

CHINA-EUROPE RELATIONSHIP AND TRANSATLANTIC IMPLICATIONS

HEARING
BEFORE THE
U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

ONE HUNDRED TWELFTH CONGRESS
SECOND SESSION

APRIL 19, 2012

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WASHINGTON: 2012

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April 26, 2012

The Honorable Daniel Inouye

President Pro Tempore of the Senate, Washington, D.C. 20510

The Honorable John A. Boehner

Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR INOUYE AND SPEAKER BOEHNER:

We are pleased to transmit the record of our April 19, 2012 public hearing on the “*China-Europe Relationship and Transatlantic Implications*.” The Floyd D. Spence National Defense Authorization Act (amended by Pub. L. No. 109-108, section 635(a)) provides the basis for this hearing.

At the hearing, the Commissioners heard from the following witnesses: Representative Dana Rohrabacher (R-CA), Mr. Andrew Small, Mr. Jonas Parell-Plesner, Dr. May-Britt Stumbaum, Dr. Øystein Tunsjø, Dr. Christina Lin, Dr. Gudrun Wacker, and Dr. Jonathan Holslag. Ms. Michal Meidan submitted a statement for the record. The subjects covered included the economic relationship between China and Europe, China’s role in addressing the eurozone crisis, Sino-European cooperation on global security issues, European defense and dual-use exports to China, and key foreign policy issues. The hearing also considered the implications of the China-Europe relationship for the United States.

We note that the full transcript of the hearing will be posted to the Commission’s website when completed. The prepared statements and supporting documents submitted by the participants are now posted on the Commission’s website at www.uscc.gov. Members and the staff 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 2012 Annual Report that will be submitted to Congress in November 2012. Should you have any questions regarding this hearing or any other issue related to China, please do not hesitate to have your staff contact our Congressional Liaison, Jonathan Weston, at 202-624-1487 or jweston@uscc.gov

Sincerely yours,



Dennis C. Shea
Chairman



William A. Reinsch
Vice Chairman

cc: Members of Congress and Congressional Staff

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CHINA-EUROPE RELATIONSHIP AND TRANSATLANTIC IMPLICATIONS

THURSDAY, APRIL 19, 2012

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in the U.S. Capitol Visitor Center, Room HVC-210, Washington, D.C. at 8:15 a.m., Chairman Dennis C. Shea, and Commissioners Carolyn Bartholomew and Daniel Blumenthal (Hearing Co-Chairs), presiding.

**OPENING STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW
HEARING CO-CHAIR**

HEARING CO-CHAIR BARTHOLOMEW: The hearing will come to order. We're starting just a few minutes late this morning, but I want to welcome everybody to the fourth hearing of the U.S.-China Economic and Security Review Commission's 2012 Annual Report cycle, which will examine economic, national security, and foreign policy aspects of the China-Europe relationship.

I want to thank you all for joining us today. I particularly want to thank our European guests who will be testifying. Some of them have made arduous travel arrangements in order to be here.

As trade between Europe and China grows, we want to examine how individual European countries balance their interests in Chinese investment with EU-level economic priorities vis-a-vis China. While China provides a vast market opportunity for European companies, there are also a number of areas of concern, such as intellectual property theft, forced technology transfers, and Chinese government limits on market access.

Today's hearing takes place at an important time. With continuing concerns about the European sovereign debt crisis, there are still many questions about what role China will play in resolving that crisis.

EU leadership has been trying to build support for

a European Financial Stability Facility, seeking financial help from the IMF, the United States, and other rich countries around the world, but it's China that has been wooing the most.

China with its \$3.2 trillion in foreign exchange reserves seems uniquely positioned among world actors to provide funding when others facing their own economic or political pressures may be unable or unwilling to help. There are certainly plenty of reasons for China to do so: the EU is China's biggest export market. Europe is struggling with economic survival and will be more open to Chinese acquisitions of European companies if it means additional jobs.

Moreover, China may be in a position to gain concessions from the EU in exchange for support. Concessions could include the granting of long-coveted market economy status and relaxing criticism of China's undervaluation of its currency, the RMB. Although there has been no official confirmation from the EU, some news reports allege that China offered to provide emergency financial assistance to the EU in return for, among other things, lifting the arms embargo. The embargo is a non-binding pact imposed by the EU on China following the Tiananmen Square massacre in 1989.

Like the United States, the EU has been running increasingly large deficits with China for many years. Coupled with China's continued use of trade distorting subsidies, this trend has led to growing economic frictions. Generally, American companies have the same concerns as their European counterparts, and we'd like to learn how Europe is addressing those concerns.

We'd also like to identify key areas where European and U.S. interests coincide and where the potential exists for better coordination in our respective policies.

The United States and the EU have been working together to address some of the challenges posed by China's anti-competitive trade practices. For example, the U.S., EU, and Japan have requested WTO consultations over China's limit on exports of rare earths, which is a precursor to the filing of a formal complaint.

We will hear today from experts on the first and second panel before lunch. We'll adjourn for lunch at

12:15, after which time the hearing will resume in this room at 1:15.

Before I turn the floor over to my co-Chair for this hearing, Commissioner Blumenthal, I would like to thank House Speaker John Boehner and his staff for securing this room for us today. With that, I'll turn it over to my co-Chair.

**PREPARED STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW
HEARING CO-CHAIR**

Good morning, and welcome to the fourth hearing of the U.S.-China Economic and Security Review Commission's 2012 Annual Report cycle, which will examine economic, national security and foreign policy aspects of the China-Europe relationship. I want to thank you all for joining us today.

As trade between Europe and China grows, we want to examine how individual European countries balance their interest in Chinese investment with EU-level economic priorities vis-à-vis China. While China provides a vast market opportunity for European companies, there are also a number of areas of concern, such as intellectual property theft, forced technology transfers, and Chinese government limits on market access.

Today's hearing takes place at an important time. With continuing concerns about the European sovereign debt crisis, there are still many questions about what role China will play in resolving that crisis. EU leadership has been trying to build support for a European Financial Stability Facility (EFSF), seeking financial help from the IMF, the United States, and other rich countries around the world. But it has been China that they have been wooing the most.

China, with its \$3.2 trillion in foreign exchange reserves, seems uniquely positioned among world actors to provide funding when others, facing their own economic or political pressures, may be unable or unwilling to help. There are certainly plenty of reasons for China to do so: The EU is China's biggest export market. Europe is struggling with economic survival and will be more open to Chinese acquisitions of European companies if it means additional jobs.

Moreover, China may be in a position to gain concessions from the EU in exchange for support. Concessions could include the granting of long-coveted market economy status and relaxing criticism of China's undervaluation of its currency, the renminbi. Although there has been no official confirmation from the EU, some news reports allege that China offered to provide emergency financial assistance to the EU in return for, among other things, lifting the arms embargo. The embargo is a non-binding pact imposed by EU on China following the Tiananmen Square Massacre in 1989.

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**OPENING STATEMENT OF COMMISSIONER DANIEL BLUMENTHAL
HEARING CO-CHAIR**

HEARING CO-CHAIR BLUMENTHAL: Thank you, very much, Commissioner Bartholomew, and good morning to all of you, and thank you so much for coming a long way to provide us with important testimony.

It's, I think, very important that the EU and the United States engage the rise of China. It's been a number of years since there's been a level of interest that's appropriate to the relationship, and usually it takes a crisis to get our many countries refocused on the issue. But I for one still believe in the concept of the West and what it can do if it stands together in the face of a rising authoritarian China.

The NATO conference is coming up fairly soon, and one of the issues they're likely to explore, I think, is increased cooperation with China and increasing European ties with China in general. China and Europe, I think, already cooperate on a number of global security issues, such as anti-piracy, peacekeeping operations and counterterrorism, to some extent.

I've noted in my own research and reading that NATO is increasingly putting out papers and talking about their own concerns with protecting the global commons, particularly in cyberspace, and their own concern, since European countries have been attacked--by Russia, in most cases--but their own concerns in terms of what China is doing in cyberspace, and I think that's a fruitful area for U.S.-NATO or NATO cooperation in regards to China's military build-up.

I've also noted that NATO is taking greater note of concerns about maritime security through the sea lanes from the Straits of Hormuz to the Malacca Strait and concerns with Chinese military build-up. I don't think anyone expects NATO to become a major security player in these areas, but perhaps there are areas of cooperation that NATO can have with the United States.

And I would also note that while the NATO-China relationship is significant from the military-to-military perspective, I think NATO has a lot to share with its democratic brethren in the Asia-Pacific, Japan, Australia

and others in terms of how to do collective security among democracies.

So those are some of the issues I think we're interested today beyond what Commissioner Bartholomew mentioned, and we look very much forward to your testimony today.

Thank you very much.

**PREPARED STATEMENT OF COMMISSIONER DANIEL BLUMENTHAL
HEARING CO-CHAIR**

Thank you, Commissioner Bartholomew, and good morning.

Next month, NATO will hold its 25th Annual Summit in Chicago. The summit will focus on three themes, one of which is the strengthening of NATO's network of partners around the world. China currently is not one of these partners, but the upcoming summit will likely explore the possibility of enhancing NATO's cooperation with China. This possibility makes today's discussion of Sino-European security ties particularly timely.

Chinese cooperation with European actors on global security matters like anti-piracy, peacekeeping operations, and counter-terrorism helps to promote U.S. objectives of peace and stability in the global commons. The United States welcomes such cooperation and supports China's will to be a responsible stakeholder in global security.

There are, however, reasons to be wary of enhanced European or NATO security cooperation with China. Not least of these reasons is the recent social media infiltration in which Chinese cyber-spies were thought to have set up fake Facebook accounts for NATO's most senior military commander in an effort to glean personal information about him from his colleagues, friends and family. Enhancing the NATO-China relationship to a military-to-military partnership also poses the risk that sensitive NATO intelligence and defense technologies will flow to China.

In addition to examining the NATO-China relationship, this hearing will examine the nature and significance of European defense and dual-use exports to China. Even with the European arms embargo, European defense and dual-use sales to China are estimated to be in the hundreds of millions of dollars annually. Some European defense scholars have asserted that EU engagement with China in the military sphere has contributed significantly to the modernization of Chinese naval forces.

Today, we will examine these issues and attempt to discern what implications they have for the United States and the future of U.S. ties across both the Atlantic and the Pacific.

Now, I'd like to welcome our excellent witnesses to today's hearing. These experts will offer unique insights into our questions and we thank them for their time and dedication. In particular, we are pleased to welcome Congressman Dana Rohrabacher from California, who has taken time out of his busy schedule to join us today.

We regret that although the Commission extended invitations to offices in the Department of Defense, the Department of State, and the Department of the Treasury to provide their views on these important issues, all declined to testify.

PANEL I - ECONOMIC RELATIONSHIP AND THE EUROZONE CRISIS

HEARING CO-CHAIR BARTHOLOMEW: Our first witness is actually going to be Congressman Dana Rohrabacher, who I think we're expecting at 8:30. So we're going to have to ask everybody's forbearance, as we have a few minutes here and there filling in the schedule.

[Whereupon, a short recess was taken.]

HEARING CO-CHAIR BARTHOLOMEW: If you don't mind, we'll shift our schedule around. It's better than just keeping people sitting here, and it means, Mr. Small and Mr. Pareollo-Plesner, we'll have more opportunity to ask you questions if you're up here for a little bit longer. So if you'd like to join us at the table, understanding that if Congressman Rohrabacher comes, we'll interrupt you and seat him.

I'm going to introduce the first panel, which will be talking about the economic relationship and the eurozone crisis.

I'm always pleased to welcome back to testify before us Mr. Andrew Small with the German Marshall Fund of the United States. He's a Transatlantic Fellow with the Asia Program at the German Marshall Fund, and he's helped lead it since 2006.

His research focuses on U.S.-China relations, EU-China relations, Chinese policy in South and Southwest Asia, and China's role in problem and fragile states.

He was based in GMF's Brussels office for five years where he established the Asia Program and the Stockholm China Forum, GMF's biannual China policy conference.

He previously worked as the Director of the Foreign Policy Centre's Beijing Office as a visiting fellow at the Chinese Academy of Social Sciences, and he was an ESU scholar in the office of Senator Edward M. Kennedy, so he's seen a full range of government action.

He's currently completing a book on China-Pakistan relations and has testified before the Commission in 2008 and 2011. He always has very interesting things to say, and we have lively discussions.

Mr. Jonas--is it Pareollo-Plesner?

MR. PARELLO-PLESNER: That's right.

HEARING CO-CHAIR BARTHOLOMEW: Great. From the European Council on Foreign Relations. He's a Senior Policy Fellow at an independent think tank, the European Council on Foreign Relations. Previously, he was the director of a development NGO with activities in Asia, and he served as Denmark's Senior Advisor on China and North East Asia from 2005 to 2009.

He is also on the editorial board of RAESON, a Danish international affairs magazine, and a regular contributor to Oxford Analytica with analysis of China. He's a graduate of the LSE, Copenhagen University, and the Ecole nationale d'administration in Paris.

Thank you very much. We welcome you both and why don't we start, Mr. Small, with you?

**STATEMENT OF ANDREW SMALL
TRANSATLANTIC FELLOW, GERMAN MARSHALL FUND OF THE UNITED STATES
WASHINGTON, DC**

MR. SMALL: Thanks very much for having us back, again.

The main three points I want to make with this are, first of all, that all of this speculation about Chinese investment in Europe and China bailing out the eurozone has seriously overstated their importance. Although it's been useful for countries to make public play of Chinese support, the euro crisis has largely hinged on internal politics rather than the need to attract external financing, which hasn't been forthcoming at significant levels from China anyway.

And when you look at FDI, stocks are still at very modest levels, and probably about as low as .2 percent of the overall total.

Second, a byproduct of the attention being paid to these issues, which I will go into in more detail, is that some more significant developments in the EU's economic policy vis-a-vis China have not necessarily received the attention they deserve.

The EU has an ambitious trade agenda in Asia and is in talks--are we about to kill--

[Laughter.]

HEARING CO-CHAIR BARTHOLOMEW: Here is Representative Rohrabacher.

MR. ROHRABACHER: Good morning.

HEARING CO-CHAIR BARTHOLOMEW: Good morning. Congressman Rohrabacher, please join us at the table. We started our panel a little bit early, but we're always pleased to welcome you.

HEARING CO-CHAIR BLUMENTHAL: Thank you very much, Congressman Rohrabacher. We're honored to have you here.

Congressman Rohrabacher is well-known regarding China issues. He represents the 46th District of California. He is the Chairman of the House Foreign Affairs Subcommittee on Oversight and Investigations and also sits on the House Committee on Science.

He has long been concerned about potential arms sales to the People's Republic of China, has co-sponsored a resolution urging the European Union to maintain the arms

embargo against the People's Republic of China, and also has been following with great concern the decision by Eutelsat, if I'm saying that right, to launch satellites with Chinese Long March rockets, which are forbidden by American satellite owners under our export laws.

Again, Congressman Rohrabacher has been a real leader on issues pertaining to China's military rise and the kinds of actions we can take here and, hopefully, with our European friends, to stem the tide of that rise. So, again, we're very honored to have you here and to listen to your testimony.

HEARING CO-CHAIR BARTHOLOMEW: I'll also join in welcoming you, Congressman Rohrabacher, and note for the record your terrific leadership on human rights in China. You've been one of the stalwarts going back to 1989 on these issues, and there are a lot of people who really appreciate what you're doing.

Thank you and we'll go ahead and have you testify, please.

**STATEMENT OF DANA ROHRABACHER
A U.S. REPRESENTATIVE FROM THE STATE OF CALIFORNIA**

MR. ROHRABACHER: First, let's remember when we started off in 1989--everything starts in 1989--had the reform movement that was set in motion by President Reagan actually been permitted to come to fruition and to dominate that society, rather than totalitarian communism or just totalitarianism, whatever we want to label their dictatorship, we wouldn't have to be worried about all this; would we?

I mean this is all about a massive power that came this close to being a non-threatening, just another part of the world, and how sad it is that those who were in power in 1989 in the United States made the wrong decision.

I have no doubt that had Ronald Reagan been President in 1989 instead of his successor that a message would have been sent to the Communist Party leaders that all of the economic benefits that they had been receiving as a "gimme" to the Chinese, that that would have at least got them to hesitate, if not prevented them, from just unleashing the Chinese Army, the People's Liberation Army, on the democracy movement, and that the fact that they didn't receive any threat from the United States that there will be consequences to this, and the only consequence the Chinese had is something I'll be discussing in my remarks, was the arms embargo that we now are going to make sure that the Chinese Army doesn't get the best weapons so that they can murder their democracy movement.

But that was it. The Chinese have gone on to benefit dramatically from our policies ever since, even since they decided that they were going to slaughter anybody who believed in democracy in their country and retake control of their country from anyone who might have religious allegiances.

So I'll go on with my testimony from there. After the brutal crushing of the pro-democracy protests in Tiananmen Square in 1989, both the United States and the European Union imposed an arms embargo on the People's Republic of China. But the embargo always had holes in the European side, and that's what we are discussing today, is China and Europe.

Even as staunch an ally as the United Kingdom has defined the embargo to apply only to lethal weapons or those that can be used for internal repression. Germany, Italy, France, and the Netherlands have used the same loophole to sell engines, helicopters, radar and sonar, night vision equipment, and a host of electronics to the Chinese government, which, of course, means to the People's Liberation Army.

In 2010, for the first time in years, lifting the embargo was on the EU agenda. The move towards officially lifting the embargo was blocked again by a resolute American opposition. Washington has repeatedly said under both George W. Bush and Barack Obama, and with strong congressional support, that European companies cannot forget about exporting, or they can forget--pardon me--they can forget about exporting to the United States if they sign contracts with the People's Liberation Army.

The European interest in China arms and the Chinese arms market is all about money, and when you talk to Europeans, they'll always talk about whether we're talking about arms dealing or talking about just economic decisions, that they always talk about this long-term strategy to make sure we develop these bonds, et cetera, or some brakes on what the Chinese can do, but it's not about strategy.

It's about making money, and we should not let people get away with that type of hyperbole either in the United States, which our own corporate world constantly talks about justifies their involvement with the world's worst human rights abuser on the grounds, well, that's going to make them into a more democratic society if we just have more ties with them.

Well, EU members are no longer Asian powers. So when they're trying to determine what their trade and policies are and what their economic policies are towards China, that is a factor that is going into play. They used to be. Many of them, like Britain, used to be Asian powers, but now they don't have any fear to face of Chinese military strength or at least so they believe.

China is working, however, to project its own power beyond the Pacific Rim. Chinese weapons are flowing into Iran, which poses a threat to the oil supplies of the

Middle East. Beijing is also expanding its involvement in Africa in competition with Europeans, especially in terms of fencing off resources, as well as fencing off those to the United States, as well as to our European friends.

So the Europeans may not be as safe as they think when they are trying to set their own ideas down as they're no longer an Asian power, thus won't feel threatened by Chinese military build-up.

The EU financial crisis gave China the opportunity to greatly influence and increase its influence in Europe by putting its massive financial reserves to work bailing out the bankrupt states on the periphery, but Beijing did not see this crisis as an opportunity to play the hero. Instead, it saw itself, saw this whole crisis as a sign of European weakness--and there's two different mindsets there--and while they didn't think of themselves as a hero to come in and help things out, they did see that these were weak European powers, and that will impact their decision-making in the future.

China holds about a quarter of its \$3.2 trillion currency reserves in euros compared to half in dollars.

According to the Heritage Foundation's "China Global Investment Tracker," China's non-bond investments in Europe, their investments have reached \$35 billion compared to \$28 billion invested in the United States. These are modest amounts, but they are being kept low because of very realistic fears by hosting countries about allowing the Chinese to buy productive assets, particularly those assets that are involved in advancing technology or critical resources.

Investment in government bonds does not give Beijing control over anything, which is where Chinese capital should be confined. They can buy our bonds, but we shouldn't let them buy our high-tech industries.

So if they're going to be recycling that money, we need to make sure that it's recycled in a way that does not increase their leverage in power over us.

The Chinese investment in projects, such as expanding the port capacity of Naples so it can process more Chinese exports, is hardly beneficial to struggling European industries. The EU's 2010 trade deficit with China of 168 billion euros was smaller than the U.S.

deficit--I think we're talking about billions of dollars here--of 204.8 billion euros, but both represent one of the largest single factors in the slowing economic recovery that we are experiencing both in Europe and in the United States as money is being drained.

Instead of paying for work at home as we expand our economic well-being, our lifeblood is being drained away and ending up in China--not the Chinese fault totally. It's the fault of the United States and European powers for having policies that gave China that type of economic leverage in the first place.

Now from a strategic perspective, the financial crisis has taken an already disengaged Europe out of the geopolitical game. So its recognized that this crisis is now rearranging the power structure of the planet, and Beijing is the beneficiary.

Beijing did not have to risk resources to neutralize European power--and that the Europeans seem to have done on their own--and if we do not get our own finances in order, we'll suffer the same fate. To the degree that we are in economic crisis, and to the degree that the Chinese are able to control huge resources that will be strategically put into our country, we are weaker instead of stronger; the world's worst human rights abuser is stronger.

The U.S. plans, of course, to "pivot" from the Middle East to Asia, which is also a pivot away from Europe. America is part of the Atlantic civilization, but is also and has long been that we have recognized that we are a Pacific power and not just an Atlantic civilization. The focus of world politics and economics, as it shifts to Asia, well, we're going to find that our relations with Europe are different and the relationship between China and Europe will necessarily be changing and not necessarily, and probably for the worse.

There is one European power, however, that can't do what Europe seems to want to do, and that's to basically not be totally activated in China and in the Pacific. I'm talking about Russia, of course, and Russia is a European power. It's a European power and a Pacific power, just like the United States.

Last summer, I saw a new French helicopter aircraft

carrier in the Maldives. I was traveling through the Maldives. There is this aircraft carrier. It was the first of the Mistral class, a very fine design, but there will be more of these warships destined to serve not just the French but the Russian fleet in the Pacific, and Moscow is buying at least two of these warships from France, and they will be deployed in Asia in the Pacific.

By 2020, the Russian fleet is expected to receive new generation submarines and destroyers and possibly, as I say, aircraft carriers.

2010, Russia held its largest naval exercise since the Cold War in the Baltics, but off of Vladivostok, to celebrate its 150th anniversary of the Russian conquest of the region. This September, Russia will host the APEC Summit at Vladivostok, and Russia intends to hold its Far East territories. Of course they do.

But China, if we take a look at what's going on, China is the only threat to Russia. Who else is threatening Russia in its Pacific posturing? China is the only threat to Russia, just as it is a threat to our other neighbors in the Pacific, but not in Europe.

At the moment, Russia seems aligned with China. Beijing has been pushing for closer ties with Moscow, and how would you blame the Russians if our European powers seem to be moving away from any type of relationship that gives them any leverage on China, how can you blame Moscow for not trying to move closer if they can with the Chinese regime?

And this is because we now know, of course, that China is there in the Pacific along with North Korea, and what other countries do we have out there--Burma. I mean, no, the only, what we've got as powers in the Pacific is the United States, we've got Japan, but Japan has chosen not to be a military power, but none of these other countries are going to have the impact on a Pacific China and a Pacific Russia and a Pacific United States.

Those are the players, but I will add Japan to that list. But that's not what we're here to discuss. We're here to discuss Europe.

In contrast, the United States has strong ties with nearly every important state in Asia. We should be striving while we are trying to make sure that we have

friends and have a good relationship with other Asian countries, that we should keep, make sure that we understand that keeping China isolated should be our goal as long as it is a Communist dictatorship, as long as they are engaged in massive human rights abuses, and as long as they see us as their enemy, and we should not ever just walk away and whistle thinking that the world is all fine because we take it for granted that someone doesn't have an evil thought towards us.

There is every indication that the Chinese dictatorship sees the United States as its chief adversary, if not enemy, in the world. So at this point, Russia feels isolated because our European powers are shifting away from any type of ability to count on them in a tradeoff with China, and thus it should be up to us, and this is the last point I'll make, and that is if Russia is a European power and our other European powers have decided that they're going to go in a softer direction towards China--and taking a soft approach to a dictatorship never works--the United States should be pulling closer to Russia, and we should be trying to pull Russia into a Western alliance, especially pushing it towards respecting the arms embargo that the European democratic powers have placed on China in terms of military trade with China.

If Russia does want to be a respected Western European power, it can prove that to us by not selling deadly weapon systems that are on our embargo list to the Chinese, and I think someday we will see that move come from Russia within the next several years as they realize China is their greatest threat.

So that's what I have to testify. Thank you very much.

QUESTIONS & ANSWERS

HEARING CO-CHAIR BLUMENTHAL: Thank you for that excellent, thought-provoking testimony.

I wonder if you had time for any questions from any of us?

MR. ROHRABACHER: Sure.

HEARING CO-CHAIR BLUMENTHAL: Okay. We have Commissioner Wortzel with a question.

