month, increasingly form what Admiral Mullen has talked about as "a thousand ship Navy." Right? And you don't necessarily have a national naval capability at this level, but you have a coalition of like-minded partners who all define quite a shared interest in the Indian Ocean.

The big question for India is can it rise to that challenge in terms of its own ambitions, in terms of its developing multiple aircraft carriers, as it's laid out to do by 2020, in terms of developing true kind of power projection capabilities, in terms of resuming India's historic relationship with the Gulf, which is something that well-predated the arrivals of Europeans in India, the way the British imperialists in turn, British Empire, defined India, as part of a kind of as the centerpiece in

a grand strategy that defined security in terms of the Indian Ocean rim lands from Aden to Singapore?

Can India resume the natural role as pivot of this region? I would say it would have to do that with the U.S., with Japan, which increasingly is projecting itself in this region, did so since 2001 after the Afghanistan War, is doing so now as part of the coalition off Somalia.

And then the question is where does China fit into all of this? There's a scenario where China is a partner in securing the sea lanes and you have a kind of shared security between these great powers. I hope that's true. It would be somewhat historic because my reading of kind of the rise of great powers is they actually want to control commons; they don't want to share them.

The premise of both British hegemony in the 19th century and U.S. hegemony in the 20th was actually control of some of the global commons rather than sharing them. So if China hopes to share management of them with us, that will be a new model, and it's going to require quite a lot of creative thinking on our side.

HEARING COCHAIR FIEDLER: Commissioner Slane.

COMMISSIONER SLANE: Dr. Spechler, can you talk a little bit about the relationship of the Central Asian countries with Russia?

DR. SPECHLER: There are five post-Soviet countries in Central Asia, and you have to differentiate between the two very poor countries of Kyrgyzstan and Tajikistan, which from a strategic point of view are insignificant, but are basically dependent on aid, which partially comes from Russia, supposedly in increasing amounts, to some extent from China, and especially from the international financial institutions.

And then you have to look at the petroleum dependent countries of Kazakhstan and Turkmenistan, and up till now they have been selling their wares largely to Russia under a system that I call staple globalism. Staple globalism means that the countries sell their staples, as Canada and indeed the United States did historically, and then buy from the world community capital goods and select consumer goods. And that's what Kazakhstan and Turkmenistan have done.

Uzbekistan to a very great extent by its own temperament and basic structural features tries to be as independent as possible, and it does sell some natural gas to Russia and probably will do more to China in the future, but its main export staples are cotton and gold and some uranium.

All of these countries have tried to distance themselves from the kind of relationship they had with Russia up to 1991. Russia has become one of many suppliers of capital goods, and one of many

buyers of their staple goods, and therefore Russia must compete on price and on quality with the rest of the world including Europe, now increasingly China, and the West.

While Russia certainly has still unequaled access to these countries; the lingua franca remains Russian; they have better intelligence assets in these countries; they have some Russian populations although those populations are diminishing and of rather little importance anymore in those countries. The big picture is that these countries have become increasingly self-confident and independent, conducting a multi-vectorial foreign policy, and the relationship with China just helps in that respect.

Russia is not a very muscular commercial power. And as a result of the recent world economic slump, which has hit Russia more than most, Russia has become less and less aggressive in Central Asia, has less and less money to spend, and their strategic interests are poorly organized with respect to Central Asia.

It's a subject, Mr. Slane, about which my wife Dina Spechler and I have published many articles. I hope to attract you to read some of our writings.

COMMISSIONER SLANE: Thank you.

DR. SPECHLER: Now let me make a point about Mr. Blumenthal's point about, that he's made a couple of times, about the possibility of a pipeline from Iran to China. I think it's a misunderstanding, and it comes from the fact that the--

HEARING COCHAIR BLUMENTHAL: I'm sorry, sir. I'm quoting from testimony that we're getting so--

DR. SPECHLER: Okay. Well, let me clear up a misconception then, not of yours, but of someone else's.

The northern part of Iran is an energy deficient, deficit area. The area that has energy to sell is the southern part of Iran. Now, if Central Asia were to sell more to Iran, which it's been doing for some years on a very small basis from Turkmenistan, this would involve supplying gas to the Tehran area, which allows more energy to be freed up in the southern Basra area to be exported.

So the idea that energy could come from northern Iran, all the way to China is simply geographical error, as well as a commercial stretch.

HEARING COCHAIR FIEDLER: Thank you.

I have a question. Dr. Twining, you basically said that China is trying to prevent India's rise; fair?

DR. TWINING: All these things are always more complicated. But, but I would say that you could find quite a distinct Chinese design, and it doesn't simply relate to India; it relates to access to the

Indian Ocean and other things. But it does involve tying India up in such a way that India isn't free to compete with China in wider Asia and globally, and I would say that's been a long-standing Chinese design.

HEARING COCHAIR FIEDLER: So I think it was not this past summer, but the one before, we were in India as a Commission, and we met with a lot of Indian scholars, academics and former government officials, and if I were to simplify what we were told, the Indians are hedging, and they sort of admitted to hedging on a constant basis. Does their hedging prevent us from helping them rise vis-a-vis China?

DR. TWINING: I take it from your question that you think that they're hedging against us in part; right?

HEARING COCHAIR FIEDLER: No, they were hedging against the Chinese. They are colloquial ways to say this, but they didn't want to make the Chinese angry.

DR. TWINING: No, I understand. But why then does it follow that that is complicating for us? It seems to me that could be helpful for us.

HEARING COCHAIR FIEDLER: Part of the hedging process is that they would not sidle up to us so openly.

DR. TWINING: This is a subject for a different hearing probably, but I would say that the U.S. has to get used to a different kind of partnership in Asia than the one it's had with Asian friends during the Cold War.

HEARING COCHAIR FIEDLER: Okay.

DR. TWINING: India is not a Japan neutered by wipeout in World War II. It's not a South Korea divided along the 30th parallel. India is an autonomous country of 1.2 billion people with a history of doing its own thing; right. And we saw this during the civ nuke debate in the Senate and in the House, which is that we're still grappling with the fact that India isn't necessarily going to toe our line on Iran or Burma or other areas.

But that I still would argue, by and large, I would associate myself with the camp of people who says that if you look out over the next 20 years, we have a set of interests in the world that India shares more closely, probably, than most allies, including actually many of our European allies, and so now we now have to spend the next few years I think grappling with how to kind of, how to frame this relationship and how to really take it global, and the civ nuke debate was part of that.

The Indian government almost fell over the deal. Manmohan Singh effectively submitted his government in 2008 to a confidence

vote on the question of relations with the U.S. and the breakthrough, and he won. And the issue is not a debate. It was not an issue in the Indian elections that just were concluded. There is broad consensus I think on this relationship.

But just to conclude, I would say that the Indians like the relationship. They would like a kind of relationship where basically we facilitate their great power rise rather than constraining it. An alliance would be constraining to them.

HEARING COCHAIR FIEDLER: An alliance would be constraining. Okay.

Dr. Spechler, you said in your earlier testimony, in your opening statement, that the Chinese don't do any real business other than extract resources from continental Asia. Why?

DR. SPECHLER: Correct. They buy some steel from Kazakhstan.

HEARING COCHAIR FIEDLER: So why? There's no business to do? Or what?

DR. SPECHLER: Well, you have to ask what do these countries have to sell that would be attractive to China? The Chinese produce all the cotton they need. They're exporters of cotton. They do buy gold, but only domestically at reduced prices, and the Central Asians sell only at world prices.

Gold, like oil, is a fungible world commodity, which is sold to the highest bidder. Okay. Now with respect to industries which are gradually developing to some extent, in Uzbekistan, for example, the production of automobiles (South Korean brands), the Chinese are the third-largest, maybe the second-largest producer of automobiles in the world.

So what do the Central Asians have? There is a possibility for the export of electricity, hydro-produced electricity from Tajikistan and Kyrgyzstan, to the energy short areas of Xinjiang. I don't think it will be of any great importance to China as a whole, but remember that China is very interested in the development of the Xinjiang Uighur autonomous region.

And as such, they have been sending actually millions of Han to Xinjiang in order to create an area with substantial Chinese group.

HEARING COCHAIR FIEDLER: That's motivated by a development impetus?

DR. SPECHLER: No, they're very worried about separatism. Now, in my opinion, contrary to what you heard before from people who actually don't know anything about it, that the amount of dissatisfaction in Xinjiang as a whole is exaggerated.