COMMISSIONER WORTZEL: Congressman Rohrabacher, thank you very much for taking the time to be here and for your leadership on these matters.

I think you're absolutely right that none of these European powers has any security interest whatsoever in Asia other than making sure that their markets stay open. It's very interesting if you look at what our supposed allies have done. England has sold fighter jet engines and advanced early warning and control radars to China. The Swiss have sold fighter jet engines and anti-aircraft guns. The French have sold anti-submarine warfare helicopters and armed destroyers, patrol craft and frigates with sea surveillance radar, sonar systems, anti-submarine warfare systems, fire-control radars and naval guns. The Germans have sold naval guns for destroyers and outfitted every class of Chinese tanks with their engines. The Italians have sold beyond-visual-range radar, fire-control radar, and torpedoes to the Chinese. And not one of these countries seems to have consideration of the fact that if they're put to use, as far as the People's Liberation Army is concerned, their main target is the United States.

So I wonder if in Congress there's any thought given to preventing companies that engage in that type of behavior, in arming the People's Liberation Army, without consideration from their allies, simply prevent them from any business cooperation or defense production cooperation or sales with the United States?

Let them make a business decision. You want to make a few hundred million on China or take part in hundreds of billions of dollars in cooperation programs with the United States?

MR. ROHRABACHER: Yeah. Officially, this is our position. Officially, there is an arms embargo, but they

have been stretching the definitions now so much that I think anything less than a nuclear weapon or triggering mechanism for a nuclear weapon is explained away.

But, look, 150 years ago, our European allies, our European friends, what were they doing? They were raping China. I mean let's face it. All these Chinese have this grudge about the West, and away from their whole dictatorship and what happens with a Communist Chinese dictatorship versus Chinese people themselves, the Chinese people have every reason to remember history.

By the way, I remember during the Boxer Rebellion--this is a very famous story where the European powers place all kinds of sanctions on the Chinese and took territory where they would then control cities and territories in China--the United States instead took money from the Chinese, which it then used as a scholarship program to educate young Chinese, and a lot of their leadership in the years when the old Manchu dynasty was falling down, a lot of their leadership came from scholarships provided by the United States rather than the United States taking that territory.

So I would think that the Chinese would have better thoughts towards us. I think the Chinese people do, but we're not talking about the Chinese people. We're talking about, just like during the Cold War, we weren't talking about Russian people. We were talking about the Soviet Union, that is Soviet Communism. Our European allies have got to--maybe they feel guilty about what they were doing 150 years ago, but I think that they're just up to the same self-interest that they always were.

We really need to evaluate history when we start talking about American policy. I mean I find all over the world, a lot of the problems that we face are based on trying to simply carry on the world, the colonial world, and the boundaries, the colonial boundaries that were established by colonists, and these colonies that was basically Europe trying to dominate the rest of the planet.

And so we need to call our European allies, especially when they're doing things like selling weapons, call them to task for this, and I would be open to trying to strengthen that retaliation.

However, do you think that has any traction in our

business community? Our business guys are over there making money, and that's a very sad commentary in the United States as well.

HEARING CO-CHAIR BARTHOLOMEW: Thank you, Congressman, and thank you also for the stark reminder that the economic reform has not led to political reform in China, which is an argument that has been made in this country for the past 20 years.

MR. ROHRABACHER: Yes.

HEARING CO-CHAIR BARTHOLOMEW: Thank you very much for appearing before us today.

MR. ROHRABACHER: Appreciate it. Good to see you.

HEARING CO-CHAIR BARTHOLOMEW: All right. We're going to go back to our first panel, and I think, Mr. Small, we'll start your seven minutes again so if you want to start from the beginning for the benefit of our colleagues who have just arrived, we really look forward to your testimony.

**STATEMENT OF ANDREW SMALL
TRANSATLANTIC FELLOW
GERMAN MARSHALL FUND OF THE UNITED STATES
WASHINGTON, DC**

MR. SMALL: Okay. Thanks again.

So to kick off again, three main points I wanted to make in this presentation. First, the speculation about Chinese investment in Europe and China bailing out the eurozone has overstated their importance. It's been useful for countries to make a play for Chinese support, but the euro crisis has largely hinged on internal politics rather than the need to attract external financing, which has not been forthcoming at significant levels from China anyway. Chinese FDI stocks run as low as about .2 percent of the total in Europe.

And second, as a result of the attention paid to these issues, a number of more significant developments in the EU's economic policy vis-a-vis China have not received the attention they deserve.

The EU has a very ambitious trade agenda in Asia and is in talks or full negotiations with virtually every major and even middle-ranking economy in the region.

Europe has also been toughening up its economic response to China rather than becoming more accommodating, not just through tactical measures such as WTO cases, but changes to how it initiates trade defense measures and broad measures to condition access to its public procurement market.

Third, partly as a result of this and partly as a result of the general convergence in transatlantic views on China that I think has been taking place over the last few years, this is actually a good point at which to be expanding cooperation with the EU. Transatlantic coordination is already well developed in some areas and, in particularly, on China trade policy, but there's a lot more scope for the United States and Europe to align their broader economic responses to China and their trade strategies in Asia.

One of the most productive elements of this will be to ensure that this new wave of bilateral and plurilateral

trade deals that the two sides are launching, such as the TPP, are mutually reinforcing and have the right effect in shaping China's economic choices.

To go into those three areas, for China, the eurozone crisis has been a mix of risks and opportunities, and it's been keen to ensure the stability of its largest export market and worried about potential spillover effects, but at the same time, a weakened Europe has appeared to present some cheap buying opportunities with fewer political obstacles and the chance to bring up its old asks, the granting of market economy status and the lifting of the arms embargo, as well as some new concessions that the IMF, that they've been looking for, and with the potential of more serious Chinese financing as a reward.

Some European member states have certainly been happy to tout statements of Chinese support as votes of confidence in their economies, and ultimately, although there's been a huge amount of ambivalence about any point of being seen to turn to outside funding when the EU has quite enough resources itself, the decision was made to leverage the EFSF.

Given the scale of its foreign exchange reserves, China is an obvious first port of call, even if there was a lot of criticism of the optics of Klaus Regling's trip to Beijing last October.

So far, though, there're no indications that China has taken on significant exposure to bonds in the eurozone periphery. Estimates for the proportion of Chinese foreign reserves that are held in euro-denominated assets range from around a fifth to a little over a quarter, but most of these appear to be concentrated in higher quality bonds.

Estimates of Chinese holdings in the EFSF have varied between ten to 20 percent, which is less than, for instance, Japan. And the numbers for all of this are very murky and very opaque on both the Chinese and European sides, but I think the general picture is no grand deals have been struck, and Chinese involvement has been pretty much that of a normal market actor rather than a white knight for the eurozone.

And as has come up, the story for Chinese FDI is relatively modest. It's certainly an upward trajectory in

2011, and investments ran about double the 2010 figure, but total stock, I mean we heard a figure of 30 billion, depends on whether those deals have actually been closed. In terms of deals that were closed, and at the end of last year, it was at about \$12 billion, and even on the higher number, you get to about .4 percent of the total, and that compares with a figure of \$1.36 trillion for the United States.

I think this reflects ambivalence on both sides. China has been treading carefully. It wants to avoid catalyzing domestic or international opposition, and on the EU's part, the view has been that external support for the eurozone is helpful but not strictly necessary, and certainly not important enough to merit political concessions to China.

Individual member states may have needed bailouts, but the eurozone itself hasn't. Market economy status is tradeable in the right circumstances, but not for this. The arms embargo wouldn't even be discussed in this context, and I can go into this later, but it's really not a live issue any more.

In fact, despite Europe's trade and economic conditions, and I'd say the EU has moved more in the direction of assertiveness than accommodation in its trade policy towards China; there's basically been a mood change in the last couple of years.

Instinctive free traders among the member states have increasingly become convinced that China perhaps uniquely requires the EU to take a more robust stance if leverage is going to be gained over a long list of bilateral disputes and have been willing to consider measures that they would previously have sought to kill.

Some of these have faded. A proposal to develop a European CFIUS, for instance, isn't legally possible at the EU level, but others, such as what is basically a China-specific reciprocity rule that will give member states the option to reject bids from countries that fail to open their own public procurement markets to European companies, have taken on momentum that would have been unimaginable a couple of years ago.

And once it became clear that the Doha Round was really dead, the agenda for new FTAs has been extremely

expansive. Aside from the Korea FTA, it encompasses talks with Japan and Indonesia, full negotiations with India, Singapore, Malaysia, Vietnam and, potentially, a revival of ASEAN talks if some of these bilaterals work out.

It's not a coincidence that this is a list of countries that essentially surround China. Although each of them has their own rationale, and in combination, there is also the hope that they will act to place pressure on Beijing.

I would say so far any concern that Europe's economic difficulties would undermine transatlantic cooperation on China has been wide of the mark. There's already close cooperation on trade issues where both sides have recognized the fact that they face pretty much the same challenges in China--market access problems, IPR theft, forced technology transfer, and a number of sector-specific issues--and, as China's two-largest trading partners, they are in a far stronger position when joint approaches are taken.

There are areas, however, where closer collaboration would be beneficial. The EU and the United States have not always been on the same page on the broader strategic dimensions of their economic approach to China. In particular, this includes currency policy where differences spilled over quite openly, for instance, at the Seoul G20 meeting, and regional trade strategy where there hasn't really been that much of an attempt to join approaches.

There are certainly "competitive liberalization" benefits that will accrue anyway from the two sides' efforts in the region, but if part of the objective of initiatives such as the TPP is to sort of set an aspirational bar on issues such as standards, especially IPR protection, even SOEs, that creates upward pressure on non-members, such as China, it's going to be far more effective if it's underpinned by an agreement between the world's largest economic powers.

I think in terms of creating a go-ahead club of like-minded countries that can establish a trade framework that is going to be attractive enough for China to make some tough decisions in order to join and create pressure to bring it back to the negotiating table on various

issues--and face serious costs if it doesn't--that club should really include the EU, the United States, and preferably Japan, too, if it's going to have the right economic weight.

So to conclude, I think the last few years has generally seen a convergence of transatlantic view on China and more appetite for cooperation. I think Europe is sometimes caricatured as being slow to wake up to the significance of trends unfolding in Asia, but on the trade front, in particular, Europe has in some respects an even more ambitious agenda than the United States, and a good basis has already been laid for transatlantic collaboration in this field.

The new U.S.-EU dialogue on Asia being established by Kurt Campbell should also help to start building some stronger habits of cooperation in the political and security arena, too.

The eurozone is certainly not out of the woods yet, and the years to come may see more substantial flows of Chinese investment, but even this is likely to create tension and create more Chinese-EU alignment. So despite some of the pessimistic discussion there has been so far, I would say in the coming period, there's more scope for the U.S. to extend cooperation with the EU in dealing with China than there is cause for concern.

Thanks.

**PREPARED STATEMENT OF ANDREW SMALL
TRANSATLANTIC FELLOW
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WASHINGTON, DC**

**China, the euro crisis and transatlantic cooperation
Testimony to the U.S.-China Economic and Security Review Commission
Andrew Small, Transatlantic Fellow, the German Marshall Fund of the United States**

The scale of China's involvement in the European debt crisis and its investments in Europe has been overstated. Internal politics, not external financing, has been the central challenge for the eurozone, and while Chinese FDI in the EU is increasing at a rapid clip, the volume remains modest. China has been nervous about being exposed to risky bonds on the eurozone periphery and is still cautious about the reaction to any major expansion of its investments in Western markets. As a result, although Beijing has suggested concessions from the EU that might attract more sizeable economic support, neither the perceived need on the European side nor the desire on the Chinese side have been great enough to bring it about.

For the United States, the opportunities to coordinate with the EU on economic policy responses loom larger than the risks that Europe's need for Chinese money will act as a constraint. The EU faces a virtually identical set of challenges to the United States in its commercial dealings with China, and—despite the depth of the euro crisis—has been seeking new ways to gain leverage in its bilateral relationship. The recent introduction of a reciprocity clause that would limit access to public procurement contracts in Europe—a measure almost entirely focused on China—is indicative of recent efforts to toughen up the EU's stance. The EU has also launched free trade talks with virtually every major economy in China's neighborhood, an approach that some have privately dubbed “Asia-minus-one”.

Transatlantic cooperation is already well developed in some areas, such as China trade policy, but there is a great deal more scope for the United States and Europe to align their broader economic responses to China, and their trade strategies in Asia. In particular, it will be important to ensure that the new wave of bilateral and plurilateral trade deals, such as the Trans-Pacific Partnership (TPP), are complementary in their effects. As Europe and the United States seek access to economic opportunities in the region, a degree of competition is natural. But closer coordination can ensure that these initiatives are mutually reinforcing, not least in shaping China's economic—and even strategic—environment.

China and the eurozone crisis

Beijing's anxieties about sovereign debt problems in Europe are longstanding, with Chinese

leaders among the first to raise concerns about the situation in southern Europe with their EU counterparts. China has been keen to ensure the stability of its largest export market, and apprehensive about the potential spillover effects for the global economy. Yet the crisis has also presented some opportunities. Europe's economic troubles have—at least in theory—provided China with the chance to snap up technology, brands, and hard assets at reduced prices and reduced levels of political resistance. Beijing has been able to dangle the prospect of financial infusions to see whether it will result in any movement on its longstanding asks of the EU: the granting of market-economy status (MES)¹ and the lifting of the arms embargo. The possibility of Chinese financing being provided through the IMF has put new potential concessions on the table there too, including a rebalancing of voting rights and the inclusion of the yuan in the special drawing rights currency unit (SDR)².

The Europeans have not been averse to the prospect of Chinese money. Member states have been keen to tout statements of Chinese support—or even talks with China—as votes of confidence in their economies, with Greece³, Portugal⁴, Spain⁵, Italy⁶ and Hungary⁷ among the most conspicuous examples. At the EU level, policymakers have been divided throughout the crisis about the involvement of outside funding, even from the IMF. But the need for a large war-chest to hold the markets at bay, together with the political and legal wrangling over various financing mechanisms, ultimately shifted the stance of the euro-group, and the European Council meeting in October 2011 gave the green light for leveraging the European Financial Stability Facility (EFSF). China is the only country other than Japan whose forex holdings exceed those in the eurozone itself, and Beijing and Tokyo were natural first destinations for EFSF head Klaus Regling after the summit.

So far though, this has not translated into any major commitment of financial resources, and there are no indications that China has taken on significant exposure to the riskier bonds. Total estimates for the proportion of Chinese foreign reserves that are held in euro-denominated assets range from around a fifth to a little over a quarter⁸, most of which appear to be

¹ Anderlini, J., & Zhang, L. (2011, 14th September). Wen sets preconditions to help Europe. *Financial Times*. Retrieved from <http://www.ft.com/intl/cms/s/0/b234ad8a-de98-11e0-a228-00144feabdc0.html>

² Kang Lim, B., & Edwards, N. (2011, 11th November). Politics Stymie China's EU Aid Offer. *Reuters*. Retrieved from <http://www.reuters.com/article/2011/11/11/us-china-europe-idUSTRE7AA1Q82011111>

³ Melander, I., & Papachristou, H. (2010, 2nd October). China's Wen offers to buy Greek debt. *Reuters*. Retrieved from <http://www.reuters.com/article/2010/10/02/us-greece-china-idUSTRE69112L20101002>

⁴ Laxmidas, S., & Yao, K. (2010, 7th November). China offers to help Portugal but silent on debt. Retrieved from <http://www.reuters.com/article/2010/11/07/china-portugal-hu-idUSLDE6A60A220101107>

⁵ BBC. (2011, 5th January). China backs Spain in new eurozone support. *BBC News*. Retrieved from <http://www.bbc.co.uk/news/business-12120069>

⁶ Regan, M. P., & Nazareth, R. (2011, 12th September). Stocks Gain on Report China May Purchase Italian Bonds; Treasuries Retreat. *Bloomberg*. Retrieved from <http://www.bloomberg.com/news/2011-09-12/asian-stocks-futures-fall.html>

⁷ Li, X., & Fu, J. (2011, 26th June). China willing to buy Hungarian bonds. *China Daily*. Retrieved from http://www.chinadaily.com.cn/china/2011weneurope/2011-06/26/content_12777603.htm

⁸ Wang, A., & Edwards, N. (2012, 15th February). China to keep investing in euro zone debt: China central bank. *Reuters*. Retrieved from <http://www.reuters.com/article/2012/02/15/us-china-europe-idUSTRE81E07J20120215>

concentrated in higher quality bonds⁹. Estimates of Chinese holdings in EFSF bonds—where the data is somewhat more transparent—have varied between 10-20%¹⁰ (less, for instance, than Japan). Although there have been offers of greater support, Beijing has made clear that this would largely be channeled through the IMF. While the lack of clear statistical information necessitates a certain level of educated guesswork, the general picture is still clear: no grand deals have been struck and Chinese involvement has been that of a normal market actor rather than a savior for the euro-zone.

The story for Chinese FDI is an even more modest one. Chinese state-owned enterprises (SOEs), private companies, and its sovereign wealth fund have all made a number of headline-grabbing purchases over the last couple of years, with Volvo (Geely), Medion (Lenovo), GDF (CIC), INEOS (Petrochina), port concessions at Piraeus (COSCO), and Elkem (China National Chemical Corporation) among the more prominent deals announced or concluded. The trajectory is certainly an upward one, with 2011 investments running at double the 2010 figures¹¹. But the baseline is low. Total Chinese FDI stock in the EU was less than 0.2% in 2010¹², a \$12 billion figure that compares with, for instance, U.S. FDI stock of ca. \$1.36 trillion¹³. The projections for the coming decade are substantial¹⁴, and the significance of even the recent Chinese investments has been magnified by Europe's straitened economic conditions – cash rich investors with readily deployable resources have been thin on the ground. But these are not yet game-changing investment flows.

Cautious China, wary Europe

The situation reflects ambivalence on both sides. China, for its part, has been treading carefully, keen to avoid catalyzing domestic or international opposition. Insofar as it can be ascertained, Chinese public opinion has been hostile to the idea of “bailing out” the “decadent” Europeans¹⁵. Moreover, the managers of China’s vast forex reserves have been under close scrutiny for years and, while seeking to diversify out of their reliance on dollar assets and improve returns, have been relatively risk averse. China has also been judicious about expanding its investments in European companies (and indeed all of its investments in advanced industrial countries), nervous about making bad judgments or getting burned again

⁹ Batzoglou, F., & Ertel, M. (2011, 16th November). Good Friends are there to help: Chinese investors take advantage of the Greek crisis. *Der Spiegel*. Retrieved from <http://www.spiegel.de/international/europe/0,1518,797751,00.html>

¹⁰ The EFSF numbers can be found at: <http://www.efsfeuropa.eu/>, which categorizes bond purchases by region, though this estimate is also based on the private assessment of a senior EFSF official.

¹¹ For statistics on Chinese FDI, I am hugely indebted to the excellent material produced by the Rhodium Group. See:

¹² See Hanemann *op. cit.*

¹³ See Eurostat, Foreign Direct Investment Statistics:

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Foreign_direct_investment_statistics

¹⁴ See Rosen, D. (2011) *An American Open Door? Maximizing the benefits of Chinese Foreign Direct Investment*, Rhodium Group

¹⁵ Edwards, N., & Kang Lim, B. (2011, 3rd November). Beijing risks public backlash if it rescues Europe. *Reuters*. Retrieved from <http://www.reuters.com/article/2011/11/03/us-china-europe-newspro-idUSTRE7A236S20111103>

politically. The EU has been seen as an easier destination than the United States, in part because it lacks a centralized process for scrutinizing and blocking investments on national security grounds¹⁶ (in fact, none of the member states with these mechanisms have used them to stop Chinese investments either) but Beijing doesn't want to spook the horses. Although there have been suggestions that China is sneakily expanding its European investments by focusing on "soft" targets among member states, the data implies that its patterns are similar to those of other external investors. The UK, France and Germany have seen the highest number of deals. Sweden and Hungary—slight outliers to the normal pattern of EU inbound investment—join them in the top 5 destinations for Chinese investment in terms of value as a result of a single large deal each (Volvo and Borsodchem)¹⁷.

On the EU's part, the view has been that external support for the eurozone is helpful but not strictly necessary, and certainly not important enough to merit political concessions. The IMF was only brought in as a junior partner for the first tranche of bailouts, and senior Europeans have been very sniffy about third-country support. Eurozone members (and, even more importantly, the ECB) have the financial wherewithal to address the crisis, with political obstacles far more pressing than any lack of resources. Individual members may have needed bailouts, but the eurozone itself has not, and there has been strong political pushback when anyone has misleadingly created the impression of Europe "begging" for support¹⁸.

This is not to say that trade-offs with China could not be envisaged in the right circumstances. The prospect of granting China market economy status, for instance, was quietly floated before the 2010 EU-China summit. This is a waning asset for Europe, given that China will be granted it automatically in 2016 under the terms of its WTO accession protocol. While sticking publicly to the mantra that this is a conditions-based process, plenty of European policymakers see it as something that should be traded off for concessions from China. Financial support to the eurozone, however, is not the deal that anyone had in mind. The arms embargo is in a different category altogether. With China having made no progress on the human rights issues that were linked to its possible lifting, and with additional strategic concerns accumulating since previous discussions of the subject within the EU, this is not in any sense a live issue. Only a combination of politeness and opportunism prevents that from being made clear publicly.

Dealing with a more assertive EU

Despite Europe's straitened economic conditions, the EU has moved more in the direction of

¹⁶ Miller, J. W. (2011, 6th June). Chinese Companies Embark on Shopping Spree in Europe. *Wall Street Journal*. Retrieved from <http://online.wsj.com/article/SB10001424052748704355304576214683640225122.html>

¹⁷ See Hanemann *op. cit.*

¹⁸ See Donahue, P. (2011, 30th October). Euro Area Could Address Crisis Without China, Juncker Says. *Bloomberg*. Retrieved from <http://www.bloomberg.com/news/2011-10-30/euro-area-could-address-crisis-without-china-juncker-says.html>; Bowring, P. (2011, 2nd November). Europe Doesn't Need China's Money. *Wall Street Journal*. Retrieved from <http://online.wsj.com/article/SB10001424052970204528204577011473701131672.html>

assertiveness than of accommodation in its trade policy towards China¹⁹. There are exceptions to this—some of the smaller member states have become more reluctant to support the initiation of anti-dumping measures against China in the EU's Trade Policy Committee, for example—but there has been a broader mood change in the last couple of years. Instinctive free-traders among the member states have increasingly become convinced that China, perhaps uniquely, requires the EU to take a more robust stance if any leverage is to be gained over a long list of bilateral disputes, and have been willing to consider measures that they would once have sought to kill.

Not all of the mooted initiatives have taken off. Two European Commissioners proposed the establishment of a European equivalent of CFIUS²⁰, claiming the backing of a number of member states, after an (ultimately unsuccessful) attempt by Xinmao to buy Draka, a Dutch fiber-optic cable company. An internal assessment has concluded that, since there is no legal basis on which a direct like-for-like body can be put in place, there is no immediate rationale to proceed, but it is an indication that Chinese investments will face increasingly close scrutiny. Other proposals have taken on real momentum. A reciprocity rule is being introduced that will give member states the option to reject bids from countries that fail to open their public procurement markets to European companies²¹. While the procedure can be applied to all countries that have not signed up to the Government Procurement Agreement (GPA), it has been drawn up with China as the principal target. Chinese companies would stand to lose access to the EU's \$500 billion market unless China either joined the GPA or stopped its own restrictive practices.

The EU has also embarked on an ambitious set of free trade talks in Asia. Apart from the agreement concluded with South Korea last year, FTA talks have been launched with Japan and Indonesia, and full negotiations with India, Singapore, Malaysia, and Vietnam are underway. There is also a potential revival of the attempt to reach an agreement with ASEAN, building on some of the bilaterals. While these are not a direct response to the EU's disputes with China, they will certainly have an effect on the pattern of trade relations for its neighbors, whether reducing their anxieties about economic dependence on Beijing or providing new opportunities to attract investment from European companies that have faced growing difficulties in China. If combined with U.S. efforts, they even promise to lay the groundwork for a higher-quality trade framework in the region and beyond.

Implications for the United States

¹⁹ von Reppert-Bismarck, J., & Guarascio, F. (2010, 22nd October). EU sends warning to China with 10-year trade strategy. *Reuters*. Retrieved from <http://www.reuters.com/article/2010/10/22/eu-trade-future-idUSLDE69L17820101022>

²⁰ AFP. (2011, 16th February). Commissioner Wants Foreign Investment Review Board. *EUBusiness.com*. Retrieved from <http://www.eubusiness.com/news-eu/economy-invest.8mz>

²¹ Simon, F. (2012, 9th March). EU to confront China with 'reciprocity' in public contracts. *EurActiv.com*. Retrieved from <http://www.euractiv.com/innovation-enterprise/eu-confront-china-reciprocity-public-contracts-news-511404>

Any concern that Europe's economic difficulties would undermine transatlantic cooperation on China has so far been wide of the mark. Trade issues have undoubtedly been the area where the two sides have worked together most closely, with officials on both sides in regular contact. March 2012 saw the filing of another joint WTO case, this time on rare earths (the first case that also includes Japan)²², and there has been close coordination over issues such as China's indigenous innovation proposals. The two sides have recognized the fact that they face almost exactly the same challenges in China—market access problems, IPR theft, forced technology transfer, and a number of sector-specific issues—and, as China's two largest trading partners, are in a far stronger position when joint approaches are taken.