There have been incidents, yes, in 1991. There was small

incident in Kashgar last year, but what people don't seem to understand is that China is overwhelmingly powerful in Xinjiang and has been, as I found from my own conversations, has been quite successful in Sinocizing, that is making more Chinese--

HEARING COCHAIR FIEDLER: I know Sinocizing.

DR. SPECHLER: --and assimilating people who are Uighur or other Central Asian by ethnicity in that area. Those people have a strong economic interest in playing along with Chinese development efforts in Xinjiang, and what's more, they're very aware, and by the way, I told them so, that there is no alternative.

The Chinese, of course, are very sensitive to separatism in Tibet and Xinjiang, and largely it's a corollary of their worries about Taiwan, but look at what they're doing with Taiwan.

They are doing more and more business with Taiwan. The policy of friendly collaboration with Taiwan is paying big dividends for them.

HEARING COCHAIR FIEDLER: Thank you. Thank you.
Commissioner Cleveland.

COMMISSIONER CLEVELAND: Carolyn, did you want--

CHAIRMAN BARTHOLOMEW: Well, I had a question, just a comment. Dr. Spechler, I think it frankly is a mistake to equate or to believe that because China has overwhelming power or is overwhelmingly powerful in some of these regions, that there's not dissatisfaction there, and I would point to the Tibetan Autonomous Region as a perfect example where the Chinese government is overwhelmingly powerful, but there is significant dissatisfaction on the part of the people who are being overwhelmingly overpowered.

DR. SPECHLER: I agree. I'm not an expert on Tibet. One of my colleagues is. I don't want to be heard, as equating the Tibetan situation with the situation in Xinjiang.

There are several big differences. The percentage of Han in Xinjiang is very different from very small Han presence in Tibet. Of course, the émigré organization, the religious differences, and so on, make the Tibetan situation quite different, and of course, there is a great deal of dissatisfaction in Tibet.

There is some dissatisfaction in Xinjiang especially in the Kashgar region, but I judge that it is significantly less inflammatory than the situation in Tibet. So don't understand me as saying that they're the same objective situation.

But certainly China, the People's Republic of China, is quite interested in development and making sure that those areas are secure.

COMMISSIONER CLEVELAND: Dan, you said that it's in Washington and New Delhi's interest to invest in long-term and good

governance and rule of law in Sri Lanka, Burma, Bangladesh and Nepal, both for intrinsic reasons and because transparency and accountability will render them less susceptible to Chinese political influence.

Can you describe what the components of a strategy to achieve that result might look like, both in terms of what the U.S. might do independently but also collectively with India?

DR. TWINING: That's a great question.

COMMISSIONER CLEVELAND: Hard countries to tackle.

DR. TWINING: Yes. This is tough and it's long term. I would say that you actually saw a glimmer of how this could work in terms of U.S.-India working together in Nepal in '06, '07, when the two countries really did work together on the political transition in Nepal, and it was interesting because both India and the U.S. shared a particularly acute concern about the role of the Maoist armed wing.

The relationship of demilitarization to political transition was something that the U.S. and India were particularly concerned about, more concerned about than the Europeans and some other involved countries.

This was something rather new because the U.S. and India, as you know, haven't worked on kind of democracy issues broadly defined in their region. I would say part of the structural problem here is that India has not yet succeeded in encouraging its neighbors to basically claim a stake in its economic success in the way that I think China did.

You look at China's relations with much of Asia, particularly Southeast Asia, 15 years ago, in the early and mid-'90s, China was occupying islets in the South China Sea; China was lobbing missiles over Taiwan. And the Chinese at some point, I think in around '96, '97, realized this was a strategic error, and then made a rather striking transition to what they then called "smile diplomacy," which evolved into kind of China's peaceful rise, and this whole narrative that sprung up in Chinese discourse in the late '90s about kind of building China into Asian regional institutions and building quite constructive economic and political partnerships with Asia.

I make the link to China because this is basically what India needs to do in its region. The fact that's astonishing is that you have this natural economic zone from the days of the British Raj and before that, now is completely kind of closed off with hard borders. Intra-regional trade in South Asia is at five percent of total trade. The comparable number for East Asia is 50 percent, is over 50 percent, meaning only five percent of South Asia's trade is with each other, which is an astonishing figure.

And I would say if you can have an India with a strong coherent

government, which I hope we will have, one that continues to grow at a rather rapid rate--India over the last ten years has grown faster than any country except China, any major economy--if India can sustain that and pursue perhaps a slightly more progressive policy towards some of its neighbors, that's how you then I think get to working together with India on some of these very hard questions.

And I would say Burma is actually the hardest. The problem with Americans when we talk to Indians about Burma is they say, well, you do exactly the same thing in Pakistan, you know, you side with military regimes for reasons of security. We're playing a game in Burma that looks just like the game you guys have played in Pakistan with the generals for many years.

They're not right about that, but they're not totally wrong, so I would say, again at the kind of 80,000 foot level, U.S. consistency on values tends to be a good thing when we talk to other countries about wanting to work together on democracy and human rights.

CHAIRMAN BARTHOLOMEW: Thank you.

Actually I have a question for Mr. Twining and a completely different question for Dr. Spechler.

But I want to follow up on Robin's question about investment in governance and transparency. Dr. Twining, it's an interesting concept, but I think what we're seeing as China is more engaged in Africa is that it's a very difficult thing to accomplish. In fact, the U.S. over the course of the past--what--six years did try investing in transparency and governance with the establishment of the Millennium Challenge Corporation, and what the MCC has been finding, I think, in a number of places is that China is providing assistance to these countries with no strings attached, no governance requirements, no human rights conditions, no transparency requirements.

Do we have a reason to believe that there would be a more receptive audience in South Asia in places like Sri Lanka to conditions attached if they can get the economic assistance or economic investment from China without them?

DR. TWINING: It's a great question, another hard question. I'm the guy with the "hard questions" pinned on my lapel today. I'm not a foreign assistance expert--when I talked about investing, I meant it more broadly than simply in terms of foreign assistance.

Just to give you a small example. When I was on the policy planning staff at State, we worked closely with South Korea, Japan, Mongolia, some other countries, to set up something called the Asia Pacific Democracy Partnership, which in short was basically designed to create an election monitoring mechanism for Asia, intergovernmental, in the same way that the OSCE's election

monitoring arm does elections in Europe.

The OSCE process is complicated by the presence of Russia. Our APDP did not include China or any other non-democratic country.

So in a way this made it easier. So we worked with Asian countries to set this up. They monitored the Mongolian elections last year, the elections in Bangladesh, elections in the Pacific Islands, and this is quite interesting because part of why Asian countries decided to invest in this I would say is because they're actually interested in--I think China's kind of accelerated and disproportionate growth and the shadow that it casts over the region has led countries to think about defining their identities in democratic terms as kind of a part of a branding issue and as part of a way to advance their interest.

We saw this in Japan with the Arc of Freedom and Prosperity, Japan as the thought leader of Asia, leading on principled multilateralism, rule of law, human rights. Japanese discourse changed a lot over the last five or six years. Manmohan Singh has talked, in India has talked about democracy as the natural form of government; India is a model; all countries should evolve in this direction.

Senior Indian officials have said that our security is linked to the absence of democratic governments in our neighbors, and that democratizing would be a good thing.

I realize some of this is simply rhetorical, but I think the point for us in the U.S. is to think about kind of creative ways to work with the Asians on democratic capacity building.

And a final example here is the Indonesian government last year set up something called the Bali Democracy Forum, and they did include Burma and China and North Korea and other non-democracies, but the idea was basically to create a set of running workshops in Asia on how you do democracy and not simply how you do it in the form of elections, but how you do media freedom and women's empowerment and these various issues.

And it's quite interesting because the Indonesians really believe in this. Their government has set up a think tank at a university in Bali to basically be the intellectual foundation of this work.

The president of Indonesia cohosted the first kind of summit meeting of it with the Australian prime minister, and so I would say one kind of U.S. objective is encouraging our friends to think about good governance as a kind of regional public good, and for them to define their own interest in this, as I would say the Japanese and the Indians and the Indonesians have done in different ways and not fully.

And that then you end up with a slightly different playing field in terms of how you then move to do institution-building in Asia.

CHAIRMAN BARTHOLOMEW: Thank you.

Dr. Spechler, did I hear you correctly when you spoke at the beginning, that China does not have multinational companies, has not been successful in developing multinational companies?

DR. SPECHLER: They're insignificant. The only example of the People's Republic of China that I'm aware of is a telecom company which appears to have some business in Central Asia, but you did hear me correctly, and thank you for being so attentive.