There are areas, however, where closer collaboration would be beneficial. The EU and the United States have not always been on the same page on the broader strategic dimensions of their economic approach to China. This notably includes currency policy, where differences spilled over very openly at the Seoul G20 meeting, and regional trade strategy, where there has been little attempt to join up approaches. In some respects, it may be harder to forge consensus on currency policy than it was a couple of years ago but it is a good juncture to seek one on trade, although that too will be difficult. With the Doha round moribund, the agenda will now largely be driven by the next wave of major bilateral and plurilateral trade deals. Some of these, such as the proposed services plurilateral, could take place within a WTO framework, but others will—at least initially—be regional in nature, and Asia is going to be the main focal point.

There are some “competitive liberalization” benefits that will accrue even if the United States and the EU are not operating in a coordinated fashion but there are clear disadvantages. FTAs with the same countries—and there is already a high level of crossover—can be more ambitious if they are based on a broadly common approach, and will be stronger if they can avoid conflicting provisions. Active coordination on individual FTAs may be too much to expect²³ but they are increasingly becoming building blocks for a broader set of economic goals. If part of the objective of initiatives such as the TPP is to set an aspirational bar on issues such as IPR protection and standards that creates upward pressure on non-members such as China, it is going to be far more effective if it is underpinned by agreement between the world's largest economic powers. Any go-ahead club of like-minded countries looking to establish a trade framework that is going to be attractive enough for China to make some tough decisions in order to join—and face serious costs if it doesn't—should include the EU, the United States, and preferably Japan too if it is going to have the requisite economic weight.

²² BBC. (2012, 13th March). US, EU and Japan challenge China on rare earths at WTO. *BBC News*. Retrieved from <http://www.bbc.co.uk/news/business-17348648>

²³ Though for suggestions on how this might be undertaken, see: *A New Era for Transatlantic Trade Leadership: A Report from the Transatlantic Task Force on Trade and Investment*, German Marshall Fund of the United States and the European Centre for International Political Economy, February 2012, accessible at: http://www.ecipe.org/media/publication_pdfs/TATF_Report_2012_PDF.pdf

Conclusion

The last few years have generally seen a convergence of transatlantic views on China and a greater appetite for cooperation. While Europe is sometimes caricatured as being slow to wake up to the significance of trends unfolding in Asia, on the trade front it has in some respects an even more ambitious agenda than the United States, and a good basis has already been laid for future transatlantic collaboration in this field. In addition, the new U.S.-EU dialogue on Asia, being established by Assistant Secretary of State for East Asian and Pacific Affairs, Kurt Campbell, should help to build stronger habits of cooperation in the political and security arena too.

The eurozone is not out of the woods yet, and the EU-China relationship has still to be tested in conditions where there are very substantial levels of Chinese investment at stake. In this sense it is premature to conclude that the last couple of years definitively reflect the future pattern of relations. But it does indicate that—as for other countries—the expansion of commercial and economic ties is as liable to lead to tension as it is to closer alignment. For the coming period at least, there is considerably more scope for the United States to extend cooperation with the EU in dealing with China than there is cause for concern.

HEARING CO-CHAIR BARTHOLOMEW: Thanks. Thanks very much. Mr. Parello-Plesner.

**STATEMENT OF JONAS PARELLO-PLESNER
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MR. PARELLO-PLESNER: Thanks a lot. It's a pleasure and honor to be here.

You're actually going to hear something that's extraordinary: two Europeans that agree. Normally, in the euro crisis, when there is just one European in the room, you would have a disagreement.

[Laughter.]

HEARING CO-CHAIR BLUMENTHAL: That's what being in the Congress does.

[Laughter.]

MR. PARELLO-PLESNER: As you might have seen also from our written testimony, we're actually very much-- Andrew Small and I--along the same lines in our analysis on China and the euro crisis. So I would follow quite sort of similar points, and while sitting and thinking, I heard Andrew, and thought, how could I fill out some small cracks to give a more detailed picture?

I mean my point would also be that we've seen China take a quite clear interest in the euro crisis, its largest export destination. It's worrying what has happened in Europe. Wen Jiabao called Chancellor Merkel yesterday. So I mean this is definitely something that's on the Chinese leaders' minds.

But these sort of public commitments, too, that they would like Europe to sort of come out of the crisis, again, is not the same as if China has been sort of the red knight and is taking a large, huge game-changing stake in Europe's public debt.

So in that sense, that's the same analysis we have that when we look, for example, at the Greek bailout, then we've seen all the sort of major international investors sitting at the table; we don't see China certainly among those. I mean the year before we would see the Chinese

pass by Greece and talk about a commitment to Greece, and we would see them actually buy up and take a lease at the port of Piraeus or a spot. When we then later came to see who is actually holding a large number of bonds, they seem to be relatively risk averse.

And as Andrew described it, probably more as sort of a normal market actor, that they have a large part, the numbers, various estimates--I would go for the 25 percent--in sort of different European countries' bond holdings, but again, here they would go for market reasoning and look for the AAA sign, which is still in Germany and other countries, rather than politically for indebted countries.

I think it's important to underline the opacity in this area for Europe. I mean I've been with our think tank making recommendations that Europe should have a sort of system of tracking foreign debt holders. It has not been the case that's been necessary for Europe before because our debt was largely intra-European.

Now, it is the situation where we're also looking for sort of outside holders. The U.S. has the Treasury system that makes these TIC data whereby you have a number on Chinese debt holdings. The Chinese only publish their total amount of currency reserves, not the breakdown into currencies.

Actually, Europe has a weaker hand in the sense that Europe doesn't have a system to track these purchases, which means that we're a little bit torn between press declarations about the Chinese coming, and if they're coming to buy and they're saying something positive, it means they're probably going to buy a lot. And then the opacity behind that.

And some European leaders, actually, because of the crisis--very short-term thinking--have just been interested in maintaining that opacity as well because you have a market reaction. When the Chinese pass by your country and say we have faith in Greece or Spain, the market says, okay, that must mean they've bought.

So in that sense there's a sort of double opacity, but there has been argument over whether it would make sense for Europe to have, through the European Central Bank and national treasuries, a similar system of tracking.

Second, on where China has been willing to take a

stake in Europe, there has been much more on foreign direct investments. I think it's right to point out, as Andrew does, that it comes from very low level, but at the same time, we're talking quite sort of spectacular rises, and also particularly in sort of mergers and acquisitions in specific areas.

We've seen it in the car sector. Now, if you drive a sort of Volvo, formally Swedish American car, now it's a Chinese-owned car. The same with Rover in the UK. And you see it in connection with the euro crisis with countries that have to do sort of austerity cuts, and Chinese companies being quite willing there to take a stake.

Portugal sold out their biggest national electricity company. There was a Chinese company that took a large stake in it. You see it in the UK with Thames Water, probably the largest public water utility, with Chinese companies.

This is also part of just a business strategy, something for the next Five Year Plan. It's access to brands. If you can't necessarily always make them at home, then you can sort of buy them. It's access to sort of long-term investment where you can see diversification of currency reserves through the China Investment Corporation. There it makes sense for the Chinese to look at long-term public utilities where there is sort of an assured return over a long period.

But I think that evolution is probably the most, the one that in the future, even though the levels are still small, we're talking about rises more than 100 percent every year over the past few years. So it is rising very, very fast, and it fits with Chinese going-out strategy.

So I think that's definitely an area where China will be much more present in Europe after the euro crisis--through investments.

The third argument would also be in the EU's policy that, paradoxically, might have been a sort of awakening amid the sway of influence from China over certain member states by coming around and giving these sort of public positive signals about trust in the economy. This doesn't necessarily have an impact on the overall thrust and direction of the EU policy.

I mean you would have some countries that might then be saying something more positive to the Chinese, be it Greek or Spaniards, about the arms embargo, but they were already relatively positive on lifting it. So it's basically just tokens to the Chinese.

So, as Andrew Small just outlined, what the EU has actually been doing at the same time is a sort of strategy towards China, very much based on the trade relationship, but also now there is climate change, that I would highlight, where there's been a much more forceful approach to China, and the whole question of reciprocity, of treating China no longer as a developing country, but as a country that's, after the crisis, now an equal to Europe, the world's second-largest economy, and therefore we meet on a much more equal footing, to try to level the playing field regarding asymmetry between China and Europe.

We see that with anti-subsidies cases, which is a new thing for the EU--it used to be only antidumping--which reunites more free traders and protectionists because it targets part of the Chinese economy, sort of the cheap loan, and the whole state structure, which is a more acknowledged phenomenon than antidumping, where some would see this, particularly free traders, more as a way of protecting sunset industries in Europe.

So, again, in these areas, we see and hear there's a lot of ground for transatlantic cooperation. It's already there, I would say, on the ground. I've been doing a lot with the European Chamber of Commerce that do a yearly position paper that is strongly coordinated with the AmCham in Beijing. So I think we're already seeing that pick-up.

**Prepared Statement of Jonas Parello-Plesner
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Testimony April 19, 2012 before the US-China Economic and Security Review Commission
Hearing on the China-Europe Relationship and Transatlantic Implications

China and Europe in the eurocrisis

By Jonas Parello-Plesner, Senior Policy Fellow, European Council on Foreign Relations

Summary: China and the EU are economically tightly linked. The eurocrisis thus has an impact on China since the EU its largest trade partner and export destination. This analysis suggests that China so far has stayed with public commitments to helping Europe but hasn't purchased in huge amount of indebted European countries' public debt. China seems like other investors to have followed a risk-averse strategy. Rumblings by some about a financial 'Munich-agreement' with China are thus overblown. Yet when it comes to direct investments in Europe, China and Chinese companies have perceived the eurocrisis as an opportunity to buy European companies. Here there is a huge growth in Chinese investments inflows. This fits with a new phase of the Chinese going-out strategy and the Chinese ambition of moving up the value chain. The eurocrisis has led China to entertain tighter relations with individual member states where investment deals are brokered. This has in some cases reinforced China's influence with some member states and reinforced the existing structural splits inside the EU hampering the development of a coherent policy on China. Yet EU's policy on China is multi-faceted and in some areas particularly on trade and climate change, the EU is presenting a tougher negotiation stance than previously. This, among other subjects, gives ground for transatlantic cooperation.

China has a fundamental interest in seeing the euro crisis recede as it is dependent on the EU for the largest part of its exports. All through the eurocrisis, China has been consistent in voicing support for the euro and for individual countries in distress; for example through numerous visits of its top leaders to Europe such as:

- Premier Wen visited Greece in October 2010 and explained that "China will undertake a great effort to support euro zone countries and Greece to overcome the crisis." The amount of public debt bought at that and later occasions is uncertain but major investment deals notably in the port of Piraeus were also concluded during the visit.
- President Hu Jintao visited Portugal in November 2010 and voiced the readiness for "concrete measures to help Portugal overcome the global financial crisis". The news coverage assumed this translated into purchases of Portuguese bonds.
- Vice-Premier Li Keqiang visited Spain in January 2011, with similar news of confidence and according to news sources a willingness to buy-up Spanish sovereign debt.

Yet the actual numbers on bond purchases are shrouded in uncertainty by both China and Europe. China does only publish the total amount not the exact composition of its foreign exchange reserves. In accordance with that policy, it has never officially provided figures for its stake in public debt financing in Europe. The European Central Bank does not – in contrast to the US Treasury (the TIC data) - keep a public tracking of the nationality of foreign investors in the debt market.

Furthermore, there is a difference between the Chinese announcement at high-level visit and the actual purchasing of sovereign debt from the country. A visit does not necessarily coincide with the issuing of bonds. The Chinese statements can thus be seen as general pledges. As a result of both opacity on the Chinese side and the EU's own lack monitoring of European bond purchases, it is hard to know how present China really is in Europe's debt. The opacity of the exact scale of buy-ups will continue to be employed by China to its advantage.

So the following is based on assumptions through some of the scant data available. The new European rescue fund, EFSF has geographical indicators with Asia as a separate category of purchasers. In 2011, Asian investors bought 40 percent of the issuances. Japan, which is transparent on its purchases, makes up 50 percent of this. The assumption is then that China takes up around 40 percent. This would be roughly a net purchase of euro 5.6 billion in the EFSF. The Spanish Treasury, as the only one in Europe to this author's knowledge, also provides geographical indicators where China is lumped together with Asia and a host of other countries. If China acquired 40 percent (in line with its estimated EFSF-ratio of purchase) of the Spanish debt in 2011 in its regional category then it amounts to 2 billion euro. And look at the Greek negotiations with major creditors on its debt restructuring, China wasn't to be found at the table thus also limiting the amount of Greek debt that China could feasibly hold.

Still, it also has to be taken into account that market estimates, again based on assumptions, put Chinese holdings of European bonds at 25 percent of its currency reserves. Just to maintain that level, would mean that China at least purchased around 80 billion euro of bonds in 2011. Yet these purchases are more likely to have been directed towards triple AAA-rated countries like Germany than towards the highly indebted and higher risk countries. Thus, what can be inferred is that China hasn't been the red knight or game-changer in the eurocrisis by massively purchasing Europe's debt either at national level or in the joint rescue fund (EFSF), where the initial ambition in the late fall of 2011 was to leverage the facility up to a trillion with outside financial assistance including China. This never materialized.

This is because the top priority for China is risk-aversion. Beijing is seeking stable and secure returns on foreign currency reserves; it burnt its fingers by investing in Wall Street in 2007 through its sovereign wealth fund (China Investment Corporation) and some would argue also by holding a too large portion of dollars relative to other currencies in a period when the US is employing quantitative easing as part of its monetary policy leading to dwindling returns. Also, with Chinese public awareness on the rise and the country's wealth colloquially baptised the 'blood and sweat' of the Chinese people, many Chinese netizens are questioning why China has to bail out 'lazy' Europeans at a time when social inequality is rampant in China. Wen Jiabao's remarks that helping Europe is in China's best interest are partly meant

to placate this Chinese blog-fuelled dissatisfaction that would rather see Wenzhou than Ouzhou saved¹.

An additional complicating factor for China is that its currency reserves are declining for the first time in years, and 2012 could turn out to be a bumpy year economically. China might need to draw on its reserves to pull up growth to the magical 8 per cent that will help ensure a smooth political transition at the end of the year.

This helps explain the tight balancing act to which Chinese leaders have committed, showing some public support for the EU's currency ills while showing an equal dose of risk-averse reluctance at throwing too much money into the EU's piecemeal solutions. For example, the head of China's central bank, Governor Zhou, stated that China's helping hand to Europe amounted to not reducing 'the proportion of euro exposure in its reserves' — hardly the same as a massive purchase.

Yet this doesn't rule out additional Chinese financial support. The most likely scenario is that China will put additional money into the EU through an international body such as the IMF where Chinese support is also contingent of discussion with other stakeholders in that organization.

Even though China seems to favour risk-aversion when it comes to buying euros and bonds, it is more than willing to accept a stake in Europe's crisis by buying up companies. Rather, it saw the euro crisis as an opportunity for investments and mergers and acquisitions. In particular, Lou Jiwei, the head of China's sovereign wealth fund, is keen on boosting Chinese investment in infrastructure as China's contribution to Europe's future growth. Chen Deming, China's minister of commerce, also sees an opportunity: "European countries are facing a debt crisis and hope to convert their assets to cash and would like foreign capital to acquire their enterprises".

China at the end of last year purchased a large stake in Portugal's formerly state-owned energy

¹ Ouzhou is the Chinese word for Europe and Wenzhou is the home of venture capital in China where financing has become tighter.

company, which was sold off because of austerity cuts. Rover and Volvo are now Chinese-owned car companies. The largest British public water utility, Thames water, was sprinkled with Chinese money. Poland is - even after the unsuccessful highway project with Chinese state-owned company, COVEC-expanding cooperation with China Investment Cooperation on proposing assets that the Chinese side could invest in. The head of the Polish investment agency remarked on the size of investments that 'the sky is the limit'. This rapid move into European acquisitions could well be the most startling change in the relationship between the EU and China in recent years. The level of investments surged past 10 billion in 2011 and was China's fastest growing FDI-destination. In comparison, the US is at half that yet also with a rising trend.

What does China's move into Europe mean for EU cohesion on China policy?

Europe faces a structural disadvantage in dealing with China. The EU is divided between member states with different economic interests and decision making involves various actors such as the Commission, European Parliament and the European Central Bank, not to mention new institutions such as the recently created rescue funds for the euro, EFSF and ESM. China, on the other hand, is still a unitary actor that can mobilise banks, wealth funds, money, and diplomacy to pursue its foreign-policy goals.

Even before the eurocrisis, China knew how to employ the EU's multi-level governance to its advantage based on differences between member states within the EU. For example, China knows that southern European countries aren't likely to be frontrunners on EU's human rights policy, and that free-traders in the north, spearheaded by the UK, Netherlands, Denmark and Sweden, will work to block strong retaliatory moves on trade that smack of protectionism. The EU's policy often ends up in a lowest common denominator which is comfortable for China. The eurocrisis and China's growing bonds with individual member states can reinforce that trend.

Still, greater Chinese influence on some member states is unlikely to fundamentally change EU's calculus. The lifting of the EU's arms embargo has been mentioned in the press as a possible concession

following Chinese purchases. This is unlikely. Countries like Spain and Portugal were already in favour of lifting it receiving China's public commitment to their economic recovery. The real resistance in Europe lies with the UK. It still does.

Actually, and paradoxically, the eurocrisis comes as the same time as the EU is working to sharpen its tool box with strategic partners including China.

The EU has moved towards a policy of more reciprocity with China on the basis that China is no longer just a developing economy but also the world's second largest economy. Now, Europeans want trade and investment to be a "two-way street", as European Council President Herman Van Rompuy put it during his visit to China in May 2011 – that is, they want equal market access and an improvement in economic imbalances in the relationship where intellectual property rights, markets access and technology transfer loom high on the agenda – just as these dominate the agenda for the US.

That can be seen in several cases of friction.

Chinese restrictions on the exports of rare earths are a source of concern for the EU and especially Germany, whose high-tech manufacturing sector is particularly dependent on the minerals. In July 2011, the WTO ruled that Chinese restrictions on the export of raw materials such as bauxite, coke and magnesium were unlawful following a joint complaint by the EU, Mexico and the US. This year, the EU joined the US in filing a suit against China's export restrictions on rare earths.

A second dispute between the EU and China was around anti-subsidy tariffs, with the first case ever by the EU on glossy paper in May 2011. This followed anti-dumping cases and was potentially less divisive among member states since anti-subsidies directly target acknowledged parts of the Chinese state-driven economic model like cheap loans, discounted allocation of land and tax incentives. This is a new tool to enforce free trade and new cases are likely, according to the EU's Trade Commissioner.

The EU is also proposing an instrument for greater reciprocity in public procurement such as infrastructure where China and other partners aren't as open as the European Union. The proposal is still under discussion in a draft version.

Lately, the emissions trading scheme for foreign airlines flying into the EU has been added to the list. The EU has put in place new legislation that makes foreign airlines liable to pay for CO2 emissions when entering European airports. This is part of the European Union's determination to meet climate change targets. Both China and the US have complained to the EU about these new rules. China has reacted with public denouncement yet also seems to have taken it to another level by blocking deals in China by Airbus, the European aircraft manufacturer.

PANEL I: QUESTIONS & ANSWERS

HEARING CO-CHAIR BARTHOLOMEW: Thanks very much, and interesting testimony from both of you. I'm sure we have a lot of questions. We'll start with my co-Chair for the hearing, Commissioner Blumenthal.

HEARING CO-CHAIR BLUMENTHAL: Thank you very much for fascinating testimony.

I have two broad questions for both of you. One, I know there is no single European position on what would be the optimal policy approach that you want to get from China to deal with the various bailouts and debt crisis and eurozone problems that are ongoing.

But if both of you can speak, in your own opinion, what would be optimal in terms of, from the economic standpoint, what you want to get out of China and what would the risks of the optimal economic policy be in terms of the political relationship with European Union?

The second question is as a Commission and as individuals we visit China often and speak to American businesses, and normally they say we're having problems in China. They really want the U.S. government's help and more export credits and this, that and the other. My usual reaction to that is: if things are going badly in China, leave. There're other places to go.

For the first time this is resonating. So, and at least with companies that I talk to, it's no longer the case that companies are so excited about doing business in China. As you mentioned, in Europe, I think they are looking for other places to go. And I just wonder, it seems like there're great opportunities if one of the other Asian countries can get their act together, particularly India or Vietnam. Then it seems like there's great strategic opportunity for those companies to just pack up and leave and stop complaining to the U.S. government and asking for bailouts and corporate welfare and the rest of it.

So, I wonder if you're experiencing the same thing with the European companies you're dealing with, which is: we've had it, and we're looking for other places to set up our supply chains and manufacturing and research and development and so forth?

HEARING CO-CHAIR BARTHOLOMEW: All right.

MR. PARELLO-PLESNER: Okay. Thanks. Very good questions.

I think on the optimal way to negotiate through Europe united in the sense that if individual member states reach out to Beijing, that's where you have the sort of vulnerability of that. If you're going on a trip, and you're the Spanish prime minister, and the main purpose is to get a sort of signal on public commitment to your economy, then, of course, other priorities, be it human rights or the trade unions, sort of drift down a bit on the agenda.

So if we could have a system where it was much more Europe that negotiated that. Look at other countries: the U.S. has debt relations with China, and nobody would say that U.S. foreign policy is decided in Beijing. So I don't think it's necessarily dangerous for Europe to have debt relations with China. The problem is just that it's opaque at the moment and Europeans are sort of divided on it, which, of course, plays to China's advantage.

So as much as we can level that playing field and that asymmetry where that tracking device I mentioned--which would be one way of saying how large is this stake, we dispel a little bit of the public myths--would be one suggestion.

The other is you could say what's slightly already happened with the European rescue fund, the EFSF and now ESM, to having a sort of somewhere where the Chinese actually--we should offer them the opportunities. As long as they're not euro bonds where you actually take a stake in the whole European economy, you have to buy in different European countries, which, of course, makes it a relation with that country.

So if we could level that, that would be my suggestion for sort of strengthening Europe's hand in negotiation with China.

On the second, the European companies, I would say it's a varied picture. I mean you have companies that have a more and more China plus one strategy of saying you need somewhere else as well to produce, and you're not completely just relying on your production chain in China. You have that both because of rising production costs that

are starting, you also have that because of IPR issues, like a company like BASF, then they would have a large part in China, but then also have smaller, the really high-tech components being done elsewhere, in Germany or in, I think it's Malaysia.

So that would be part of the sort of business strategy. I would say, though, particularly, I'm doing a project on China and Germany, and there you actually see the companies really being in China for the long haul and seeing particularly the fact that China is also not just a production hub but a huge market for German cars that are now really part of the landscape of Chinese cities, and thereby seeing it a different way of actually partly becoming a Chinese company producing for Chinese as well.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

Andrew, go ahead.

MR. SMALL: Sure. Thank you.

As long as China is buying these bonds in normal kind of market circumstances and is not extracting any political concessions, then it's fine if they're buying EFSF bonds, ESM bonds. It's fine if they're buying bonds from some of these individual countries.

And I think that's where things stand. I mean it would be helpful if China wanted to take a larger tranche of money potentially through the IMF in terms of a holding in the European bailout funds. It does not necessarily, as long as there's no political price being paid for that, then I think that's not a problem and people are happy to take the money in these circumstances.

The problem is if with individual member states they're able to extract concessions bilaterally with them. So I mean in some respects, there's greater value if they're coming in at, even at large sums of money, at the EU level, but again I mean it's helpful if the money comes in, but it's not absolutely necessary for the eurozone if it does. So I think people are-- they have thrown, put some of these things on the table in terms of concessions that might be offered, and the Europeans have just said this is not how this transaction is going to take place.

I mean on the other issue, I think this is why some of these new trade, new FTA negotiations around China, and some of these kind of higher quality deals that are being

negotiated will be important in terms of the behavior of European companies, U.S. companies, too.

I think if it is possible to seal our own agreements with ASEAN and even with India and some of these other places, I think that will make a difference to companies' calculations. It is clearly already happening, as Jonas said, the sort of China plus one stuff. There is some outflow from certain companies. There are decisions being made on where you place your higher-tech investments and things like that that take these things into account, but that could be strengthened if some of these trade agreements were able to be concluded as well.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you both for being here and, Andrew, for being back. Much appreciated.