I think that almost all of the important large companies in China are state companies, and these state companies have been reluctant--they haven't really had the incentive or push, I think, from the Chinese government to become multinational companies. The multinational companies that you may have in mind are based in Taiwan.

CHAIRMAN BARTHOLOMEW: No, actually what I'm interested in is what your definition of multinational companies is. How do you define what makes a company multinational? The company I had in mind--actually there were two--but one of them is Lenovo's acquisition of IBM. Doesn't that make it a multinational company?

DR. SPECHLER: My definition of a multinational company is a company that's headquartered say in China and that has significant production and permanent activities in several other countries.

CHAIRMAN BARTHOLOMEW: But production, production is what, is a piece of what you define-- not market share?

DR. SPECHLER: Absolutely.

CHAIRMAN BARTHOLOMEW: Or presence or anything like that?

DR. SPECHLER: Well, a company that is located in one country and simply exports to another country is not considered by specialists a multinational company.

You have to have permanent production or other, let's say, marketing activity in a number of other countries, but basically production and assembly are crucial.

CHAIRMAN BARTHOLOMEW: I don't mean to belabor this point, but what about a company like Haier? Are they producing refrigerators, air conditioners, and all of those things only in China or have they acquired companies elsewhere in the world where they might be producing?

DR. SPECHLER: I can't speak about Vietnam, but they have not produced in Central Asia, definitely not.

CHAIRMAN BARTHOLOMEW: Right.

DR. SPECHLER: I've inspected their goods actually, and there is some potential, but of course the domestic market in China is still enormous, and that probably discourages them from producing

elsewhere.

The incentive is to produce in China where there are still some 70 million underemployed people available for production activities. So why go and solve someone else's unemployment problem?

CHAIRMAN BARTHOLOMEW: Sorry. This keeps raising more questions. Just one more along those lines, which is my understanding is that some of what Chinese companies have wanted to do, and in their acquisition of American companies, is to pick up certainly the brand name that's associated with it. I'm thinking of Westinghouse, but that's not the one. Maytag. Companies like that, that then allow them to have a presence elsewhere in the world. Maybe I've learned this wrong.

DR. SPECHLER: I don't know about that. It would make some sense. The Chinese have never been able to develop their own brand presence anywhere else in the world. They have piggybacked on brands developed in Japan, Taiwan, and Korea.

So the idea of producing under a very reliable name like Maytag would be a good idea. The Chinese have a terrible record in quality control and Maytag is a brand we all know in Indiana is one of the most reliable producers of washing machines. I'm not sure that Americans or even Europeans want goods from China these days because of the very poor quality control situation there.

CHAIRMAN BARTHOLOMEW: Thank you. I had forgotten about the Indiana connection.

HEARING COCHAIR FIEDLER: Thank you.

We have two other commissioners that have questions. Commissioner Videnieks and Commissioner Mulloy.

COMMISSIONER VIDENIEKS: You mentioned that most rising powers looking back at history want to control the global commons. My understanding is that China views the global commons as extending forever (upward and downward) from the borders of its EEZ. How does India view its control over global commons and would that be an impact on trade? That's one.

The other thing is -- I somehow heard surprisingly that you mentioned that the intra-Asia trade is only five percent. My understanding was that the countries surrounding China supply quite a quantity of components for assembly for export to the U.S. so that five percent to me sounds a little bit--

HEARING COCHAIR FIEDLER: No, it's five percent with South Asia.

DR. TWINING: It was South Asia. Thank you.

HEARING COCHAIR FIEDLER: It was South Asia, not Southeast Asia.

DR. TWINING: I was contrasting it--

COMMISSIONER VIDENIEKS: I misheard.

DR. TWINING: Yes, it was only five percent in South Asia.

HEARING COCHAIR FIEDLER: Five and 50.

DR. TWINING: And versus over 50 in East Asia.

COMMISSIONER VIDENIEKS: Right.

DR. TWINING: So your point is correct. And my point was that India needs to kind of lead South Asia in the East Asian direction.

COMMISSIONER VIDENIEKS: But the view of the global commons?

DR. TWINING: It's a good question.

COMMISSIONER VIDENIEKS: Any impact on the trade, services from India and goods from China?