This is really a critical area of discussion. Last year, a poll was done of the American people, and, as I recall, 62 percent believed that China was the number one economic power, and that the U.S. had fallen. I believe it was the Pew poll. The Pew Global Poll showed some similar views by Europeans.

You're facing economic crisis or many of the member states are facing crisis. A lot of that is because of not only economic, but trade pressures, the same thing that we're facing here.

It's now been more than ten years since China joined the WTO. I've heard both of you talk about frustrations, technology transfers, dumping, et cetera, similar problems we have here. Should we be waiting?

American and European people have lost their patience as they've lost their jobs. I don't know anyone who says that the economic situation with China is working as it should. What are we waiting for? Shouldn't we be aligned more and taking aggressive action rather than simply having more and more dialogues trying to have ASEAN plus one, TPP, containment strategies? Shouldn't we be dealing with the problem directly?

MR. PARELLO-PLESNER: Thanks for that question.

The difficulty is answering that last lingering part, dealing directly with the problem, what precisely then that strategy would entail because I would say there

has been that sort of change from the honeymoon period, from let's say 2001 till 2006-7, whether or not sort of WTO cases against China, where we all have to adjust to the system, and so on. There has been a completely different take.

The U.S., Europe and Japan are just launching a case on rare earths against China in the WTO. China is also launching cases, which in a certain sense is positive, because they have been winning some of theirs. It means that their likelihood of respecting the others, I would hope, is bigger because they actually see that this is a system that works and deals with trade and is not something that is rigged against them either.

And as we mentioned earlier, what Europe is now doing, which is internal in Europe, and it's still just a proposal, has been this idea on public procurement, saying China hasn't signed up to the WTO Agreement on Public Procurement, which is a separate agreement, and since that's not happening, and they are coming with offers that are not really in the order that they should be, therefore, Europe, since it's predicated on a different type of openness, is trying to take steps so that internally will be discussed quite heavily.

I think the difficult discussion inside Europe is that the whole idea of Europe is based on the internal market and a free internal market. So it means that everything we make has to make sure we don't discriminate against each other internally, which has always not been that easy-- actually accepting that Euro Railways can be built by another European country when there is a lack of jobs in your own country.

So that makes it that Europe, the type of action that we can take in the outside world really has to fit into that framework, which is why I think the Commission has really been looking for things and therefore ended up targeting this issue of public procurement where you can say here you really have an international deal, that you have China and other partners that haven't signed up to, and they are able to compete in the European market, and we are not, and there's an asymmetry that we have to address.

MR. SMALL: I don't think there is much faith on the European front at the moment in kind of where all of

these dialogues and things are going. I mean, I think people are sitting around plotting to work out how to gain leverage, which case, what can you win in terms of cases at the WTO, what sort of framework can you create to put pressure on China, and what can you get through the system, given that there will be resistance to certain countries to certain measures?

And I think even on the direct trade defense measures, after September 2012, the balance will shift. It will be easier to bring direct measures at the EU level, and the public procurement market is \$300 billion in Europe that Chinese companies are potentially cut out of. That was framed entirely to target China.

I mean the difficulty has been working out exactly which of the direct instruments will work, and is there some kind of--will building some kind of a framework around China and some of these other things actually make more of a difference over time in terms of changing China's calculus? How much can you just do directly bilaterally?

But I think the mindset is not at the moment we will improve things with these economic dialogues and things like that.

COMMISSIONER WESSEL: I understand my time has lapsed, so your comments may be in writing. There is a global mechanism at the WTO known as an NVNI, a non-violation nullification and impairment case, which basically allows you to say: I can't point to every specific instance where this isn't working, but the benefits I expected, a country expected, or the WTO as a whole expected, when the deal was entered into have not been achieved.

I'd like you, after this hearing, if you're willing, to look at NVNI and give me your thoughts about whether we should have a wholesale review? It's not working. If we do rare earths, we do this case, we do that case, by the time we're done with our cases, there are no jobs left.

Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: A quick technical question. On the European level, on the EU level, can you track

Chinese ownership of companies throughout the EU? So if they have a Caymans' company, can you track it? Do you force them to tell you the full owners?

MR. SMALL: People try. I'm not sure if--

COMMISSIONER FIEDLER: No. I'm talking at the government level. Is there one government in Europe better than any other in forcing multinational companies to--I mean foreign investors to disclose their ownership?

The United States is no good at it, by the way. We don't have any government entity that tracks it. Do you in Europe?

MR. PARELLO-PLESNER: We have quite a lot of difficulty with these FDI numbers, and you would see different, I think in the introduction, there were numbers from Heritage which are quite a lot larger than numbers from Rhodium Group, and so there would be different numbers in Europe. So I think that already gives an answer to your question then.

COMMISSIONER FIEDLER: Okay. So you don't know, and we don't know. And the hedge funds are still prevailing politically.

MR. PARELLO-PLESNER: And there are areas, as well, where it's not disclosable. From having done a project on Germany, most companies will say we know the Chinese have portfolio investments below the stake that you have to declare.

COMMISSIONER FIEDLER: Yeah.

MR. PARELLO-PLESNER: And bought. And this is potentially a large sum of money. Of course, it's always below these three to five percent stake holds in a company, but they're not necessarily--

COMMISSIONER FIEDLER: So we're doing biometrics on individuals crossing immigration lines but not corporations with lots of money. So we've calculated risk a little differently in the West--all of us.

Could you comment on the politics of market economy status for China within Europe? So are they interested in giving it to them? I mean let me be frank with the question. Are you interested in giving it to them in defiance of the facts like people in--

[Laughter.]

COMMISSIONER FIEDLER: No, no--like people in the

United States? I'm not being critical of Europe. I'm trying to understand the politics better.

MR. SMALL: I think the answer is it has been seen as something that can be traded for some kind of concessions from China. I think there is, the view is notionally any official that you would get here will kind of go through a mantra about the five tests that China has to pass and all of this sort of thing.

But there is a view that in terms of leverage that Europe has, it's one of the only assets, and it disappears in 2016, and maybe we could get something for it. I would say that's the mindset, and before the 2010 EU-China summit, it was sort of floated again to the Chinese that this could happen. What would you do in return? The answer was not very much so the response was, well, nothing is going to happen with it. At the moment, I don't think there's very much momentum.

COMMISSIONER FIEDLER: Isn't there an automatic aspect to it at some point?

MR. PARELLO-PLESNER: 2016.

MR. SMALL: 2016, yeah. I mean under the terms of

COMMISSIONER FIEDLER: I mean so if I'm--

MR. SMALL: It is debatable--

COMMISSIONER FIEDLER: So if I'm the Chinese--

COMMISSIONER WESSEL: The test remains.

COMMISSIONER FIEDLER: If I'm Chinese, I would be patient?

MR. SMALL: And that's the problem because I mean there is a legal debate obviously still about whether, but I think the assumption on the part of most officials is that at the end of 2016, under the terms of its accession protocol, they will be--

COMMISSIONER FIEDLER: Again, in defiance of the facts. Right?

MR. SMALL: Yeah, I mean it could be possible to find delaying mechanisms. There has been some speculation in the last year about whether it would be possible to find ways around this, but I would say the assumption, asking about the politics of it, the assumption at the moment is that that will go ahead.

COMMISSIONER FIEDLER: You agree?

MR. PARELLO-PLESNER: Yeah. Europeans have the realization that it's sort of a dwindling bargaining chip, and you would have some--there's also division inside Europe in that you have some that actually would state, not just because they're being official, but to sort of fight for it here, and say China has actually fulfilled it.

Others would see it more politically and say here are some of our concerns on the economy, market access, better protection of IPR, if China could sort of give us something on some of these things, could we then sort of trade it as a bargaining chip with the Chinese? And, again, time is then ticking towards 2016, which the Chinese know.

COMMISSIONER FIEDLER: I'll have a second round.

HEARING CO-CHAIR BARTHOLOMEW: Chairman Shea.

CHAIRMAN SHEA: Thank you both for being here. I appreciate it. Some of you have traveled--at least one of you has traveled from pretty far away.

Question about cyber. The U.S. National Counterintelligence Estimate that came out last year identified China as a major source of economic espionage through the cyber domain. We've heard from former Secretaries of Homeland Security, Deputy Secretary of Defense, former head of the NSA, saying that China as a national policy matter is engaged in a massive cyber effort to steal our economic and intellectual property.

I assume that just about every large U.S.-based company has been tapped in some way. Is cyber espionage a major concern of European-based companies? What level, what level--I assume it is a concern--but what level of concern is there, and is there room for cooperation between the U.S. and Europe, at least on the economic aspects of cyber espionage?

MR. PARELLO-PLESNER: Thanks, Andrew, for passing that on.

[Laughter.]

HEARING CO-CHAIR BARTHOLOMEW: He's been doing that a lot through this.

MR. PARELLO-PLESNER: Yeah. The point I would make would be, yes, I think there is a common concern. I think there is room for cooperation on that. If I look, and this is a little bit more my layman estimation because, in the

press, I would say cyber security with Russia has probably been a bigger thing in Europe with sort of attacks on Baltic states, and so that's been much more sort of in public opinion about that Russia is--

But I do know that EU and China actually agreed to some sort of, again, we're talking the sort of soft power dialogue on cyber security where Europeans are trying to show that it's a priority to engage the Chinese on this. So I think that could definitely be an area that could be trilateral also, trying to discuss this.

MR. SMALL: Yeah. I think most of these things will be relatively and are relatively equivalent. I mean there is what's been going on from the Russian side, but I mean what's been going on from the Chinese side has, I think, been not dissimilar, and, again, kind of going right into Angela Merkel's e-mail accounts and things.

I mean it's very extensive. It's a sort of equivalent level of concern I would say, and I think there are conversations taking place on the transatlantic side about how to deal with that. I mean, as Commissioner Blumenthal mentioned, it's even come up in the NATO context as well. It hasn't necessarily been talked about. I mean even though so much of it is China specific, there's still a slight wariness in NATO about properly coming up with China policies.

But for a lot of the other governments and through other mechanisms, I think this is, and there are already substantial discussions that have been taking place about it and fairly similar concerns to the U.S.

CHAIRMAN SHEA: It's becoming an increasingly, I think, visible issue in the discussion here in the United States, and I've seen some commentators suggest in the U.S.-China Economic and Security Dialogues, cyber should be front and center as one of the top two or three issues discussed. It doesn't sound like it's in the European Union-China dialogues.

MR. SMALL: It was in the last EU-China summit, and that was one of the major issues--cyber security and cyber freedom were one of the main focal points at the last summit. So I would say it's up there. It's pretty much equivalent. It may not have the level of depth I mean just in terms of the sort of people that are being fielded on

the Chinese side of the dialogues here versus who's being fielded for the ones with the Europeans.

I'm not sure it's advanced quite as far, but in terms of where it sits on the European agenda, I think it's very much up there.

CHAIRMAN SHEA: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Reinsch.

VICE CHAIRMAN REINSCH: Thank you.

Andrew, one of the things you said that intrigued me was you made a reference to the impossibility of a CFIUS-like structure in the EU. And I wonder if you could elaborate on that a little bit?

I recall after the Lisbon Treaty that the EU has taken over cognizance of investment and has been, as near as I can tell, on some other issues fairly aggressive in trying to assert itself. Why couldn't they do a CFIUS or how far in that direction could they go under the treaty?

MR. SMALL: I mean the problem is it's a member state competence, and as far as I know, there are three--the UK, Germany and France--have something that is not unlike CFIUS or is sort of vaguely equivalent. A lot of the other member states just don't have any mechanism of that sort.

There were two commissioners who raised the possibility of establishing this, and after a particular Chinese company, Xinmao, tried to take over a fiber-optic cable manufacturer and kind of put it, wrote a letter to the Commission President that was leaked, to say that some kind of body should be established.

I think because it's a security issue, and it's member state competence, they concluded that they couldn't legally establish a body that would be a direct equivalent for CFIUS, and the question is could you establish a body that at least monitors a lot of these investments taking place across the EU even if it's not legally binding?

And there is concern about reaction from member states in terms of encroachment on their prerogative to have whoever they want invest in their country. And so people have been a little bit careful about the issue in the Commission, but I don't think it's gone away as an issue.

It's just that barring a treaty change, I don't think anyone thinks there's a way to establish it at an EU level. I mean other member states could also establish these things as well. I mean, as noted, none of the member states that have these bodies have actually blocked a Chinese investment to date.

VICE CHAIRMAN REINSCH: Okay. Thank you for that.

On another matter, I was intrigued by the point that both of you made relating to the EU negotiations of trade agreements with the surrounding states, which I thought was interesting. My impression of those, aside from the Korea deal, is that most of them get about 90 percent of the way finished and then stop--the Indian deal being a good example--because they run into some fairly significant differences of opinion on some fairly fundamental issues, that thus far there has not been the political will on one side or the other--it's not always on the same side--to surmount.

How likely is it that these things are actually going to be--there's going to be a ring of Korea-like deals around China or does a lot of this end up being wonderful publicity when they begin, but they end up fading off into the ozone two years later?

MR. SMALL: I mean I would say people are relatively optimistic about this. The ASEAN, the last attempt with ASEAN kind of unraveled.

VICE CHAIRMAN REINSCH: They're always optimistic until they end up not happening.

[Laughter.]

MR. SMALL: I mean from the readout fairly, I mean India has actually, I think, just appointed its Commerce Minister to be Ambassador to the EU to try and kind of go through and conclude that deal. I mean there is the question about whether these will be closed. I think there is, genuinely, the negotiators think on a number of these cases, I think the first, the Southeast Asian ones are the ones that are likely to come to fruition first in terms of the ones that are in the mix.

India could be slower, but I mean we are still talking about in the course of this year, you could see some of these things concluded. As you say, things could unravel at the last minute, but if you take the readout

from the people who have been involved, they think there's a decent chance they can push a number of these through.

And obviously, the kind of scoping exercise with Japan and things like that is much more, that is much further away; Indonesia is much further away.

VICE CHAIRMAN REINSCH: Thank you.

I've got more questions than time so let me ask one quick one, and hope if we have another round, I'll have another opportunity.

I was interested, and neither one of you mentioned the airline emissions dispute, which is an area where I think ironically we and China are probably on the same side. What potential does that have for disrupting the EU-Chinese relations and what is the level of seriousness of this issue compared to the thousand other ones that are out there?

MR. PARELLO-PLESNER: Yeah, I'll try. I think I mentioned it briefly when I said EU has also been getting more assertive on climate change. I was actually thinking of the airlines.

VICE CHAIRMAN REINSCH: That was really encoded.

MR. PARELLO-PLESNER: But, unfortunately, EU has ended up quite isolated on this issue. What I think it shows, and that relates back to a point of what can we do--shouldn't we deal--by Commissioner Wessel--directly with the problem, is that when we talk about reciprocity, which the EU is doing a lot more, maybe sometimes the Chinese because of their state-controlled system are in practice much better at doing it, which means that now since they are in strong disagreement with the airline emissions scheme, they are not just protesting diplomatically like other countries are, as well, but they're also blocking deals with Airbus, and thereby using the powers they have over the economy, which is one of the issues for tougher strategy, is that with a state-controlled economy, they basically have levers that Europeans and Americans do not have to the same degree and don't wish to have over our economies.

So that actually relates back to your point, and your question, I imagine, was more about are we going to see a solution? I think it's a really difficult one because where you have the EU is strong is when there is

made a decision at 27, then sort of people stick to it even though internally now some of the member states, particularly the ones with the large stake in Airbus, are sort of screaming a little bit what is this; we're getting into real trouble here. But at the same time there has been made a decision to go forward with this airlines emission scheme.

EU can be very indecisive when there are internal negotiations, but since the decision has been taken on that, and the EU sees it a little bit not as it's imposing for commercial benefits, but that it is doing this for the benefit of climate change for everybody in pursuing the agenda since the negotiations have been advanced. So I would say you're sort of touching a core point of EU's sometimes regulatory imperialism.

HEARING CO-CHAIR BARTHOLOMEW: Thanks.

Commissioner Wortzel.

COMMISSIONER WORTZEL: Appreciate you both coming in, and Mr. Small, you've put up with us, I think this is the third time; is that right? Thank you.

I like, Commissioner Reinsch, focused on your statements on page four of your testimony about the failed attempt to look at a CFIUS-like structure in Europe, and you answered half of what I was interested in in your response to him. I'll see if I can follow up with a little more in-depth focus.

But in specific European states that exhibit national security or technology security concerns, what sectors do they most worry about as potentially threatening either the national lead or national security interests when Chinese firms try and acquire companies there?

Mr. Plesner, if you have--

MR. SMALL: In a sense, the proposal that was being looked at and also has been a question of economic security as well as national security. So in one sense, and the initiative in that sense, it's the French and some of the southern European countries who were actually raising it as much in terms of concerns about European technologies that aren't necessarily dual-use technologies but sort of the crown jewels of Europe being bought out.

And so in terms of the new momentum and the specifics in terms of Draka, the company that kind of

prompted this, much of it has been a concern about getting access to high quality technologies that aren't necessarily under the auspices of national security concerns.

As I mentioned, the member states that have these processes have not actually blocked any measures on national security grounds so far. And if you look at some of the companies that are operating, that have been investigated by CFIUS, I mean Huawei and companies like this, are more active in purchases and in activities in Europe than they are here.

So if you're looking at sort of like-for-like cases from here that might be considered to have national security implications, in Europe, some of these have not been treated with the same weight, which is why in some respects China has found the EU, partly because of the mess of these processes, partly because there isn't a proper CFIUS, partly because a lot of member states don't have at all to be an easier way to get in, including on the tech side.

But if something does come up at the EU level, it could as much be about economic security as national security because that will still be reserved to member states, but you could have a body that would be looking at the pattern of Chinese purchases of technology companies and certain other areas taking place across the Union and drawing attention to that.

But I think it would be driven by member states that had that kind of angle on it rather than kind of purely on national security terms.

MR. PARELLO-PLESNER: Andrew has covered it quite well. I think the only thing to add is maybe in the European perspective of having such a system, vetting system, on economic security would have caused member states to show the different view of what is economic security.

You would have some member states who think yogurt is a strategic good, and others that would be a little bit more free trade inclined. So I think part of the reason why it also hasn't come further in the debate has been that, that it would probably expose many of these fault lines among European countries and would perhaps not lead to such a system.

But, as Andrew just pointed out, I think Huawei is a good case in point of the difference in the evaluation, that it's operating in all 27 member states and has quite a lot at stake, and it has in a couple of deals been blocked in the U.S. So this is different levels of perception and were just not part of the European debate.

COMMISSIONER WORTZEL: First, since our Defense Advanced Research Projects Agency has sort of laid out what the crown jewels are, I take it there's no pan-European effort to say, okay, these are really the crown jewels?

HEARING CO-CHAIR BARTHOLOMEW: All right.

[Laughter.]

COMMISSIONER WORTZEL: A resounding silence I'll take as a no.

HEARING CO-CHAIR BARTHOLOMEW: Yes.

Commissioner D'Amato?

COMMISSIONER D'AMATO: Thank you very much, Mr. Chairman. Let me add my thanks to both of you for coming out.

A couple of quick questions. I'm actually glad to hear you talking about linking economic security with national security. As you probably know, that's the concept that really was central theme driving the creation of this Commission so we take that relationship very seriously.

I have two quick questions. One has to do with FDI and may have been partly answered with Commissioner Fiedler's question. If the EU is now taking over cognizance of investment, let's look at it both ways. Is there a developing tracking mechanism in and out? European investment into China and vice versa, Chinese investment into the eurozone?

Is there a tracking mechanism that is being developed in this respect or is there something that's now effective or how would you judge that?

MR. PARELLO-PLESNER: The other way around, into China, is probably quite well defined because the Chinese also have an interest in tracking that. But flows into Europe, as we mentioned previously, have levels of uncertainty. There is, of course, a set of numbers from the MOFCOM, but there you have the question of what goes through Hong Kong, what goes through Cayman Island, and

other directions before going to its final destination. So you could have levels there.

Then there is the other way of doing it, sort of bottom up. For example, as both of us quote in our studies that the Rhodium Group has done, goes through on the mergers and acquisitions in Europe and say how much do they add up to. So you have different efforts at trying to track Chinese FDIs into Europe, but it's not yet at a sort of pan-European where there is--that would be then connected to this type of sort of vetting, be more like Andrew mentioned, an advisory body less than a sort of real competent body that could sort of take decision, that could do such a--

COMMISSIONER D'AMATO: So it's not really in place yet?

MR. PARELLO-PLESNER: No, no.

MR. SMALL: Because of the problems with Chinese investments specifically, it's been hard. Eurostat gathers a lot of the statistics from across the EU monitors the FDI flows in and out, and you can kind of get the sort of general numbers for all of the countries, and it's broken down by country basis.

The statistical service does try and pull this together, and, if you look at the figures, up to about 2010, China doesn't even feature yet. It doesn't make the top ten. They're tracking them, but it's been at too low a level, and the question in the next round is going to be given the nature of Chinese investment flows, how effectively are some of these statistical services going to be at trying to do this?

Some of this research works quite hard obviously at disentangling what's coming out of Hong Kong and which of that is actually Chinese investment. I'm not sure it's absolutely clear yet how good a job the EU statistical services will do with that. But if you go and look down the numbers now, China hasn't even crossed the threshold yet. It's still below a certain--it's still at a relatively modest level.

So I think it hasn't kicked in yet at quite the level of concern about the opacity of Chinese investment that it might do in the coming year.

COMMISSIONER D'AMATO: Thank you.

Are there two or three sectors that stand out as the ones that are the most traveled by the Chinese into Europe, except for Huawei, which is its own sector in some ways, but are there--what, given the nature of understanding the flows, can you name the two or three most important sectors in terms of Chinese investment into the European zone?

MR. PARELLO-PLESNER: As Andrew mentioned, it's still at a relatively small scale. It's actually the deals that we would be--automotive industry is, of course, one with both the Rover and the Volvo deal--broadly defined, high technology and machinery. You'd have the purchase of the Hungarian largest chemical factory, and recently the merger of Sany and Putzmeister, which is a German company dealing in sort of high precision machinery.

So those would be--the third I would probably mention would be logistics, when you look at the port of Piraeus, Naples, the sort of interest in since China, Euro-based China's largest export destination, basically also controlling a larger part of the supply chain to Europe.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Slane.

COMMISSIONER SLANE: Thank you.

Does the EU government in Brussels have a counterpart commission similar to ours advising them on China?

MR. SMALL: Not really. There are external, I mean there is no direct equivalent.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Cleveland.

COMMISSIONER CLEVELAND: I apologize for being late, but finding this place was a challenge for a Senate staffer.

I'm interested, you may have covered this, and if so, I apologize. I'm interested in the relationship between China and the IMF. I'm looking at a Bloomberg article from February talking about an IMF report that said China's growth could drop by as much as four percentage points from the Fund's current projection of 8.2 percent, which would obviously be catastrophic for China.

And I'm wondering, as they look at their options, what the relationship with the IMF is at this point, what are the factors that would contribute to their making a

substantial commitment to the IMF, or alternatively, to the European Support Fund?

MR. PARELLO-PLESNER: Yes. To make sure that I disentangle the great question, on the question of how China could contribute to Europe, definitely IMF has been sort of figuring as an option in it, I would say it is still on the table. It's right now with the IMF Spring Meetings, there's discussion of sort of an enlarged contribution.

I was at a reception last night where the IMF Director Christine Lagarde spoke, and she was saying, I'm holding \$360 billion here in commitments, and I would imagine that China figured among those.

So I think here we see that China, as we described earlier, as being relatively risk averse investor go through a sort of international financial institution, and therefore be together with other investors in taking this risk, and would have a financial institution as buffer as well. And the second, for China, I think spinoff would, of course, be that it would sort of heighten their position in the organization as well.

And highlight, particularly if it would be China and other BRIC countries, to change the power in the world, that they're now putting the money for the old West, and particularly Europe. So I think that would be my answer to that.

MR. SMALL: Yeah, I agree. Only point of nuance, China has put money in directly to the EFSF, that will become the ESM, and we heard estimates like ten percent, 20 percent, depending on how you look at it. So there is bilateral support going into EU's bailout fund.

The question over the last few months, has then been if China were to put in a larger tranche, would it do it directly, bilaterally, or would it do it through the IMF mechanism? And it's become quite clear that if it's larger tranche, you know, a couple hundred billion dollar, whatever the number is, more, they would want to do it through the IMF and so that seems like where the action is now.

COMMISSIONER CLEVELAND: I think that you have asked the question better than I have. What is it about the IMF that they would prefer? Is it because they're

looking for an enhanced role or why would they prefer that mechanism to the direct route to Europe?

MR. PARELLO-PLESNER: Well, they had a role internationally in sort of economic multilateral governs, and second, the sort of risk sharing with other investors of if you imagine a huge sort of intake in leveraging, which was what Europeans were hoping at some point, that China and Japan, as well, would be the ones to sort of leverage the EFSF, which didn't happen. There they would, of course, take the full risk on the euro crisis on their own.

And as you've seen with the currency reserve, internally, even though it's an authoritarian system, there's really much more public opinion writing on Chinese blogs on how the currency reserves are invested, and the feeling that when they invested in Wall Street back in 2007, and then afterwards came the crisis, that they've lost money, and that dollar holdings also sort of less certain return.

So there is sort of public opinion feeling which I think is part of the Chinese calculation as well. I mean there's this popular expression that they don't want to bail out "lazy" Europeans when they still have many social issues and inequality of their own to solve.

COMMISSIONER CLEVELAND: Andrew, this is for you. Have you given any thought to the impact of a sizable contribution to the IMF on the basket of currencies?

MR. SMALL: You mean in terms of--

COMMISSIONER CLEVELAND: SDRs.

MR. SMALL: SDRs.

COMMISSIONER CLEVELAND: Uh-huh.

MR. SMALL: Yeah, I mean this has come up in the negotiation with the Europeans as well; would they support this? The impression was in the first cut not, and again the statements from Christine Lagarde suggested that the next revision would be put off to whatever it is--2014--2015. So the sense is there wouldn't be immediate movement on it, but that's certainly being put by the Chinese and is in the mix.

COMMISSIONER CLEVELAND: Okay.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

I think I'll take my turn. First, just a comment.

You mentioned, Jonas, the purchases staying below the three to five percent threshold so that it's not noticeable. One of the issues that we have had some concern about in the past is that different Chinese investment arms would each buy just below the threshold, and if you look at the whole thing, the possibility of control shifting is there.

So I wanted to mention that every time I hear three to five, I think, yes, but you can have SAFE buy something and CIC buy something, and you can stay below that threshold and still end up with a problem.

But I would like to get to this issue a little bit more of the possibility of the Chinese playing off individual states against the greater body, particularly as their FDI grows. I think all of us think this is going to be happening because, I'd note, that the Chinese do that within the ASEAN. They will divide and conquer where necessary.

And we also see, although this is greater Europe and not the EU, their willingness with Norway to try to use economic means to achieve some sort of political ends. I'm thinking particularly of the Liu Xiaobo Nobel Prize.

So do you see this as a problem that will grow? That as they make investments in certain countries, they will try to leverage, use those countries in order to achieve other ends that they might have within the EU?

MR. PARELLO-PLESNER: Well, I think there are two ways. The Chinese know the European system quite well, and know and take Europe as it is, not the way some sort of federal Europeans would like it to be. So they consist of member states that take positions, and they know the whole game pretty well. Now, they go to Brussels, and so both, sort of try to influence member states and at the same time at the Brussels level.

So that was also there before the crisis, I think is a point to take. And you can, which we did at the European Council on Foreign Relations in a poll on sort of EU-China relations, sort of take and put the different member states into categories and say where do they fit as free-traders, the ones that would be a little bit more slackers on human rights, and so on.

So I would rather say that this sort of reinforces some of the structural trends in how European policy is

shaped rather than it really makes a sort of big fundamental change. I mean when you mentioned the Liu Xiaobo case and that impact, you have seen that with the whole of Europe. For example, the Dalai Lama visits, which used by a number of countries to be conducted at prime minister level, and China has been putting soft sanctions, like they're doing now on Norway, on individual member states, and the EU hasn't really had a system to counter that.

So you could say it just as well be Norway outside of the European Union than being inside. So even the large countries, like Germany and France, have got rough turn with China on the Dalai Lama visits in 2007 and '8.

So, in that sense, we see some of that, but I would still say, as both of our initial statements, with the euro crisis, it hasn't much more than reinforced sometimes some of these. It hasn't, again, with like trade policy really where you could see the influence.

Anecdotally, you could say that Greece held a sort of Tibet conference, which was completely sponsored by the Chinese government, and the president there is a Greek--Chinese chairman had this lovely quote in saying, it's nice to talk to the Chinese. We are being chased by Brussels night to day. But this is, again, this is a conference. So it's not something that really fundamentally changes the foreign policy priorities of a country now. But I mean in that sense, you could see some sort of effects of it.

HEARING CO-CHAIR BARTHOLOMEW: Andrew.

MR. SMALL: Yeah, I think there are, I think on the human rights areas and the Dalai Lama issue, you can see some shifts in behavior on the European front that have been unhelpful in the last period of time, and you can attribute that to various things, but they did do a good job of punishing certain countries, and so there was a response to that. So I think undoubtedly on that front, there has been an effect.

You've seen, again, sort of anecdotally, on one or two, the Chinese find out what everyone is doing in the EU. If there is a closed door meeting, someone will tell them what everyone says. It's almost completely transparent, which is one of the problems. They get papers before some member states.

Which means that countries' behavior, voting in particular committees like, say, trade policy committee, looking at safeguard mechanisms and trade defense instruments, they'll find out what people do, and so they, and there have been one or two kind of small member states that may have been more reluctant in the last period of time to bring certain cases than has been the case in the past.

So I think it is a concern that they will be able to pick some of these countries off. What you have, at least on the economic, I mean some of the big issues obviously require, it will vary in terms of whether there are issues that require unanimity where people can hide behind each other anyway. Qualified majority issues, where there is some scope for that, or some of these that are coming down to majority votes.

And so the practice, whether it comes to foreign policy issues, security issues, and in some of these trade issues, I think it will pan out in different ways. So far, on the major policy areas, I don't think you could point to EU-level decisions that have been substantially affected by the Chinese through their investment.

I think you can point to some elements of individual member state behavior, it's a concern. But, for the most part, other than one or two member states that I won't name, that behavior is consistently unhelpful across the board in terms of how they align them on these things.

People have actually pulled together on a number of these issues and have been willing to support some of these new things that we're talking about--the Government Procurement Reciprocity clause, and even the way they're going to be doing trade defense instruments that will now basically require a qualified majority to block a trade defense instrument rather than a simple majority in the future, which will mean it's harder for a blocking minority of the free-traders to prevent actions from being brought against China.

So, in theory, you could see on something like that, which was supported by a lot of these small countries that still want the EU to be able to perform its role and do these things, even if bilaterally they may be kind of more cautious and make the odd concession, at the EU level,

people are still kind of dependent on these instruments.

And so, at that level, I think there will be an attempt to pull together on some of these issues rather than it necessarily being the case that China can pick people off.

HEARING CO-CHAIR BARTHOLOMEW: Great. Thank you.

We have two, three, four, five Commissioners who would like to do a second round of questions so what I would like to ask of you is -- we will get to some of them, and I'll ask my colleagues to stay brief -- but could we give you some questions for the record in order for people to be able to get all of their questions out? Would that be acceptable to both of you?

MR. SMALL: Yes.

MR. PARELLO-PLESNER: Yes.

HEARING CO-CHAIR BARTHOLOMEW: Great. Thanks.

Okay.

Commissioner Blumenthal, you're up first.

HEARING CO-CHAIR BLUMENTHAL: In terms of foreign direct investment, what types of foreign direct investment would you like to see coming from China into Europe? You mentioned some of the CFIUS concerns and so forth.

Congressman Rohrabacher mentioned the port in Naples. Clearly, Europe has capital needs and so on and so forth.

What, in your opinion, would be useful types of foreign direct investment that Europe would encourage or should encourage? That's for both of you.

MR. PARELLO-PLESNER: In short, there's no European answer to this. I think it really depends a lot on member states, and so that's very reduced to the different discussions in member states and also business interests.

Of course, now in the euro crisis with companies and state assets being sold off, it's a question of are there buyers, and China could be one of them. So when you see that part of the austerity cuts in member states, that part of that would be to sell off state assets, you need to find buyers, and I think China figures into that.

I think maybe, knowing from the debate in the Nordic countries, there it has been very much the sort of desire to see greenfield investments from China less than what you can see what China is actually doing now, the sort of mergers and acquisitions, of saying it's not the state's

role at all to promote that Chinese companies sort of take over companies because it's not necessary there is a benefit to jobs in that, but, whereas, sort of greenfield investments of Chinese companies coming in, starting up a new operation would be the one that is sought after.

MR. SMALL: Yeah, there are obviously various failing European companies that will not get money from elsewhere and where it's quite helpful if the Chinese are willing to come in and buy that.

The Volvo deal was seen to be a good one, and the Swedes would like them to come in and do something similar with Saab. There are these sorts of cases where there are a lot of companies that are quite happy to see Chinese money coming in for these sorts of things.

As Jonas said, I think the big question will be do the greenfield investments step up? The numbers are still relatively modest in the proportion of the investments that are coming in, but that will be the big shift. There is some suggestion that if states at the moment are in austerity conditions, can't put investment in infrastructure and things like that at the moment, and, as has been suggested, for instance, in the UK, if CIC wants to put substantial sums of money in for some of these things, I think--but I mean Britain, I mean the UK attracts more Chinese investment than any other country, and it has obviously historically been more open to anyone coming in to buy anything it likes and put money into anything it likes.

But this is one of the areas that I think they would like to see larger sums come in, not buying Thames Water, which doesn't contribute anything.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you.

This is fascinating, and as the Chair indicated, we'll all have some follow-up questions because of the enormity of these issues.

I guess a real question is: from different viewpoints, how do you measure success? From a diplomat's point of view, you measure success probably by the number of communiqués you can issue. A business, by the profits they receive, but by a citizen, it's by the wages and the wealth they can accrue.

While we were sitting here, I went online and saw that the Bureau of Labor Statistics reports that the average worker in the U.S. is making \$13.60 an hour. The average worker in Germany is making \$17.27.

When you look at the eurozone crisis, Germany has been in a different situation than most of the other member states. When you look at trade, for example, in auto parts, the U.S. has a \$10 billion trade deficit with China. In auto parts, Germany has a trade surplus. What's Germany doing differently? How is that viewed by the rest of the member states? And is there a model there that should be pursued by many others, both related to the eurozone crisis, but maybe in terms of trade generally with China?

HEARING CO-CHAIR BARTHOLOMEW: Two minutes, please.

COMMISSIONER WESSEL: Two minutes and a treatise afterwards.

MR. PARELLO-PLESNER: Yes. I think there is both inspiration and some envy when it comes to looking at German success in China. A large part of the Chinese stimulus package has basically also been going to buying German goods both for consumers that might be nationalists when they are on their Chinese micro blog, but when they are going out to buy a new car, they're actually ending up buying a German or an American car.

So I think Germany has been very predicated on a market for technology, which some other European countries would have been less willing to do, which has given them an enormous market, but, of course, also encouraged these problems of IPR, and will there be stronger competition further down the road?

COMMISSIONER WESSEL: But let me interrupt. Do they have a different negotiating style? Do they have a results orientation? They seem to be achieving better results than anyone else. Certainly they have great products--Porsche, BMW, et cetera. But there is a broader issue here. You talk about technology. We have great technology here as well. We're losing it. It seems the Germans are capitalizing on theirs.

MR. PARELLO-PLESNER: I think there is also a convergence right now where Germany is really producing what China needs for its next phase of growth, and Germany and German companies will be facing some of the same

problems, just a little bit further down the road.

I've met some engineers with German automotives, asking them precisely about this, and they say, well, we've been here for 20 years, and they know our blueprints and everything, but they're not able to do the full management of making a high quality car. So as long as that's the case, we stay sort of competitive, and if we are not here on the Chinese market to beat them, they will come anyway to third markets and beat us. So we better be here and take the competition right on.

COMMISSIONER WESSEL: So their time is coming.

HEARING CO-CHAIR BARTHOLOMEW: Sorry. I'm going to have to--okay. Commissioner Reinsch.

VICE CHAIRMAN REINSCH: I take your point about convergence of view between the U.S. and the EU, which I think is happening. It's probably slower, but I do think it's happening. But it does seem to me--and this is sort of an agree or disagree question--it does seem to me that one of the driving forces behind the EU-U.S. High Level Working Group on the Transatlantic Trade Alliance, trade relationship, is concerned about how we can work together to meet a common challenge, meaning China.

And that at the end of the day, the fulcrum of that discussion is going to be on standards and regulation because we face a common challenge from the Chinese there. (A) do you agree or disagree with the hypothesis; and (B) what do you think are the odds that we'll actually, having had 20 years of failure on exactly that area, that we're going to be able to achieve more success this time?

MR. SMALL: Agree. Agreement on the old standards and harmonizing these things has obviously been so difficult. There's more scope with EU standards, and evidently that's the case. I mean standards obviously in TPP and some of these new arrangements, I would be pessimistic about, given how difficult it's been to get some of these things through on existing standards, being able to harmonize them. Clearly, that would make the biggest difference to--and, as you say, would have the most positive effect.

If it's possible at least to focus on standards in some of these new areas that are emerging, and when some of these new agreements are being negotiated to be in a

position to have reached a transatlantic consensus on some of these things, then, obviously, that would be very helpful.

VICE CHAIRMAN REINSCH: Want to comment?

MR. PARELLO-PLESNER: Agree. And it's even difficult inside the European Union to agree always on setting the joint standards. We can see Germany with China now setting standards on electromobility because there's a joint interest in developing that and maybe not really even waiting for the full European consensus on it.

VICE CHAIRMAN REINSCH: My view has always been if you can't do chickens, you can't do anything.

HEARING CO-CHAIR BARTHOLOMEW: Right. Okay. Chairman Shea.

CHAIRMAN SHEA: Two questions. One, very quick. Has the Chinese government hired an array of lobbyists and public relations officials to work the European government in Brussels the way they have in Washington, D.C.?

MR. PARELLO-PLESNER: Yes, and we have China Daily Europe.

CHAIRMAN SHEA: Okay. Thank you.

You mentioned reciprocity with respect to government procurement--the Europeans are taking that more seriously. What about reciprocity with respect to FDI? I mean can a European company buy a chemical factory, a high precision machinery company, logistics, do port management, water utilities, national electricity utilities, car companies in China, or are you guys just so cash strapped that thinking about reciprocity in this context is a luxury you can't afford?

MR. PARELLO-PLESNER: There is some thinking of it, and actually now after Lisbon Treaty the EU has the possibility to negotiate in the investment area, opening up of investment treaty negotiations with the Chinese, and the hope is there, that some of these other concerns, they wouldn't just be about investment protection, but also pushing market access, what areas can you actually go into so that that would be the joint push of Europeans.

At the same time, you have these elements of austerity that are strikingly different in different countries. So the need is there now sometimes for a company to be sold off, and that, of course, doesn't really

strengthen the leverage of Europeans.

CHAIRMAN SHEA: Andrew.

MR. SMALL: I'll only add very briefly, reciprocity was virtually a banned word a few years ago, on some of this stuff, and it's now actually being explicitly put as the basis of the procurement agreement, but the concept is now being openly looked at across all sorts of areas where with certain European prime ministers who would just, any talk that this might be a European approach, would be just kind of knocked down as a matter of course. So at least there's been some movement, been some concrete areas.

Whether it translates in some of these other areas, like FDI, remains to be seen, but I think that's at least the mood animating a lot of what trade officials and people are looking to do at the moment.

CHAIRMAN SHEA: Okay. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Madam Chairman.

Real quickly, in terms of Chinese trade distorting practices, whether it be forcing transfer of technology or picking off intellectual property, is there one mechanism that jumps out in your minds as to the most effective that the Europeans as a whole or a European country has used to resist and rebut effectively these trade distorting mechanisms by the Chinese?

[Pause.]

COMMISSIONER D'AMATO: Take your time.

MR. SMALL: The joint EU-U.S. efforts on indigenous innovation have probably been one of the tangible areas in the last period of time that have made a difference, and I do think that in some respects points to the fact that -- I mean it could have been achieved possibly bilaterally but -- it does help to have a joined up approach to this.

And I think the other thing that--at least it's pertinent to the hearing, but that hasn't been highlighted is the view that there needs to be more cooperation with other like-minded countries on these things, and gaining collective leverage across all of the different instruments has also escalated in the EU. I think that's a good example of an instance where that's worked reasonably well, and that's the animating spirit of this moment, is an attempt

to find ways to join up with the Japanese, with the U.S., and others across the board on WTO cases, on comparable measures, and on a whole series of different areas. So I mean that's a broader point, but I think speaks to it.

COMMISSIONER D'AMATO: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

We actually managed to get through the complete second round, but there might still be a few more questions for the record.

Thank you both very much, very interesting. This is actually one of the first times I can recall we had so many people with second-round questions. We look forward to working with you and to having contact. Thanks for very interesting testimony.

We're going to take a break until 10:45. Thanks.

[Whereupon, a short recess was taken.]

PANEL II: DEFENSE AND NATIONAL SECURITY ISSUES

HEARING CO-CHAIR BLUMENTHAL: Thank you. We're going to start this second session, and we're very happy to be here and have experts. Dr. May-Britt Stumbaum, Dr. Oystein Tunsjo, and Dr. Christina Lin are all here to discuss defense and national security issues, as they pertain to Europe's position regarding China's rise and some of the security concerns that Europe might have and Europe might share with the United States.

All of you are very well placed to speak about these issues, well-credentialed, and we're very happy to have you here. So why don't we just go from left to right.

HEARING CO-CHAIR BARTHOLOMEW: Are you going to introduce them?

HEARING CO-CHAIR BLUMENTHAL: No, I'm not actually. I think their bios are available to everybody.

COMMISSIONER WORTZEL: Yes, we have a packet.

HEARING CO-CHAIR BLUMENTHAL: Okay. So why don't we just start with Dr. Stumbaum.

**STATEMENT OF DR. MAY-BRITT STUMBAUM
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DR. STUMBAUM: Thank you very much, Commissioner Blumenthal, and thank you very much for this honor and the opportunity to testify on the EU's policy towards China and security related policy fields.

In general, I would like to make the point that transatlantic differences towards controlling export of defense-related technology and commodities in regard to China come down to two major aspects:

First, we have differing perceptions of the rise of China, its implications, and the policy approach that we should take towards this; and

Secondly, differences in statehood. The EU is not a nation state, but it operates at several levels, at the national, the European and the international level, and so sometimes it's quite cumbersome to understand.

I want to start with a short general remark on the EU's strategic outlook on the Asia-Pacific and China, in particular, and then address the EU arms embargo, exports in defense-related items, and outlook on transatlantic cooperation.

Overall, the arms embargo clash in 2004-2005 illustrated the differences in perceptions. For the United States, China is the strategic competitor; for the European Union and the member states, the focus is still on domestic issues, so primarily internal suppression, human rights, and the European Union believes in a policy of engagement of China at all levels.

In general, the strategic outlook among the 27 member states is still rather fragmented. You can see in the United Kingdom and France having more of a strategic global outlook. Also to the region, the EU as such is still more of a regional power that rather focuses on Russia, Afghanistan, those countries in between, but rarely reaches out to Asia.

Moreover, strategic in the European sense, different to the United States, does not necessarily have a military implication, and no EU member state has

permanently deployed military forces to the region.

However, a more strategic outlook among the 27 within the EU is slowly underway. It's primarily pushed by the United Kingdom and also the perceived need to reorient after the U.S. returns to Asia.

Concerning the EU arms embargo on China, this differs from the U.S. embargo quite substantially. As a political declaration of June 27, 1989, the embargo predates the European Union's Common Foreign and Security Policy, which was only introduced in 1993, and it's, therefore, as Commissioner Bartholomew opined this morning, not legally binding.

It was triggered primarily by human rights concerns, and these concerns are still the major cause for considerations. The embargo becomes effective due to translation into national law of all 27 member states. For example, the British reading of it is that any lethal weapons that could be used for internal repression shall be excluded from export to China. So, again, primarily domestic issues.

It has limited utility. Defense exports are controlled by the EU export control system on all three levels of the EU--the national, the European, and the international level--by, firstly, the legally binding 2008 "EU Common Position on defining common rules governing control of exports of military technology and equipment," which is a successor of the EU Code of Conduct of 1998; and secondly, the EU regulation on dual-use exports.

The export control system is integrating all internationally agreed export control regimes, such as Wassenaar, the MTCR, Australia Group, the NSG and the CWC.

While these regulations provide a common framework on the EU level, the difference is that the implementation happens on the national level so the final say still lies with national authorities on a national level, which sometimes leads to deviating interpretations and also so-called "license shopping" throughout the European Union.

The embargo as such will not be lifted in the near future. On the one side, lifting needs anonymity and you have those who are more in favor of lifting, countries like France, but you have also those countries which strictly oppose that like Germany and the United Kingdom. Moreover,

the strong opposition from the United States also makes it not likely to be lifted unless it will be in coordination with the United States.

The impact on European-Sino relations of the embargo is that it is still a dormant, but a constant, irritant to what we call the "strategic partnership," and it has not been addressed by the Chinese side for the last one-and-a-half years. Actually, the last time it was mentioned in a joint communiqué was in 2007.

On the impact of European defense exports on the modernization of the Chinese military and security forces, I have to admit there's hardly any research done on the European side. There is the assessment, though, that involuntary transfers, such as espionage and reverse engineering, have contributed, plus defense exports such as, for example, diesel engines sold to China have contributed to the modernization, yet still with a marginal effect when you compare it to other major suppliers like Russia.

The claim can be made that, for example, those different diesel engines that have been sold to China had an impact on various submarine and surface vessels and therefore contributed to the anti-access/area denial capabilities for the PLA Navy.

Contracts predating the arms embargo are still honored and this leads to some small defense related exports. For example, in 2010, this was 70 million euros from the European side in defense exports to China. Moreover, major sports events like the Olympic Games or the Asian Games also open a window of opportunity for sensitive technology and equipment.

On the aspect of export of dual-use technology, member states do not report either the volume nor the nature nor the generation of those being exported. Only denials are reported on a European level.

The German Association of Industries, for example, estimates that the share of dual-use exports is about two percent of all German exports, while the UK government assesses it at about three to four percent of all UK exports. So it's a relatively small part.

About 90 percent of all dual-use applications to China are approved. That is primarily because most

companies conduct an in-house review already in-house before they apply for a license, and so most licenses are most likely to be granted.

Further transatlantic exchanges on exports to China are generally welcomed from the European side in order to decrease the potential for friction and misunderstandings and conflict across the Atlantic. Based on the same international export control regimes and a shared vision of a whole life cycle observation, European and U.S. export control regimes are evermore converging.

There is an extensive overlap of the Common Military List of the European Union and the United States Munitions List.

Regular exchanges take place on the political and the operational level. In these exchanges, China is only mentioned as one of many aspects. So there's no special forum just to address China.

Obstacles remain, as I said before, in the different assessments of China's rise that are the bottom line of all these export controls and also the level of transparency. So it's not quite clear how much actually both sides want to share and want to apply.

Regarding ITAR, also one of the questions, European companies comply in general with the U.S. ITAR regulations in order to safeguard their business interests in the U.S. market in terms of access to these markets but also in terms of cooperation with U.S. companies.

One example of that, before Airbus, for example, set up its assembly line for the A319/A320 in Tianjin, they asked for the green-light from the U.S. first before they went ahead.

Please let me conclude with some recommendations. Despite increasing convergence, the overall threat perception is and will remain to some extent different and also will lead to different policy choices.

The risks in defense and dual-use exports cannot be eliminated, but they can be managed.

Europe, as well as the United States, has a stake in Asia, and particularly in dealing with a rising China; more coordination and more exchange will strengthen each partner's position in the long-term and lead to less undercutting and more impact of common positions.

The U.S.-EU Strategic Dialogue on East Asian Security that has been mentioned before already, which has now been pushed very much by Kurt Campbell and others, will be a very vital opportunity to push for that kind of exchange.

The recommendations are, therefore, to encourage the U.S. government to increase and maintain the exchange on these issues and overall approach on the level of the governments, the executing agencies, and on Track 1.5 and 2 to further a better mutual understanding, a better coordination, and to find common ground for common action.

Thank you for your attention.