DR. TWINING: I think the Chinese and the Indian positions are quite different, one, simply for kind of geographic reasons which is that China is surrounded by strong powers. China has a difficult time projecting outward east or south. It's got what they call the "first island chain," which is Japan, Korea, the Philippines, going down into Southeast Asia.

So much of the Chinese kind of grand strategic debate is about how do you break out beyond the first island chain? And part of this then gets into issues like control of the South China Sea and the question of how you define the territorial waters, the exclusive economic zone, where do China's territorial rights start and end?

India, by contrast, sits in the middle of its own ocean, isn't surrounded by strong states. It's actually surrounded by weak ones.

COMMISSIONER VIDENIEKS: Satellites circle the globe. So, in other words, I'm saying China seems to interpret their sovereignty as going forever through space, whereas, the U.S. view is that the global commons begins where maybe the air gets thin or nonexistent.

DR. TWINING: Right, right, right. The Indians are competing in space, and it's quite interesting if you look at who the space powers are. It's the U.S., Russia, the Europeans in a kind of civilian sense, and then China and India.

Indians doing all sorts of things with reference to outer space, the kind of stuff that the U.S. was doing in the '60s. The Indians, I mean on space questions, again, I don't think the debate is quite as advanced as in China. The Indians are not developing anti-satellite weapons.

I don't think they're thinking about the militarization of space in the terms that the Chinese are. The Indians, though, do, I mean a predecessor in U.S.-India relations, before the civ nuke agreement, was the next steps in strategic partnership which was very much about

teaming up with India on space technology and dual-use technology issues that have space applications for India.

So the Indians do think about these things. They care about things like missile defense and have talked to us about it for actually five or six years now. But I don't think the Indians are thinking about the militarization of space the way the Chinese are.

COMMISSIONER VIDENIEKS: Or have a position with respect to sovereignty as it pertains to space?

DR. TWINING: No, I think that's right.

COMMISSIONER VIDENIEKS: Sir, do you have an opinion on an impact on business? Commerce?

DR. SPECHLER: These geostrategic speculations leave me cold. I think they are, indeed, quite spacey. I think you have to understand that both China and India are enormous countries, both of which have many differences of opinion within them. It's not a question of what some analysts will say, but what the government actually does, and that's a much more difficult thing that cannot be appraised from 30,000 feet and basis of these geopolitical or geostrategic speculations.

I have nothing to say about Indian space ambitions. What I do know is that India has been trying for some time to have more energy investments in Central Asia and its success has been only very modest. They, too, need energy, and however the problem is that there is no direct access from Central Asia into India, and the idea of a pipeline--

COMMISSIONER VIDENIEKS: Peace pipeline.

DR. SPECHLER: Yes. Peace pipeline--from Turkmenistan over Pakistan into India, well, a friend of mine said that that's a pipeline from across to nowhere. It's just not on in the foreseeable future. He didn't use the word "nowhere," but this is a public hearing.

HEARING COCHAIR BLUMENTHAL: Thank you.

By the way, there is something very observable on the space program. It's called an ASAT that was shot down two years ago by the Chinese direct ascent. It's not an analyst take on it. It happened. The U.S. government reacted to it and the Chinese took responsibility for it. So maybe you should stick to the things you know about. Anyway, Pat.

COMMISSIONER MULLOY: Thank you, Dr. Twining and Dr. Spechler for being here.

Dr. Twining, if I could go through a couple quick questions that we get on the table and then we could ask maybe Dr. Spechler his views as well.

In your testimony on page five, you talk about great powers as they rise, they expand their spheres. And then you say China is rising. Do you think China is a rising great power?

DR. TWINING: Yes.

COMMISSIONER MULLOY: Yes. Now what period do you associate with China's rising great power? When, in your perspective, when did this really begin to take place?

DR. TWINING: Part of the complication here, and I didn't mean to kind of be a graduate student and put in this historical, this speculation that everyone is cottoning on to, but part of this is that China is rising in a very different environment than the U.S. rose in or Great Britain rose in.

COMMISSIONER MULLOY: Right.

DR. TWINING: So I would say now we define a great power in part in terms of "going global," right, in the way that China has clearly gone global in the last five to ten years.

COMMISSIONER MULLOY: Five to ten years.

DR. TWINING: I would say it started in the '90s.