**PREPARED STATEMENT OF DR. MAY-BRITT STUMBAUM
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April 19, 2012

Hearing on "China-Europe Relationship and Transatlantic Implications"

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

Security and the EU – China relationship: The EU arms embargo on China and the export of defence and dual-use technology and commodities and opportunities for transatlantic cooperation in this field

The differences between the US and the EU's approach towards exporting defence-related technology and commodities to China are triggered by two major reasons: firstly, a differing perception of the rise of China, its implications and the adequate approach towards it, and secondly, the difference in statehood: The European Union is not a nation state and export controls take place on all three levels of the EU's multilevel governance system (international, European, national levels). The transatlantic clash over the intended lifting of the EU arms embargo in 2004/5 illustrated the different views that the United States and the European Union (EU) and its Member States have on the security implications of the rise of China. In debates in the United States, China is often seen as the coming strategic competitor; EU Member States rather focus on domestic issues in China such as internal oppression and human rights violations. The EU has its roots in integrating trade policies to achieve long-term solutions to Europe's historical security challenges and only slowly develops a strategic outlook on the Asia-Pacific and China in particular. Among its 27 Member States, the "Big Three" have more of a strategic outlook in differing degrees towards the region, while it is still very nascent in other Member States' foreign policies. The EU's 'Strategic Partnership' with China still needs to be defined in detail, with 'strategic' being equated to long-term and comprehensive, yet not necessarily embodying a military notion. No EU Member State has permanently deployed military forces to the region. The 'tyranny of distance'¹ aggravates this perception of Asia-Pacific and the rise of China – that is, with countries like Russia and Afghanistan in between Europe and East Asia, the European Union as a still predominantly regional power with limited resources tends to concentrate on these countries first. Accordingly, interpretations concerning the aim and the reading of the arms embargo and export controls in regard to China differ. The European Union still perceives China primarily through an economic prism and believes into a policy of engaging a rising China at all levels and in all policy fields. A more 'strategic outlook' on the region and on China among the 27 EU Member States and the European Union, however, is slowly underway, although it still differs from American perceptions: While 'strategic' implies

¹ Term coined by Michael Yahuda in his work on EU-China relations

a military notion for Americans, it does not for Europeans. Misunderstandings are also triggered by the lengthy process on the EU side to come to a common point of view that often gets misunderstood by the US side as passivity and lack of political will. The following testimony aims to respond to questions raised on the EU arms embargo, European export controls in defence and dual-use commodities and technologies and possible transatlantic cooperation.

1. The status, prospects and utility of the European Union's arms embargo on China and its implications on EU-China relations and the United States

Today, the European Union (EU)'s arms embargo on China has primarily symbolic meaning. Enacted as a political declaration on June 27, 1989, it differs from the US embargo that had been enacted shortly before on June 7, 1989. Driven by concerns over human rights instead of China's military development, this "embargo on trade in arms with China" predates the EU's Common Foreign and Security Policy as set up in the Treaty of Maastricht in 1993 and, as such, is only politically and not legally binding. It has become effective by the Member States introducing it into national law, leading to different interpretations across the 27 EU Member States. Contrary to the US perspective that sees China as a strategic competitor in the region and potentially globally in the future, the majority of EU Member States focus on domestic issues such as internal repression in China when referring to the embargo. Accordingly, in national interpretations such as the British reading of the arms embargo, "any lethal weapons that could be used for internal repression" are excluded from exports to China.

The utility of the arms embargo is limited: As a non-legally binding, political declaration, its main purpose – the prevention of the sales of militarily relevant technologies and commodities – is covered by the legally binding 2008 "EU Common Position defining common rules governing control of exports of military technology and equipment" (Council Common Position 2008/944/CFSP), the successor of the EU's Code of Conduct, and the EU Regulation 428/2009 on dual-use exports, in the framework of the EU's supranational trade policy (both regulations are currently being revised). European export controls are located at all three different levels of the European Union's system of multilevel governance (international, supranational and national) that provide for a unique system of export controls, integrating all internationally agreed dual-use control regimes such as the Wassenaar Arrangement, the Missile Technology Control Regime, the Nuclear Suppliers Group, the Australia Group and the Chemical Weapons Convention. The common guidelines and frameworks such as the EU Common Position 2008/944/CFSP and the EU Regulation 428/2009 are set up at the European level; however, legislation, implementation and operationalisation takes place at the national level with national authorities executing the interpretation of the regulations as well as having the final decision as to whether to grant a national, global or individual export license (Art. 9 (2), Regulation 428/2009; see Annex I).

What implications might the arms embargo have for China's ability to acquire defence technologies in the future? The regulations of the EU export control regimes are strict, yet with the final decision being located at the national level, differing interpretations of the commonly agreed guidelines for export controls by national authorities can lead to deviating parameters for denial and approval. A removal of the arms embargo would remove one of the eight Criteria for assessing the export of military technology and equipment² and might shift

² Criterion One refers to those states where an arms embargo is in place. Applications were criterion one can be applied are

in some of the EU Member States the tendency from “export granted in exceptions” to “export denied in exceptions”, hence leading to a slightly higher likeliness of the application being approved (see Annex I for Criteria). Overall, due to the export control regimes in place, strict national regulations i.e. in Germany and business interests of the national defence industries marginalise the likeliness of China being able to acquire complete weapon platforms. From an industrial-political point of view, most companies will most likely refrain from selling and exporting defence technologies and equipment to the People’s Republic of China in order to not jeopardize potential sales to the United States – a lesson learnt from the rift over the potential arms embargo lifting in 2004/5.³

The embargo is not likely to be lifted in the near future, despite repeated efforts to start the discussion lifting the arms embargo on China. Recent endeavors encompass the initiative by the Spanish EU residency in 2010 and the forays by the EU’s High Representative on Common Foreign and Security Policy, Catherine Ashton, in 2010 and 2011. The EU Member States are divided over the lifting with countries such as France, Spain, Greece, Malta, Romania, Bulgaria, Austria, the Czech Republic and Italy are in favour of discussing the lifting while others such as Germany and the United Kingdom have publicly declared their opposition. Officially, two conditions are set out for a potential lifting: Improvements in a) the domestic human rights situation in China and b.) the situation in the Taiwan Straits.⁴ Particularly the strong US opposition towards lifting the embargo makes a change of the current status quo highly unlikely. Accordingly, the European Union will most likely only lift the embargo in coordination with a U.S., and concurrently with a lifting of the US’ embargo.

The arms embargo remains a constant irritant in the European-Sino relations, although the Chinese side has refrained from mentioning it at Summits for the past one and a half years and it has not appeared in the Joint Communiqués issued after the annual EU-China Summits since 2007. In the EU’s China-policy approach of engagement at all levels, and the established “Strategic Partnership”, maintaining an arms embargo – particularly one that is de-facto already replaced by the EU’s arms control regulations - does not reflect the level of engagement that the European Union aspires to establish with China. For now, the arms embargo issue is dormant while the EU aims to intensify its engagement with the PR China on all levels. The impact of a potential lifting of the embargo has led to a controversy: While Chinese representatives continue to insist that they will not buy more weapons from the European side, the European companies might most likely refrain from deals with China in order to not jeopardize their more profitable sales in the US market. On the US side, a lifting of the US side might most likely increase the pressure of US industry on the US government to lift the US embargo in order not to lose out to European competitors in the Chinese market.

most likely declined. “Criterion One: Respect for the international obligations and commitments of Member States, in particular the sanctions adopted by the UN Security Council or the European Union, agreements on non-proliferation and other subjects, as well as other international obligations.”(Council Common Position 2008/944/CFSP, Article 2, Criteria, § 1, 8 December 2008

³ In the acrimonious debate over the lifting of the EU arms embargo, the House of Representatives passed in May 2004 its version of the National Defense Authorization Act for FY2005 (H.R. 4200), reported out of the House Armed Services Committee. This bill included a provision to impose procurement sanctions against any foreign person that transfers certain military items to China, that is, the Pentagon could be barred for 5 years to purchase from the sanctioned company. ARchick, K. et al (2005) European Union’s Arms Embargo on China: Implications and Options for U.S. Policy, CRS Report to Congress, April 25, 2005

⁴ The European Union as well as its Member States adhere to the One China Principle.

2. Implications of European defence exports on China's military modernisation

Due to the primarily economic outlook of Europeans to China, European research focusing on the impact of European defence exports on the modernization of the Chinese military is still marginal and has only recently emerged.⁵ Overall it can be stated that besides involuntary transfers due to espionage and reverse engineering, defence exports to China have contributed to the modernization of the Chinese military and security forces, yet to a marginal extent compared to Russian exports. In 2010, military exports from the European Union to mainland China accounted for 69 510 882 EUR, to Hong Kong for 103 611 EUR and to Macao for 54 040 EUR.⁶

Some European firms have exported defence items to China since the EU established the embargo. These exports occurred because the 1989 agreement which established the arms embargo stipulated that existing contracts would be honoured (see Annex III). Moreover, the deviating interpretations of the arms embargo in national legislations, including its focus on human rights issues and internal repression in China, has led to some defence exports. However, the impact of these exports on the modernisation of the Chinese People's Liberation Army (PLA) and/or China's internal security forces such as the People's Armed Police (PAP) has been marginal, particularly when compared to Russian and Israeli exports.

Transfers since 1989 included among others British Searchwater radars in 1996 and Spey Turbofan (from 2004 – 2011, ordered in 1988), French helicopters (i.e. AS-565SA Panther, SA-321 Super Frelon, ordered in 1980/81) between 89 and 2011 and French marine diesel engines and German MTU marine diesel engines to be used in the Chinese Type 051 Luhai destroyers, Type 052 Luyang destroyers, Type 054 Jiangkai-series frigates, and Type 039A Song conventional attack submarines,⁷ which led e.g. in June 2006 to co-production of MTU Series 2000 engines in Suzhou, China. Recent large sports events have been providing windows of opportunity for the Chinese side to acquire sensitive technology and equipment worldwide that can be used in the modernisation efforts for the internal security forces; examples from the European side include for instance German monitoring systems for chemical substances as in the case of the Olympic Games 2008 or French monitoring systems delivered to provide security to large public events such as the Asian Games in Guangzhou in 2010.

Probably the most significant contribution from a US perspective is the variety of diesel engines used in various submarine and surface vessels and the resulting anti-access/area denial capabilities (A2AD) for the Chinese PLAN. The use of these less effective engines – as compared to their military counterparts – sheds light to the still prevailing difficulties of the Chinese military industry (CMI) to provide adequate indigenous military commodities.

3. European export controlled dual-use technology to China

⁵ See Duchatel, M. and Sheldon-Duplaix, A. "The European Union and the modernization of the People's Liberation Army Navy: the limits of Europe's strategic irrelevance", *China Perspectives*, 2011/4, pp. 31-43; also see the work of SIPRI in the context of the "Study of Innovation and Technology in China" of the University of California San Diego.

⁶ Numbers taken from Thirteenth Annual Report according to Article 8(2) of Council Common Position 2008/944/CFSP defining common rules governing control of exports of military technology and equipment, 30 December 2011 (2011/C 382/01)

⁷ Figures are taken from the SIPRI Arms Transfer Database and Jane's Intelligence Review.

Due to industrial policy considerations, European Union Member States do not report the volume and type of licenses that have actually been granted. Instead, they report denials of licenses. Accordingly there is no official overview on the European level of the volume, nature and generation of dual-use technology exported to China. In its response to the European Commission's Green Paper on the EU's Dual-Use Regulation, the German Association of Industries (BDI) for example assesses the percentage of controlled dual-use exports to 2 percent of the total volume of German exports.⁸ The UK Government, in absence of data on the actual value of goods under dual-use licenses, estimates the share of 3 – 4 percent of all UK exports.⁹ The official answers of the EU Member States to the request by the European Commission to obtain from the EU Member States the quantities and types of exported dual-use technology in the course of the ongoing revision of EC Regulation 428/2009 shows the differences among the 27 Member States: The share of dual-use exports is differently estimated (if at all) and the availability of the necessary data differs among the EU Member States.

Because firms conduct in-house reviews of export requests prior to applying for export licenses, the actual license applications are likely to be approved; national governments approve an average of 90% of all applications for export licenses to China. Controlled dual-use exports are listed within the general export statistics of the individual member states (Annex II provides an overview of the main categories of exports to China by the six EU countries with defence industries ("LoI"-countries)). Predominantly commodity end items are being exported¹⁰, examples for these dual-use technologies exported include chemical processing equipment, imaging cameras, equipment and software for Information and Communication technology, equipment and software for microelectronics, inertial equipment, optical technologies and others.

All commodities, end items, enabling technologies, the export of technical assistance, and granting Chinese access to the development of export controlled items, fall under the regulations of the three different levels of the regime (international, supranational and national) that provide for a unique system of export controls, integrating all international agreed dual-use controls. Yet, some firms may export problematic goods to China because the regime has potential loop holes and because governments have different national export control systems. (see Annex I for further information on the EU Export Control System).

Accordingly, room for improvement in this export control regime is in the details. The EU law requires Member States to apply the guidelines adopted in export control regimes in their export licensing decisions. However, as outlined above, the final assessment and decision is still taken on the national level – opening the door for differing interpretations and so-called "licence shopping".¹¹ A so-called "catch-all article", Art.4 of the regulation,

⁸ Bundesverband der Deutschen Industrie, Eingabe: EU-Kommission Grunbuch zur EU-Dual-Use-Verordnung. BDI-Bewertung, 31 October 2011

⁹ BIS Export Control Organization, Response from Her Majesty's Government to the European Commission Green Paper on the dual-use export control system of the European Union, January 2012

¹⁰ In the German case, for example, German companies rather establish a joint venture in China to produce onsite, with production being based on older designs of the most recent products.

¹¹ See SIPRI, 'The European Union arms embargo on China'. Available at: http://www.sipri.org/research/armaments/transfers/controlling/arms_embargoes/eu_arms_embargoes/china/china?searchterm=EU+China+Arms (accessed 29 May 10).

supplements the regularly revised list of dual-use items in Annex I of the Council Regulation.¹² However, subparagraph 4.2 and 4.3, that are targeted on dual-use items that do not fall under the WMD category of chemical, biological or nuclear weapons or other nuclear explosive devices, do not capture items exported to China: Art. 4.2 and 4.3 require a license for export if the EU has implemented an arms embargo against the recipient country, based on a common position or joint action. As the 1989 EU embargo on China pre-dates the introduction of common positions and joint actions by the Maastricht Treaty in 1993, this regulation does not apply to China.

Do any of these technologies pose a challenge to U.S. security interests vis-à-vis China? There are still no systematic studies available that investigate the kind and volume of European technologies being used in the modernisation of the Chinese military and security forces. Hence it is not possible to argue in a substantiated way if any of these technologies pose a challenge to US security interests vis-à-vis China (see 2.) for the impact of European equipment on A2AD capabilities). However, most of the controlled exported technologies are already available uncontrolled on the world market. The danger of jeopardising market access to the US market by eventually violating ITAR further decreases the inclination of companies to aspire export licenses to China for technologies that could seriously challenge US security interests.

4. Transatlantic alignment and cooperation on defence and dual-use exports to China

Concerning the way and structures of export controls, European and US export control regimes are ever more converging. All are based on the international export control regimes and aim to follow the whole life cycle of the exported commodity, including regulations regarding re-exports, best practices, end-use and end-user. The Common Military List of the European Union and the United States Munitions List show a great deal of overlap. Regular exchange is happening in the international regimes' working groups, between the EU working group COARM and US officials, and between EU Member States and US officials. Although the European Union and its Member States aim for greater harmonisation in the practice of export controls, the executing agencies and hence the final decision is still located at the national level. Therefore, US-European exchange happens hence predominantly between Washington and the EU Member States. Transatlantic exchange on the working level between the operating officials in the national authorities remains sporadic and is limited by human resources, that is, the amount of coordination that is feasible concurrently to the licensing work load as such. China is mentioned in these forms of bilateral and multilateral exchanges, yet not in a special forum or coordinated way.

Further exchange has generally been welcomed from European sides as desirable to decrease the potential for frictions. Yet obstacles are seen in a.) the different assessments of European countries and the United States regarding the rise of China and b.) to what extent this cooperation would happen on eye level. Regarding a.), Europeans predominantly regard China through an economic lens and feel less threatened by a militarily modernizing China, thereby deviating from a US view of China as strategic competitor. Regarding b.) there are complaints that the United States shares only selectively on export control issues while expecting comprehensive transparency from the cooperation partner. Moreover, the US authorities sometimes seem to tend to unilaterally set the standards for cooperation. In a nutshell, it has been questioned, to what extent

¹² Art. 4 requires a licence for every dual-use export if the EU has implemented an arms embargo against the recipient country, based on a common position or joint action.

Washington would be open to commonly develop a shared view among equals. The European perception that the United States expects its partners to fall in line with the US view on exports has triggered some resistance to a more coordinated approach. For example, the Europeans resisted Washington's attempt after the arms embargo clash to establish a renewed version of the Cold War-era Coordinating Committee for Multilateral Export Controls (CoCom).

Do European exports to China comply with the U.S. International Traffic in Arms Regulations (ITAR)? As mentioned before, the European export control regimes resemble to great parts the US control regimes in general. The revision of the European Community's regime for the control of dual-use items and technology in 2009 by replacing EC Regulation No 428/2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items entails Annex I Cat. 7 on Navigation and avionics that led e.g. in Germany to a special export license requirement concerning data acquired through satellite technology (administered by BAFA)¹³. Regarding ITAR, the responsibility to comply lies with the exporters, the companies as such. Companies operating in several countries and with substantial business interest in the United States pay careful attention to comply with the different rules of ITAR. For example, before the European company Airbus opened up a final assembly line for the A319/A320 in Tianjin, it sought the 'green light' from the US administration. However, the occurring delays and lack of predictability have also led to the development of ITAR-free technologies and also in European defence procurement bids the notion of ITAR-free has received additional attention due to concerns of security of supply.

Recommendations

Despite some degrees of convergence, the perception and assessment of China's rise and the adequate policy response still differs and will remain different between the United States, the European Union and the EU Member States. Contrary to the Cold War and the times of CoCom, the threat perception and subsequent policy choices will remain different. Risks cannot be eliminated, but they can be managed. Both sides have their stake in Asia and particularly in dealing with China: With more coordination and exchange, each position can be strengthened and the different approaches in selected policy initiatives merged. Without, the United States and the European Union are likely to weaken each other's position and policies in return. Recommendations are therefore to encourage the US government to:

- Increase and maintain exchange on these issues on the government level in formats such as the US-EU Summit, the 2005 established US-EU Strategic Dialogue on East Asia and comparable fora in order to push for a better understanding of each other's views and approaches
- Promote open exchange at eye-level between US and EU/Member States agencies and bodies on the concurrent reform of the US export control system and the EU export control regimes
- Continue and increase the transatlantic exchange on the Track 1.5 and Track 2 level in order to provide for a comprehensive approach that can draw on both sides' advantages and interests and to pave the ground for further cooperation on the government level

¹³ http://www.bafa.de/bafa/de/weitere_aufgaben/satdsig/index.html

Testimony based on the following papers:

Stumbaum, May-Britt U. and Oliver Bräuner (2010c) "The Current State of EU-China High-Tech Cooperation with a special focus on the aerospace industry and the arms embargo debate.", in Tai Ming Cheung (ed) *The Rise of the Chinese Defense Economy. Innovation Potential, industrial performance, and regional comparisons.* Policy Brief No. 15, IGCC University of California San Diego, September 2010

Stumbaum, May-Britt U. (2009), "Risky Business? The EU, China and Dual-Use Technology", Occasional Paper No.80, EU Institute for Security Studies: Paris, October 2009

Stumbaum, May-Britt U. (2010), Toward a Transatlantic Approach to Technology Transfers to China, Policy Brief, Asia Program, German Marshall Fund of the United States, 9 July 2010

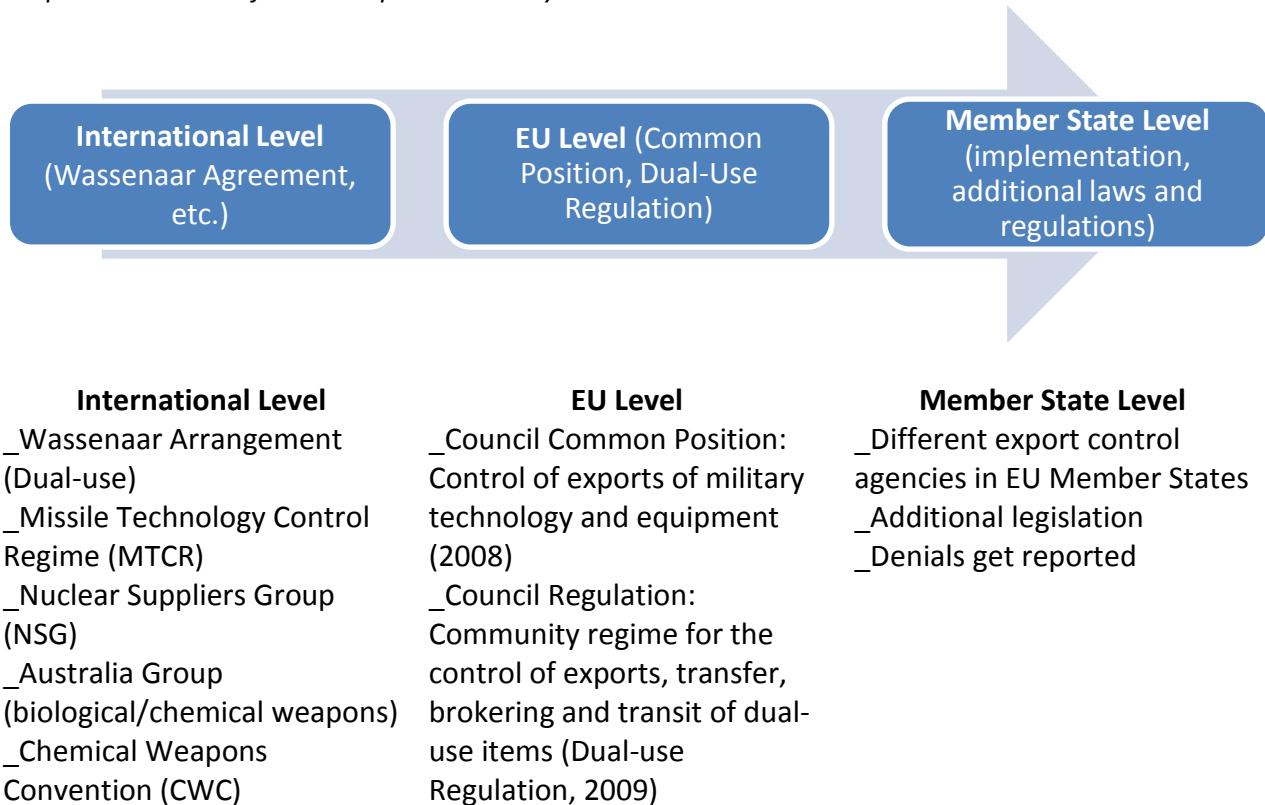
Stumbaum, May-Britt U. (2009) "The EU and China. EU Decision-Making in Foreign and Security Policy toward the People's Republic of China", Nomos: Baden-Baden

Stumbaum, May-Britt U. (2008) "The invisible ban. EU maintains weapons embargo on China." Jane's Intelligence Review: Chinawatch, December 2008, p. 52-3

Annex I: The Export Control System of the European Union

European export controls¹⁴ are located at all three different levels of the European Union's system of multilevel governance (international, supranational and national) that provide for a unique system of export controls. While the framework and guidelines are decided on the European level, legislation and implementation are executed on the national level:

Graph: Three levels of the EU Export Control System



All civilian goods fall under the auspices of European community law, but military goods listed in the Annex of Art. 296 of the EC Treaty can be excluded from aspects of community law for national security reasons. Therefore, exports of goods that were specially designed, developed or modified for military use are governed by national laws. In order to promote a Europe-wide harmonized approach to exports of military listed items, the European Union has provided a framework for reference, which was initially provided by a June 1998 non-binding EU Code of Conduct on Arms Exports.¹⁵ In December 2008, the EU Council adopted an updated and

¹⁴ For concise and informed articles on European export controls, see the writings of Ian Anthony, Sybille Bauer, Oliver Brauner, Mark Bromley, Paul Holtom, Ivana Micic, Sam Perlo-Freeman, and others at the Stockholm International Peace Research Institute (<http://www.sipri.org>)

¹⁵ Council of the European Union, 'Code of Conduct on Arms Export', 8675/2/98 Rev2, Brussels 5 June 1998.

strengthened version of the 1998 EU Code of Conduct as an EU Common Position.¹⁶ Member States have worked together over a number of years to develop a best practice guidance document to be used by national export licensing officers, further narrowing the scope for different national interpretations of current guidelines. The EU Common Position lists eight criteria for the denial of export licenses:

Criterion One:

Respect for the international obligations and commitments of Member States, in particular the sanctions adopted by the UN Security Council or the European Union, agreements on non-proliferation and other subjects, as well as other international obligations.

Criterion Two:

Respect for human rights in the country of final destination as well as respect by that country of international humanitarian law.

Criterion Three:

Internal situation in the country of final destination, as a function of the existence of tensions or armed conflicts.

Criterion Four:

Preservation of regional peace, security and stability.

Criterion Five:

National security of member states and of territories whose external relations are the responsibility of a member state as well as that of friendly and allied countries.

Criterion Six:

Behaviour of the buyer country with regard to the international community, in particular its attitude to terrorism, the nature of its alliances and its respect for international law.

Criterion Seven:

Existence of a risk that the military technology or equipment will be diverted within the buyer country or re-exported under undesirable conditions.

Criterion Eight: Compatibility of the exports of the military technology or equipment with the technical and economic capacity of the recipient country, taking into account the desirability that states should meet their legitimate security and defence needs with the least diversion of human and economic resources for armaments.¹⁷

¹⁶ Council Common Position 2008/944/CFSP of 8 Dec. 2008 defining common rules governing control of exports of military technology and equipment, Official Journal of the European Union, L335, 13 Dec. 2008, pp. 99–103; The Common Rules have replaced the 1998 EU Code of Conduct on Arms. Council of the European Union, EU Code of Conduct on Arms Exports, 8675/2/98 Rev. 2, Brussels, 5 June 1998

¹⁷ Council of the European Union, Council Common Position 2008/944/CFSP of 8 Dec. 2008 defining common rules governing control of exports of military technology and equipment, 8 Dec. 2008.

An annual report documents the implementation of the Common Position including an overview of the individual nations' granted licenses and volumes of arms transfers compiled by regions and countries of recipients. Moreover, Member States regularly inform each other about particularly sensitive licenses granted and denials.

By contrast, exports of dual-use items are governed by a single primary legislation adopted at EU level that is binding on all Member States.¹⁸ This regime aims to implement all internationally agreed dual-use controls, including the Wassenaar Arrangement, the Missile Technology Control Regime (MTCR), the Nuclear Suppliers Group (NSG), the Australia Group and the Chemical Weapons Convention (CWC). Dual-use technology transfer by means of technical assistance is covered by a Council Joint Action¹⁹, which means that the member states have committed themselves to implement its guidelines by producing the necessary national legislation. In its tradition of striving to export its norms and regimes and in order to promote UNSC Resolution 1540²⁰, the European Union tries to actively spread its concept of non-proliferation by spurring the dialogue with third countries such as China in EU-OUTREACH Pilot Projects – where China has been one of the partner countries.²¹

As supranational law, the EC dual-use regulation is directly applicable in all 27 member-states. Each state is required to take the necessary steps to implement and enforce the regulation and to put in place the necessary national laws and sanctions for violations. They are interpreted and executed by national authorities such as the German BAFA export control authority or the British Export Control Organisation (ECO). While many smaller member states just use the regulation directly, larger trading nations, such as Germany²², have passed a number of additional laws to complement the EC dual-use regulation.

¹⁸ Council Regulation (EC) No 428/2009 of 5 May 2009 setting up a community regime for the control of exports, transfer, brokering and transit of dual-use items (recast), 29.5.2009

¹⁹ Council of the European Union, 'Council Joint Action concerning the control of technical assistance related to certain military end-uses, 2000/401/CFSP, Luxembourg, 22 June 2000

²⁰ UN Resolution 1540, 28 April 2004, S/RES/1540 (2004) , <http://daccess-ods.un.org/TMP/6545339.html> (accessed: 29 May 10)

²¹ Organised by the German BAFA export control authority. See: www.ue-outreach.info (accessed 10 April 12)

²² Namely the Außenwirtschaftsgesetz (AWG, Foreign Trade and Investment Act) and Außenwirtschaftsverordnung (AWV, Foreign Trade and Investment Regulation).

HEARING CO-CHAIR BLUMENTHAL: Dr. Tunsjo.

**STATEMENT OF DR. ØYSTEIN TUNSJØ
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DR. TUNSJO: Thank you, Mr. Chairman. First, I would like to thank the members and the staff of the Commission for inviting me to this important hearing. It is an honor and privilege to testify before you today.

I've been asked to address China-Europe security cooperation; Europe-China counter-piracy cooperation; Europe-China cooperation in U.N. operations; and China's Arctic interests. It is a lot of ground to cover in seven minutes, but I refer you to my written statement.

I will start by addressing China's Arctic interests and then examine China-Europe security cooperation.

China has few security interests in the Arctic, and its increased activism in the region is largely commercially and scientifically driven. There are strong indications that China supports the Law of the Sea as the legal framework for the Arctic region, and that it respects the sovereignty of the Arctic littoral states.

Inter-state relations in the Arctic are as of now benign, and prospects for cooperation in the region are strong. Currently, the stakes in the Arctic are not high enough to warrant confrontation. It has been argued that the High North will be an area of high stakes in the future, which may fuel rivalry and assertiveness in the Arctic.

Nonetheless, the countries that interact in the Arctic have more common than diverging interests. China, the U.S. and European powers are unlikely to prioritize the Arctic in the future. The harsh environment and the geographical distances are more likely to foster cooperation than conflict, and European states, the U.S. and China have no conflicting territorial or maritime claims in the region. Accordingly, competition and conflict of interest can be managed and cooperation promoted.

While there has been some Europe-China collaboration and coordination on global security issues, contemporary Europe-China security cooperation remains limited. China-Europe security collaboration is restricted to non-traditional security challenges, such as promoting global governance through U.N. operations and safeguarding the global commons through participating in counter-piracy operations.

In short, Europe-China collaboration or cooperation on soft security issues does not challenge transatlantic relations.

There is no strategic interaction in the triangular relations between the EU, China and the U.S. so that change in one leg of that triangle can affect vital security interests for the third actor, with the possible limited exception of the chance for European arm sales to China, an issue discussed by my colleague, Dr. Stumbaum.

Nonetheless, the emerging dynamics in U.S.-China-EU relations present the transatlantic relationship with a core challenge. Europe and the U.S. do not share the same threat perception of China, which push Europe and the U.S. to develop different strategies and approaches towards China.

I, therefore, contend that a new division of labor in transatlantic relations is needed in order to maintain strong ties across the Atlantic in an Asia-centered world and when the U.S. is rebalancing towards the Asia-Pacific.

The important new development in transatlantic relations, which is an additional factor to the disappearance of the Soviet Union and the lack of a common threat as a rationale for NATO's collective defense, is that China is rising and emerging as a peer-competitor of the United States. Creating a balance against China is not a priority in Europe.

Europe is more likely to be marginalized than to play a significant role in great power politics in Asia in the 21st century. However, instead of undermining European interests, marginalization can be conducive to European interests. By maintaining a low profile in world affairs and accepting that Europe has a limited role to play in great power politics in Asia, Europe can instead "keep calm and carry on" by focusing on more pressing challenges at

home.

A strategy for European countries of "splendid isolation" that enables Europe to minimize its involvement in Asian affairs can ensure Europe's disengagement from great power rivalry in Asia, but simultaneously promote Europe's trade relations with Asia and other power centers.

However, should competition and rivalry increase in U.S.-China relations, the U.S. may seek to restrict Chinese access to technology and to deal more forcefully with Chinese trade policy. Europe might resist U.S. pressure to support U.S. economic policies towards China. Hence, the potential for U.S.-European friction over economic relations with China could become a challenge for transatlantic relations.

A European strategy of "splendid isolation" could also frustrate the U.S., and the coming of a bipolar system, concentrated on U.S.-China relations, could push the U.S. into a position where its allies are asked if they are "with us or against us."

But geography and Europe's moderate power projection capability limit the role that European powers can and will play in Asia and in counterbalancing China. The U.S. acknowledges these constraining factors.

Nonetheless, Europe can compensate for its lack of resources and shared threat perceptions by being able and willing to take more responsibility for its own defense and by maintaining stability in Europe through keeping NATO's and the EU's "house in order." It can also more effectively participate and assume leadership in out-of-area operations to provide security in Europe's neighborhood.

Such a new division of labor in transatlantic relations can complement a U.S. strategy that focuses on China's rise.

In order to maintain strong transatlantic ties, the U.S. and Europe need to acknowledge and come to grips with what is NATO's and Europe's role in an Asia-centered world.

It will not be easy for Europe to take on more responsibility for its own defense and security and to change its worldview and become accustomed to a world where Europe no longer is the pivot of great power politics, but it may be necessary in an Asia-centered world. A new

division of labor in transatlantic relations suggests one way forward and a proposition not least Europe needs to reflect upon.

Thank you for your attention.

**PREPARED STATEMENT OF DR. ØYSTEIN TUNSJØ
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April 19, 2012

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

Hearing on “China-Europe Relationship and Transatlantic Implications”

Prepared written statement of

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I first would like to thank the members and the staff of the commission for inviting me to this important hearing. It is an honor and a privilege to testify before you. I have been asked to address Europe-China security cooperation; Europe-China counter-piracy cooperation; Europe-China cooperation in UN operations; and China’s Arctic interests.

The EU-China-US relationship differs from, for instance, the US-USSR-China triangle during the Cold War. The latter was frequently called a ‘strategic triangle’. Although the EU, China and the US are all important global actors, there is not a similar strategic interaction in their triangular relations, so that change in one leg of the triangle can effect vital security interest in the third actor, with the possible limited exception of the chance of European arms sales to China, an issue discussed by another panellist.¹

Europe-China security cooperation is restricted to non-traditional security challenges, such as promoting global governance through UN operations and safeguarding the global commons through participating in counter-piracy operations. In addition, there has been some collaboration or cooperation on humanitarian relief operations, on anti-terrorism operations and through military exercises and military exchanges. In short, Europe-China cooperation or collaboration on ‘soft’ security issues does not challenge transatlantic relations. Instead, the return of great power politics and traditional security, mainly driven by the rise of China, pose a more daunting challenge for transatlantic relations because Europe and the US do not share the same threat perceptions of China. It is therefore contended that a new division of labour in transatlantic relations is needed in order to maintain strong ties across the Atlantic in an Asia-centred world and when the US is rebalancing towards the Asia-Pacific.

Europe China-Security Cooperation

¹ Robert S. Ross, Øystein Tunsjø and Zhang Tuosheng, “Introduction,” in Robert S. Ross, Øystein Tunsjø and Zhang Tuosheng (eds.) *US-China-EU Relations: Managing the New World Order*, London: Routledge 2010, pp.1-4, 1.

While there has been some Europe-China collaboration and coordination on global security issues, contemporary Europe-China security cooperation remains limited. This is explained by a number of factors: First, the European Union (EU) does not have a cohesive and coherent foreign policy and Europe rarely acts as a unitary security actor cooperating with China on global security matters. China basically ignores the EU as a security actor and there is no real security and defense aspect in the so-called strategic partnership between the EU and China. Second, and instead, China largely deals bilaterally with European powers, including when it comes to security and defense issues.

Third, security issues in Europe are predominantly dealt with through NATO and China remains cautious when it comes to engaging NATO. Fourth, Europe and China do not play any prominent role in their respective spheres of influence and theaters. That is, Europe is not a major actor on the Korean Peninsula, regarding the Taiwan issue and in the South China Sea. China is not a major security player in the Mediterranean, the Atlantic, the Arctic, Eastern Europe and the Balkans.

China's unprecedented deployment of the frigate *Xuzhou*, operating anti-piracy missions in the Arabian Sea and the Gulf of Aden, to assist and provide security during the evacuation of more than 35,000 Chinese workers trapped in the conflict in Libya in March 2011, demonstrates that China has had a security presence in Europe's neighborhood. While China is unlikely to prioritize naval deployments to the Mediterranean in the years ahead, the Libya mission shows that China's global portfolio of interests have expanded rapidly which has led to more interaction with European states on security issues.

China has gained influence from its growing global activism, but it has also become more vulnerable. Worldwide interests, including overseas Chinese citizens and businesses need to be protected, and the flag often follows the trade. For Beijing, China-Europe security cooperation could be one way of managing potential negative spill-over effects of a more prominent Chinese global security role.

UN operations

The largest and most substantive Europe-China security cooperation has been within UN operations. China began contributing to UN peacekeeping and peace support operations in the late 1980s. In recent years, China, together with France, has been the leading contributor to UN peacekeeping operations among the permanent five members of the UN Security Council. According to the UN, as of February 29, China had 1,894 police, UN Military Expert on Mission and Troops in 11 UN missions. This is the highest contribution among the permanent five members and the 16th largest contribution overall among 118 contributing countries.²

China and its UN troops have cooperated with European countries within various UN missions and Europe-China engagement has been facilitated through the UN system. A growing number of dialogues

² <http://www.un.org/en/peacekeeping/resources/statistics/contributors.shtml> In March 2007, China's Assistant Foreign Minister Cui Tiankai in his opening address to the China-Norway peacekeeping workshop in Beijing pointed out that since 1989 China has participated in 16 UN peacekeeping operations and sent an accumulative total of over 7000 peacekeeping soldiers and policemen. See <http://www.fmprc.gov.cn/eng/wjdt/zjyh/t306951.htm>

and conferences have been set up to promote Europe-China cooperation on UN operations.³ Cooperation on UN operations is less sensitive for China since it is not contributing with combat troops. As a permanent five member of the UN Security Council, China can ensure that UN operations are consistent with the UN charter, approved by the UN and mandated by the UN.⁴ In addition, it can object and reserve its position regarding peace enforcement operations, making China's contribution to UN operations less controversial and risky.

China and Europe may continue to cooperate on UN operations, but a stronger Chinese footprint on the ground in various UN missions may not be preferable. China has re-emerged as a great power with growing global interests and influence, which suggest that a strong Chinese involvement on the ground in UN operations could compromise and undermine the neutrality of the UN mission. As a great power, China could instead facilitate UN operations and contribute more financially to these operations, and 'outsource' UN peacekeeping to smaller powers that have stronger impartial credentials.

Counter-piracy operations

There has been coordination and collaboration between Europe and China on counter-piracy operations, but no real steps towards full cooperation. China supported the unanimously adopted UN Security Council Resolutions 1836 of 7 October 2008 and 1851 of 16 December 2008, under Chapter VII of the United Nations Charter, and with the consent of Somalia's Transitional Federal Government to enter Somalia's territorial waters and use "all necessary means" to repress acts of piracy and armed robbery, China decided in January 2009 to deploy two navy destroyers and a supply vessel to the Gulf of Aden.

The People Liberation Army Navy's (PLAN) first operational combat deployment far from China's territorial waters has been a milestone and historic mission for the Chinese military. By the end of November 2011, China had deployed ten different escort taskforces to the Gulf of Aden and conducted 393 escort operations. The destroyers and frigates deployed have been some of China's most sophisticated and modern surface warships. China clearly considers its first potential combat mission beyond its territorial waters as an important and prestigious task. It also highlights that China is behaving as a responsible permanent member of the UN Security Council. This gives China status and prestige and promotes Europe-China security cooperation.

Three coalitions of naval forces, the Combined Maritime Forces of NATO, the US-led Combined Task Force 151 and the EU's NAVFOR Somalia (Operation Atalanta), in addition to individual nations such as Japan, India and China, have deployed patrol vessels to conduct counter-piracy patrols off the coast of Somalia, in the Gulf of Aden and in the Indian Ocean. The cooperation and collaboration between the

³ For example, Norway and China arranged a conference about UN integrated peacekeeping operations "Multidimensional and Integrated Peace Operations – The Way Forward" in Beijing, March 2007; The Norwegian Institute for Defence Studies and the Stockholm International Peace Research Institute, in collaboration with the US Naval War College China's National Defence University arranged an international workshop on *China in Peace Support Operations: Current Perspectives, Future Aims, and Next Steps* in Oslo, Norway, March 17-19, 2010.

⁴ Zhang Tuosheng, "On China's concept of the international security order," in Ross et al (eds.), *US-China-EU Relations*, pp. 26-47.

three coalitions have been extensive.⁵ Conversely, cooperation with individual nations has room for improvement. Instead of emphasising cooperation, Norwegian Navy officers participating in Operation Atalanta characterise Europe-China interaction more as coordination and collaboration under the umbrella of SHADE (Shared Awareness and Deconfliction Meeting) and through ‘permanent liaisons’ with the main objective to sort out patrol zones and escort tasks.

It is important to remember that the primary objective of China’s participation in both UN and counter piracy operations is not to enhance China-Europe security cooperation, but to promote China’s national interests. In particular, the deployment of naval vessels to the Indian Ocean shows that China has developed some limited military capabilities that can help it protect its growing global economic interests and overseas presence.

Participation in UN operations and escort missions in the Gulf of Aden also provide the PLA with an opportunity to gain experience from long-range military deployments. Although the tasks may be defined as somewhere between a policing and a military operations, they have allowed for important testing of combat readiness, long-range logistic supply, real-time C4ISR connections with PLA headquarter in Beijing and Haiku, surveillance training, improvement of navigation skills and exposing sailors, troops and commanders to long-term deployment at sea and regions far from China. Operating alongside, and collaborating with, advanced foreign navies means the PLA obtains intelligence information and benchmarking. Finally, by protecting its overseas interests, the PLA deployment can demonstrate to China’s domestic public some of the returns on China’s high military spending.

Additional Europe-China security cooperation

There has been some Europe-China collaboration or cooperation on humanitarian relief operations, but China’s conceptualisation and emphasis on state sovereignty, and its restrictive interpretation and reluctance to accept the principle of responsibility to protect, often conflict with European views and compromises cooperation on humanitarian relief operations.⁶ Nonetheless, as both Europe and China consider participation in relief missions as enhancing their status and prestige and the role as responsible stakeholders in the international community, future relief operations may allow for more Europe-China security cooperation and expanding multilateral interaction.

Europe and China have cooperated with the US on initiatives and measures taken in order to prevent

⁵ For example, both the NATO’s Allied Command Head Quarters and the EU Operational Head Quarters are based at Northwood, UK, while Task Force 151 and the EU’s NAVFOR Somalia are currently in discussions regarding the introduction of exchange officers between the two forces. See Catherine Zara Raymond, “Countering piracy and armed robbery in Asia: a study of two areas,” in Peter Dutton, Robert S. Ross and Øystein Tunsjø (eds.) *Twenty-First Century Seapower: Cooperation and Conflict at Sea*, London: Routledge 2012, pp. 213-236.

⁶ For example, US, India, China and some European countries (the United Kingdom and the Royal Navy dispatched *HMS Westminster*) participated in humanitarian relief operations in the aftermath of the 2008 tropical cyclone in Myanmar. This was the first time the PLAN had carried out a maritime humanitarian relief operation. The UK was critical of the Burmese regime resistance to receive international assistance and insistence on bilateral aid. China, however, was supportive of the Burmese junta’s fear of international actors violating Burmese sovereignty.

nuclear terrorism and the proliferation of nuclear material. In 2007, China joined the International Ship and Port Facility Security Code (ISPS) of the International Maritime Organisation (IMO). In cooperating to prevent nuclear proliferation, China has also joined the Global Initiative to Combat Nuclear Terrorism (GICNT).

The PLAN has conducted a number of exercises with foreign navies during the past twenty years, including a number of European countries (France, the Netherlands and the United Kingdom). In September/October 2010, the PLA Air Force (PLAAF) conducted an exercise with NATO member Turkey. This was the first time the PLAAF engaged in a combined exercise with a NATO member in a NATO country.⁷ China has also participated in defence and security consultations with various European states (Germany, the United Kingdom and Turkey). Finally, Europe-China security cooperation is reflected in military personnel exchanges, between both operational units and military educational institutions.

Europe-China Security Cooperation and Implications for Transatlantic Relations

What then are the transatlantic implications of potentially growing Europe-China security cooperation? Since Europe-China security cooperation is limited and largely related to common security concerns, in most cases, transatlantic relations and the US benefit from this cooperation.

However, as China's great power status, global influence and interests increases, China's participation in UN mission may cause some concern, but this concern would probably be shared across the Atlantic. For example, the US may have objected to a large Chinese UN peacekeeping contingent to Haiti, European countries might have been reluctant to a strong Chinese presence in their neighbourhood and China would probably be alarmed if the US decided to participate in UN operations on its doorstep. Thus, if great powers are heavily involved in UN operations their participation may compromise the mission.

While the US and European countries welcome China's participation in counter-piracy operations and encourage China to become a responsible stakeholder that contributes in safeguarding the global commons, such a policy might eventually undermine US and Western leadership and order. A more constructive and responsible role by China in dealing with global common challenges and threats, justify and legitimises China's military build-up and power projection capability, which eventually may challenge US dominance at sea. Again, however, this concern would probably be shared across the Atlantic.

More military exercises between China and NATO countries could give China access to sensitive US and NATO technology, give China more knowledge of NATO's operational and tactical considerations, give China important benchmarking for developing and modernising the PLA and give China better insight into NATO logistics, maintenance and training.

⁷ <http://www.reuters.com/article/2010/10/08/us-china-turkey-usa-idUSTRE6975HC20101008>

So far I have pointed to some opportunities and challenges that may arise from Europe-China security cooperation. *The core challenge for transatlantic relations, however, is that Europe and the US do not share the same threat perception of China.*

Creating a balance against China is not a priority in Europe, but then China does not represent the same threat to European powers as to the US. Chinese social and political instability, and China's economic and environmental policies, are often seen by the EU as a greater danger or risk to European interests and the world than growing Chinese military power and potential expansion. The fact that the US and the EU are unequal powers and distinct actors in international affairs, currently leads to different threat perceptions and pushes Europe and the US toward different strategies and approaches towards China.⁸

The US, uncertain as to whether China represented a threat in the post-Cold War period, has been hedging against China's rise and the risk that China might become more aggressive and a peer competitor in the future by combining limited balancing measures and extensive cooperation. The more recent US 'push back' strategy against a supposedly more assertive China is more attuned to stronger balancing and also in accordance with a gradual transition towards a bipolar system.⁹ Conversely, the EU continues to focus on risks rather than threats emanating from China's rise. How the US and the EU will reconcile these different threat perceptions and strategies toward a rising China will be important in understanding the future of transatlantic relations.

One example is illustrating. Threat perceptions of communism were largely shared across the Atlantic in the post-World War II period and the US and European powers more or less agreed on strategies of balancing and containing communism. Indeed, one of the important implications of the Korean War in June 1950 was that it cemented transatlantic relations and contributed to the creation of NATO. If a conflict erupted on the Korean Peninsula, in the Taiwan Strait or in the South China Sea today, one may ask whether that would reinforce and revitalise transatlantic relations. Different threat perceptions and strategies for dealing with China's rise suggest that another conflict in East Asia may constrain and weaken transatlantic ties rather than strengthen the relationship.

A bipolar system concentrated on US-China relations, US rebalancing towards the Asia-Pacific and an Asia-centred world are most likely to shape and condition European states behaviour and transatlantic relations in new and unprecedented ways. From being the area of primary strategic consideration during the twentieth century, Europe is now of less significance for the US and other powers.

As Robert Art and others have pointed out, the end of the Cold War "removed the 'common-enemy cement' that held the NATO alliance together."¹⁰ Stephen Walt has succinctly stated about NATO: "[n]o

⁸ Rosemary Foot, "Strategy, politics, and world order perspectives: comparing the EU and US approaches to China's resurgence," in Ross et al (eds.), *US-China-EU Relations*, pp. 212-234.

⁹ Hedging is positively correlated to uncertainty about systemic power distribution. Hedging is more likely in a unipolar system and transition periods, less likely in a multipolar system and least likely in a bipolar system.

¹⁰ Robert Art, "Europe Hedges its Security Bets," in Paul et al. (eds) *Balance of Power: Theory and Practice in the 21st*

threat. No cohesion.”¹¹ Richard Haass, the President of the Council for Foreign Relations, has contended that the relative importance of transatlantic ties is eroding.¹² Thus, transatlantic security cooperation in the post-Cold War era is past its heyday, it is argued. This is especially the case, asserts Walt, “since major security challenges are more likely to arise in Asia, and that is where the most likely future challenge to US hegemony – the PRC – is located.” Consequently, East Asia is likely to be to the twenty first century what Europe was to the twentieth century: the main area of great power balancing, conflict and economic growth.

Conversely, tension and disagreement in transatlantic relations are nothing new,¹³ and NATO revitalised itself through humanitarian operations in the 1990s and the “war against terrorism” in the first decade of the 21st century, thereby disproving claims about its disintegration. The US is still committed to NATO and Europe through institutional ties, shared history, democratic values and cultural factors. Europe remains the largest trading partner of the US and US’ leading investor. Europe is nearly always the most effective and most important US partner in addressing transnational challenges. Peace and stability in Europe, largely promoted through NATO, US presence in Europe and the EU, is essential to the US objective of preventing a two-front confrontation as the US focuses on the rise of China. The US will continue to scale down its presence in Europe as long as Europe remains peaceful.

Nonetheless, the new and important development, which is an additional factor to the disappearance of the Soviet Union and the lack of a common threat as a rational for NATO’s collective defence, is that China is rising and emerging as a peer-competitor of the US. Europe is more likely to be marginalized than to play a significant role in great power politics in Asia. However, instead of undermining European interests, marginalization can be conducive to European interests. It may offer an opportunity to avoid traditional destructive ‘high politics’ conflicts, to consolidate and revitalize the EU and to promote and strengthen Europe’s neighbourhood policy in the Arctic, Eastern Europe, the Near East and North Africa.

By maintaining a low profile in world affairs and accepting that Europe has a limited role to play in great power politics in Asia, Europe can instead ‘keep calm and carry on’ by focusing on more pressing challenges at home. This includes prioritizing tackling the economic crisis and fiscal challenges that threaten the EU, maintaining stability in Europe, promoting Europe’s neighbourhood policy and providing more for Europe’s defence. A strategy for European countries of ‘splendid isolation’ that enables Europe to minimize its involvement in Asian affairs can ensure Europe’s disengagement from great power rivalry and conflict in Asia, but simultaneously promote Europe’s trade relations with Asia and other power centres.