COMMISSIONER MULLOY: Okay. That's good. Because before you talked about '96 when they began to change their policy on-now what do you think is driving China's great power rise?

DR. TWINING: Part of it, again, I'm a student of international relations, so I just think that countries behave in certain ways, and part of it is wanting to secure a broadening array of interests as it rises. Part of it though is very much about regime security and legitimacy, which is where questions of Taiwan, of Japanese nationalism and other issues come in. Part of the way China benchmarks itself against the United States relates to some of these questions of regime legitimacy.

COMMISSIONER MULLOY: But China may have wanted to do these things 20 years ago, and it couldn't. What is the basis of China's rise? Is it the economic strength and the growing power of the Chinese economy?

DR. TWINING: Yes. I think that's where it starts. And then your foreign interests expand as you start worrying about protecting your sea trade and your access to energy resources.

COMMISSIONER MULLOY: Do you think that this rise of China is taking place in a period of relative decline for the United States?

DR. TWINING: No, I don't think it's relative decline. Again, I think some of these interpretations--Fareed Zakaria wrote an entire book about the post-American world in which he then argued the conclusion was that America isn't in decline.

The introduction and the conclusion was that American isn't in decline. It's just that other countries are rising.

The Chinese, there's a strand of thinking in the Chinese strategic

community that talks about a world of one superpower and many great powers; right. So this is different than a multi-polar world. There's a strand of thinking in China, a discourse about the G2, which is kind of the U.S. is number one and China number two, and then everybody else kind of down here.

So I think if you were kind of trying to draw out a hierarchy, any hierarchy you draw out, the U.S. is on top and has these residual advantages that I think will sustain preeminence for decades.

COMMISSIONER MULLOY: Do you worry about the international debtor position of the United States and the massive current account deficits year after year?

DR. TWINING: Yes. This is where economic historians are so good because this can be a core source of great power decline.

COMMISSIONER MULLOY: Decline, right. That's what happened. Turkey began to run those kind--

DR. TWINING: But I would also say that people talked about the U.S. in this way in the '70s. People talked about the U.S. in this way in the '80s. People talked about it this way, and I mean there have been many predictions of American decline.

I remember the day when Japan or Germany were going to take over the world. I'm young. Didn't happen. So I don't think China's rise isn't real, but I would say that kind of declinists have tended to be wrong rather than right, at least in talking about the United States.

COMMISSIONER MULLOY: Good.

I'll just conclude what I got out of that. That China is rising. You noticed it probably mid-'90s, and it's probably accelerated at an increasing pace since then, and part of it is fed by their economic growth.

Do you think their economic growth has been spurred by running major trade surpluses with the United States?

DR. TWINING: I'm not an economist but, yes, they clearly have had an export-based model. I have a smart economist friend, though, who says that China obviously can't do for the next 30 years what it has done for the previous. That basically China had an easy 30 years in the sense of just unlocking the potential of the Chinese people and exporting very cheap products at very low premiums.

China as a superpower, this is not a sustainable model for a superpower.

COMMISSIONER MULLOY: Right. That's fine.

Do you have anything you wanted to add on that, Dr. Spechler? I wanted to get those points out.

DR. SPECHLER: In my opinion, if you observe what China has done since 1978, it's largely to try to develop China itself and to make

sure that the Communist government of the country is secure. It now has mounting problems in continuing to assure Communist power in China.

The most important one is the decline of environmental resources in China itself. But one must also mention the rising income inequality between rich and poor and between internal or interior provinces and the coastal provinces.

I think that all of the statements of Chinese leaders--although they're divided--are mostly involved with domestic issues in China rather than projection, and on the whole, I think China has pursued a policy of harmonious development in Asia.

Now, that doesn't mean that we should cease to worry about China or about any other potential rival. But we should look at what they're actually doing.

COMMISSIONER MULLOY: Thank you both very much.

HEARING COCHAIR BLUMENTHAL: Thank you both very much for your testimony. We're going to wrap up a long day. We'd also very much like to thank Marta McLellan-Ross for putting together this wonderful day of testimony where we learned so much, and I believe this may be your last.

So we're saddened to see Marta go and thank her for putting this together and thank you both for your time and patience. Thank you.

CHAIRMAN BARTHOLOMEW: Thanks.

[Whereupon, at 3:45 p.m., the hearing was adjourned.]