¹¹ *Century*, Stanford: Stanford University Press, 2004, pp. 179–213.

¹¹ Stephen M. Walt, “The Ties That Fray: Why Europe and America are Drifting Apart,” *The National Interest* 54 (Winter), 1998/1999.

¹² Richard Haass, “Why Europe no longer matters”, *The Washington Post*, 18 June 2011. Available at

http://www.washingtonpost.com/opinions/why-europe-no-longer-matters/2011/06/15/AG7eCCZH_story.html

¹³ See for example; Geir Lundestad, *Just Another Major Crisis, The United States and Europe Since 2000*, Oxford: Oxford University Press, 2008.

However, should competition and rivalry increase in US-China relations, the US may seek to restrict Chinese access to technology and to deal more forcefully with Chinese trade policy. Given Europe's minimal stake in the security issues in East Asia, and the European countries' focus on seeking national profit in China at the expense of each other and a common EU position,¹⁴ Europe might resist US pressure to support US economic policies towards China. Will the US tolerate European resistance? The potential for US-European friction over economic relations with China could become a challenge for transatlantic relations.

A European strategy of 'splendid isolation' could also frustrate the US and the coming of a bipolar system could push the US into a position where its allies are asked if they are "with us or against us". But geography and Europe's moderate power projection capability limit the role that European powers can and will play in Asia and in counterbalancing China. The US acknowledges these constraining factors.

Nonetheless, Europe can compensate for its lack of resources and shared threat perceptions by being able and willing to take more responsibility for its own defence and by maintaining stability in Europe through keeping NATO's and the EU's 'house in order'. It can also more effectively participate and assume leadership in out of area operations to provide security in Europe's neighbourhood. This new division of labour in transatlantic relations can complement a US strategy that focuses on China's rise and the long-term competition with its peer-competitor.

Maintaining stability in Europe is in the interests of both European states and the US. However, the US lacks the resources and financial strength to priorities two theatres and Europe lacks the capabilities to play a security role in Asia. Europe can no longer expect that the US will continue to carry out a disproportionate role in maintaining stability in Europe in the coming of a bipolar system and an Asia-centred world. Complementing the US "pivot" to Asia-Pacific and preserving strong transatlantic could be an important secondary goal for Europe, and a potential spill-over effect of European countries pursuing its primary goal of maintaining stability in Europe and making the EU and NATO more successful in its neighbourhood policy.

Although few countries beside the European countries are working as closely with the US on global issues and regional security concerns, including sending battle troops to fight alongside the US military, NATO is unlikely to 'go global' in providing security and in participating in conflicts and new wars in Asia in the years ahead. Nonetheless, in order to protect European interests and strengthen and maintain transatlantic ties, a potential European contribution to a 'coalition of willing' in a conflict in Asia cannot be ruled out.

Eventually, however, the political will in Europe to take on more responsibility in defence and security affairs will be essential. As in the past, diverging threat perceptions, financial predicaments, costly

¹⁴ See chapters 5-7 in Ross et al (eds.), *US-China-EU Relations: Managing the New World Order*, 2010.

welfare programs, demographics and the benign European security environment will constrain Europe's efforts to boost its defence commitments and take the lead in out of area and expeditionary operations.

Nonetheless, the coming of a bipolar system, an Asia-centred world, and the US "pivot" to the Asia-Pacific region might prompt European states to invest in defence capabilities and mechanisms that can preserve Europe's stability and maintain Europe's benign security environment. In order to maintain strong transatlantic ties the US and Europe need to acknowledge what is NATO's and Europe's role in an Asia-centred world and come to grips with the implications of Europe's security cooperation with Asian powers, and China in particular. It will not be easy for Europe to take on more responsibility for its own defence and security and to change its worldview and become accustomed to a world where Europe no longer is the pivot of great power politics, but it will be necessary in an Asia-centred world. A new division of labour in transatlantic relations suggests one way forward and a proposition not least Europe needs to reflect upon.

In fact, Norway may provide an example of a European country and a NATO member that conform to a new division of labour in transatlantic relations. Norwegian decision-makers have stated that they understand the US need for rebalancing towards Asia and that the "pivot" towards the Asia-Pacific does not mean that the US is turning its back on Europe, but instead is shifting from focusing on asymmetric threats and the "war on terrorism" to symmetric threats and great power rivalry. The US has always been both a Pacific and an Atlantic power and will sustain that position.

Norway has stressed that NATO's primary objective is to maintain stability in Europe and the commitment to article five. However, Norway also participates in out of area operations and seeks to safeguard Europe's neighbourhood. Norway has also participated in counter-piracy operations and Norway is supportive of NATO's partnership with Asian countries. It has even considered participating in the Pacific Rim exercise in 2014. Finally, Norway is willing to invest in its defence and will purchase F-35 and other US military equipments and systems, which means that Norway will be in the same bed as the US military for decades to come.

China's Arctic Interests

China has few security interests in the Arctic and there is no Europe-China security cooperation in the Arctic. China is a newcomer to the Arctic and has not published an official document or directive on its Arctic policy. Nonetheless, while remaining cautious, China has been pro-active in preparing and positioning itself for a more active role in the Arctic.

The push for a permanent observer status in the Arctic Council, and an increasing Chinese presence both on Iceland and Svalbard, evince a clear, official Chinese interest.¹⁵ China's growing interest and activism in the Arctic are primarily shaped by scientific considerations, commercial interest in the

¹⁵ China has a large diplomatic presence in Iceland and its embassy is the largest in the capital Reykjavik. China's first Arctic research station, Hunghe (Yellow River), was founded at Ny-Ålesund in Norway's Svalbard archipelago in July 2004.

petroleum, shipping and mineral sector, as well as diplomatic and legal concerns. It remains to be seen to what extent the Arctic Ocean will play a role in the strategic planning of the People's Liberation Army (PLA). Other regions and issues are of higher priority and importance for the PLA.

China has expanded its polar research capabilities and is developing strong polar scientific research programs. The building of a new 8000 ton conventional icebreaker, in addition to the 20.000 ton conventional-powered icebreaker Xuelong (snow Dragon) purchased from Ukraine in 1993, promises to provide China with the capacity to operate in the Arctic more frequently than many of the littoral states. While status and prestige might be an additional factor driving China's polar research, developing its own Arctic research may allow China to make a stronger contribution in addressing Arctic affairs.

The gradual melting of Arctic ice may allow China to further diversify its trade routes and sources and routes of petroleum and mineral imports. It has been increasingly recognized that Arctic petroleum reserves, minerals and new transportation routes may offer investment and commercial opportunities for Chinese national oil companies (NOCs), Chinese entities interested in Arctic mineral resources and the Chinese shipping sector, which push China to seek a more prominent role in the Arctic.

China lacks an EEZ and rights to underwater continental shelves in the Arctic and China's NOCs are likely to struggle to secure a stake in the challenging and high-cost Arctic Exploration & Production (E&P) environment that requires state-of-the-art technology. One option is to partner with foreign companies in joint ventures or to invest in companies already operating in the Arctic.¹⁶ Top officials from the Norwegian Ministry of Petroleum and Energy and the Norwegian petroleum sector anticipate more Chinese investments, M&A and competition for E&P contracts and licenses in the Arctic. They not only expect Chinese companies to participate in this process, but also see Chinese involvement as a normal feature of the competitive international petroleum market.

Regarding diplomatic and legal concerns in the high north, some Chinese civilian and military observers have questioned the legal framework for the region. With no authoritative Arctic strategy published by the central government, it appears that alarmist voices have been allowed to shape China's public debate over its Arctic policy. At the same time, Hu Zhengyue, Assistant Minister for Foreign Affairs, has clearly stated that China supports both the legal framework of the Arctic and the cooperation promoted by the Arctic Council. The littoral states' sovereignty over the EEZs and extended continental shelf where most of the hydrocarbon reserves are located, are not questioned by China officially and a leading law of the sea expert at the China Institute of Maritime Affairs (CIMA), an institute under the State Oceanic Administration (SOA), has confirmed this position.¹⁷

In July 2009, Hu stated that "international law, including a series of conventions, has provided the basic

¹⁶ For example, in August 2011, China Investment Corporation (CIC) bought 30 percent of the French company GdF Suez E&P, a deal worth about \$4 billion. GdF Suez E&P Norge has been operating in Norway since 2009 and CIC thereby secured indirect access to E&P and licenses to drill in the Barents Sea. In addition, in 2008 China Oilfield Services bought the Norwegian offshore company Awilco for roughly \$2.5 billion.

¹⁷ Conversation with international law expert from CIMA, Beijing, November 2011.

legal framework for addressing Arctic affairs.” Although Hu simultaneously noted that “full consideration should be given to the fact that the outer continental shelf is linked to the International Seabed Area which is the common heritage of mankind to ensure a balance between the rights and interests of the coastal states and the common interests of the international community,” he stressed that “China supports the current legal order in the Arctic, including the law of the sea …[and] China respects the sovereignty of Arctic states, and their sovereign rights and jurisdiction in accordance with international law.”¹⁸

China shares some interests with European non-Arctic coastal states, especially Germany, regarding the position that the outer continental shelf is the “common heritage of mankind.” For example, it is emphasized that the Arctic offers new shipping routes for German-Chinese trade and both China and Germany are supposedly skeptical about Arctic coastal states seeking to exclude non-Arctic states from the region.¹⁹

Circumpolar cooperation is maintained and advanced through the Arctic Council, which is a forum recognized by the Chinese government as playing an important role in coordinating cooperation and development in the region. China has actively sought permanent observer status in the Arctic Council. However, the member states of the Council have not yet approved this and other permanent observer applications. At the last ministerial meeting, they did establish a set of formal criteria for states to acquire such status, but the decision whether to accept China and the other applicant countries is still on hold.

Recently there has been some media reporting suggesting that Norway has changed its position regarding China’s application for permanent observer status at the Arctic Council. This is a misinterpretation and the Norwegian Ministry of Foreign Affairs has repeatedly stated that “Norway continues to support China’s application for permanent observer status on the Arctic Council.”²⁰ At the same time, Norwegian diplomats have emphasized that Norway can better facilitate China’s application if Chinese officials starts talking to Norwegian governmental representatives. However, this does not mean that Norway has shifted its position to blocking China’s application.

In sum, there are strong indications that China supports the law of the sea and the legal framework for the Arctic region and that it respects the sovereignty of Arctic states. China is likely to boost its Arctic-focused research and has recently acquired an additional conventional powered ice-breaker. China’s interests in the Arctic are commercially and scientifically driven, and Chinese investments and competition in the petroleum and offshore sector may be characterized as “business as usual” or what can be expected from international oil companies and other actors operating in the region.

¹⁸ Hu Zhangyue, “China’s Arctic Policy,” presentation at High North study tour, Spitsbergen, 2 July 2009.

¹⁹ Margaret Blunden, “Geopolitics and the Northern Sea Route,” *International Affairs*, 88(1), 2012, pp. 115-130.

²⁰ See http://www.regjeringen.no/en/dep/ud/Whats-new/Speeches-and-articles/speeches_foreign/2012/policy_address1202.html?id=672235

Inter-state relations in the Arctic are as of now benign and prospects for cooperation in the region are strong. Currently, the stakes in the Arctic are not high enough to warrant confrontation. It has been argued that the High North will be an area of high stakes in the future, which may fuel rivalry and assertiveness in the Arctic. Nonetheless, the countries that interact in the Arctic have more common than diverging interests. Other areas of the world remain more important to major European powers, the EU, China and the US; the harsh environment in the Arctic and the geographical distances are more likely to foster cooperation than conflict; and European states, the US and China have no conflicting territorial or maritime claims in the region. Accordingly, competition and conflict of interest can be managed and cooperation promoted.

HEARING CO-CHAIR BLUMENTHAL: Dr. Lin.

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DR. LIN: Good morning. First of all, I'd like to thank the Commission and co-Chairs Bartholomew and Blumenthal for inviting me to discuss the important subject of China's increasing ties with NATO.

Let me begin by relating several broad trends that are converging and compelling NATO to cooperate with China, and then I will summarize answers to some of the specific questions asked of me.

President Obama said the 21st century is going to be the Pacific century, and the U.S. is pivoting east towards the Asia-Pacific. However, while we are pivoting east, China has been pivoting west in the last decade on the New Silk Road towards the Mediterranean.

As NATO is expanding eastward, China is expanding westward across the Eurasia continent, which brings China into NATO's traditional area of responsibility and the hitherto "NATO Lake" of the Mediterranean Sea. Chinese warships entering the Mediterranean Sea to help evacuate 36,000 Chinese nationals from Libya last March highlighted this emerging trend.

In Asia, NATO's ISAF campaign in Afghanistan has also brought NATO to China's border. NATO's Afghan mission largely defines NATO's relations in Central Asia region, where it is key for NATO's military logistics through the Northern Distribution Network, EU energy logistics of pipelines and sources that bypass Russian control, and overall trade logistics corridors for regional stability based on U.S.' New Silk Road Initiative, launched by Secretary Clinton last autumn. So Afghanistan and Central Asia is thus a region for practical cooperation between NATO and China.

In addition to meeting China fighting overland

terrorism in AfPak, NATO also meets China in fighting the maritime terrorism of piracy in the Gulf of Aden and the coast of Somalia. NATO and Chinese navies have been conducting anti-piracy operations in the region since 2008 and have engaged with each other through a multinational forum for maritime security. So all these trends point towards closer engagement and cooperation between NATO and China.

However, these opportunities also present challenges. China as a U.S. peer competitor and its ambitions of extending power projection capabilities make it a partner whose importance merits engagement. China and the West have different perceptions of sovereignty and global commons, so this drives competing global interests and creates political friction.

For NATO, the critical question is how to be selective in choosing partners to help secure access to global commons, as well as other issues of mutual interest such as counter-terrorism, WMD proliferation, anti-piracy and energy security.

Interaction with China will help to construct joint engagement and enhance cooperation on areas of mutual interests, but at the same time, NATO should remain alert to Chinese intentions and hedge potential negative spillovers.

The U.S. can exercise strategic leadership in this regard by informing other NATO allies and partners of Asia-Pacific security concerns vis-a-vis China and help shepherd a balanced NATO approach towards engaging a rising China.

Currently NATO does not yet have a policy towards China with engagement mainly at the political level. Until mid-2000, NATO's interaction with countries outside of the Euro-Atlantic region was of low level of importance. The first direct NATO engagement with China unfortunately was in 1999 when NATO bombed the Chinese embassy in Belgrade.

But after the September 11 attacks in 2001, Afghanistan brought NATO to Asia and next door to China. In 2002, the Chinese ambassador in Brussels visited NATO headquarters to discuss ways of engagement in Afghanistan, and since then, NATO and China have normalized engagements and developed political dialogue to discuss issues such as terrorism and maritime piracy.

NATO Secretary General Rasmussen names three main reasons for engaging China. Number one, China is a rising power; number two, China is a U.N. Security Council member. Because NATO operates from U.N. mandates, it's important to engage China. Moreover, NATO is already engaged with all members of the U.N. Security Council except China. Britain, U.S. and France are NATO members, while NATO engages Russia through the NATO-Russia Council. So NATO -- Secretary General Rasmussen would like to set up a NATO-China Council eventually.

And the third reason to engage China is that China shares NATO interests in Afghanistan, especially in terrorism and drug trafficking.

NATO's current approaches and objectives towards China as a potential global partner complement U.S. security interests in terms of pooling resources to address issues of mutual concern, especially in Afghanistan.

Given NDAA 2000 restrictions, the DoD has sought areas of cooperation, such as humanitarian assistance, peacekeeping, disaster relief, educational exchanges and dialogues as ways to enhance understanding and reduce misperceptions. And NATO is exploring similar issues for practical cooperation with China, especially anti-piracy and counterterrorism.

Moreover, NATO's objective of working with China to stabilize Afghanistan supports U.S. interests vis-a-vis China in Afghanistan. China's influence over Pakistan and as a neighbor of Afghanistan plays an integral role in AfPak post-2014 when NATO combat forces depart. China with its \$3.2 trillion war chest can also contribute to NATO and U.N. trust funds to help sustain and train Afghan armed forces, since China will be a great beneficiary of Afghan stability and protection of its investments.

As regards to how China views the role of NATO as it begins to draw down its operations in the AfPak theater, China does not want a permanent NATO military presence in AfPak, but envisions NATO still playing a residual role to address the continuing threat of terrorism. China would like SCO to play an increasing role, and Chinese scholars have proposed NATO-SCO cooperation in counterterrorism, as well as having an alternative forum for U.S.-China engagement in AfPak and Central Asia.

So NATO-China engagement is a nascent trend that is still unfolding, and Afghanistan is evolving as a good test case for further cooperation given shared interests in the region.

Thank you, again, for the opportunity to testify, and I welcome your questions and comments.

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

Hearing: China-Europe Relationship and Transatlantic Implications

Panel IV: Defense and National Security Issues

By Christina Lin

Visiting Scholar, Center for Transatlantic Relations, Johns Hopkins University—SAIS

April 19, 2012

“NATO-China Cooperation: Opportunities and Challenges”

Good afternoon. I would like to thank Co-chairs Bartholomew and Blumenthal for inviting me to discuss the important subject of China’s increasing ties with NATO. Let me begin by relating several broader trends that are converging and compelling NATO to cooperate with China, and then I will provide answers to each of the specific questions asked of me.

President Obama has said that the 21st century is going to be the Pacific Century and U.S. is pivoting to the east towards the Asia Pacific. However, while we are pivoting east, China has been pivoting west in the last decade on the New Silk Road towards the Mediterranean.¹ As NATO is expanding eastwards, China is expanding westwards across the Eurasia continent, which brings China into NATO’s traditional area of responsibility (AOR), and the hitherto “NATO Lake” of the Mediterranean Sea. Chinese warships entering the Mediterranean Sea to help evacuate 36,000 Chinese nationals from Libya last March highlighted this emerging trend.

In Asia, NATO’s ISAF campaign in Afghanistan has also brought NATO to China’s border. NATO’s

¹ “Jiang touts new ‘Silk Road’ between Asia, Europe”, *CNN*, May 25, 2001; “China presses a ‘new Silk Road’, *Taipei Times*, May 26, 2001; “Wen: China to continue to develop western region”, *China Daily*, October 16, 2010; Tang Yongsheng, “Actively Promoting Westward Strategy”, *Beijing Xiandai Guoji Guanxi*, November 29, 2010; Hasan H. Karrar, *The New Silk Road Diplomacy: The Making of China’s Central Asian Foreign Policy in the post-Cold War Era* (University of British Columbia Press, 2009); Christina Lin, “China’s New Silk Road to the Mediterranean: The Eurasian Land bridge and Return of Admiral Zheng He”, Paper presented to China Maritime Studies Institute, U.S. Naval War College, October 27, 2011, *ISPSW*, Issue No. 165.

Afghan mission largely defines NATO's relations with Central Asia region, where it is key for NATO military logistics through the Northern Distribution Network (NDN), EU energy logistics of pipelines and sources that bypass Russian control, and overall trade logistics corridors for regional stability based on U.S.' New Silk Road Initiative launched by Secretary Clinton last autumn.² Afghanistan and Central Asia is thus a region for practical cooperation between NATO and nonmembers such as China.

In addition to meeting China fighting overland terrorism in AfPak, NATO also meets China in fighting maritime terrorism of piracy in the Gulf of Aden and coast of Somalia. NATO and Chinese navies have been conducting anti-piracy operations in the region since 2008, and have engaged with each other through the multi-national Shared Awareness and Deconfliction (SHADE) forum for maritime security. All these trends point towards closer engagement and cooperation between NATO and China.

However, these opportunities also present challenges. China as a U.S.' peer competitor and its ambitions of extending power projection capabilities make it a partner whose importance merits engagement. China and the West have different interpretations of sovereignty and global commons, thus this drives competing global interests and creates political friction. For NATO, the critical question is how to be selective in choosing partners to help secure access to global commons as well as other issues of mutual interests such as counter-terrorism, WMD proliferation, anti-piracy and energy security. Interaction with China will help reconstruct joint engagement and enhance cooperation on areas of mutual interests; but at the same time NATO should remain alert to Chinese intentions and hedge for potential negative spillovers. U.S. can exercise strategic leadership in this regard by informing other NATO allies and partners of Asia Pacific security concerns vis-à-vis China, and help shepherd a balanced NATO approach towards engaging a rising China.

(1) How has NATO's approach to Asia and China evolved in the past decade? How has NATO directly engaged with China, and what were the objectives and outcomes of specific instances of engagement?

NATO does not yet have a policy towards China, with engagement at the political level and not at the military level. Until the mid 2000, NATO's interaction with countries outside of Euro-Atlantic region was of low level of importance. NATO had limited and infrequent dialogue with Asian states, such as Japan, with little element of concrete cooperation. But after September 11 attacks in 2001, Afghanistan brought NATO to Asia. Henceforth, NATO increased interactions with Japan, South Korea, Singapore, Australia, New Zealand and Mongolia that contributed directly and indirectly to NATO ISAF's Afghan campaign.³

This also brought NATO closer to China, which shares border with Afghanistan via the Wakhan

² Christina Lin, *China's Empire Express: Expanding Frontiers and Military Rail Transport on the New Silk Road*, Jamestown Foundation monograph, forthcoming; "New Silk Road eyed for Afghanistan", *Agence France Press*, September 22, 2011.

³ NATO ISAF Troop Contributing Nations (TCN) in Asia Pacific: New Zealand since 2003; Australia in 2006; Singapore in 2008; Mongolia in 2010; South Korea in 2010. Japan is limited by its constitution to engage in combat, so it has contributed to development assistant, naval refueling in the Indian Ocean to support NATO ISAF, support PRT in Afghanistan.

Corridor. China is driven to engage NATO due to Afghanistan, and so is NATO. As such, Afghanistan and Central Asia is a good test case for exploring possible NATO-cooperation with China.

Why does NATO want to engage with China? NATO Secretary General Rasmussen said he sees NATO and China have many shared interests and would like to see close ties between the two. He expressed a desire for NATO and China to establish a NATO-China Council, similar to the NATO-Russia Council.⁴ Although the new strategic concept at the November 2010 Lisbon Summit did not mention China, it is looming large as an emerging issue. He understands China has a non-aligned policy, but views that NATO has partnered with other non-aligned countries so this is not an issue. SecGen Rasmussen names three main reasons why NATO should engage China: (1) China is an emerging power, with a growing economy and increasing global responsibility for security. As such, he would like to see regular political consultations with China; (2) China is UNSC member. NATO operates from UN mandates, so it is important to engage China; (3) China shares NATO interests in Afghanistan, especially in terrorism and drug trafficking.⁵

SecGen Rasmussen said China was invited to participate in a political discussion to strengthen counter piracy efforts for the first time in 2011. This was an effort to explore further similar security issues for cooperation and to establish regular NATO-China Dialog. He does not see China as a threat and urges that both sides should cooperate.⁶ Similarly, Masako Ikegami, a professor at Stockholm University, said that it is important for NATO to engage with other countries with different values for confidence building measure and to reduce misperception.⁷

From the U.S. perspective, since we already have the bilateral U.S.-China Strategic & Economic Dialogue (S&ED) to enhance understanding and reduce misperceptions, NATO and China should also have a dialogue similar to the NATO-Japan Dialogue that is already in place.

History of NATO-China engagements. China and NATO contact is a relatively recent development. NATO-China relations were non-existent during the Cold War and for most of the 1990s. The first direct NATO engagement with China was in 1999 when NATO bombed the Chinese embassy in Belgrade during the Kosovo campaign. After the 9/11 attacks in 2001 and invasion of Afghanistan next to Chinese borders, in 2002, the Chinese ambassador in Brussels visited NATO headquarter with then SecGen Lord Robertson and explored ways for engagements, particularly in Afghanistan. Since then NATO-China have normalized engagements and developed a political dialogue to focus on exchanging information and issues of cooperative security. These issues include terrorism, maritime piracy, international security, weapons of mass destruction (WMD) proliferation, and crisis management.⁸

⁴ Jorge Benetiz, "Time for a NATO-China Council?" Atlantic Council, May 25, 2011; SecGen Anders Fogh Rasmussen, "NATO: A Changing Alliance in a Changing World", Speech at Paul H. Nitze School of Advanced International Studies, May 12, 2011; Wu Mei, Liu Xiang, "China, NATO have potential to develop partnership: Ischinger", *Xinhua*, February 2, 2011; "China Says it will Continue Exchanges with NATO", *Xinhua*, February 12, 2010;

⁵ In an interview with CNC (Xinhua) at NATO HQ on Nov. 24, 2010.

⁶ Interview with CNC on Sep 17, 2011 at NATO HQ.

⁷ Masako Ikegami, "NATO and Japan: Strengthening Asian Stability", *NATO Review*, Summer 2007.

⁸ Assen Agov, "The Rise of China and Possible Implications for NATO", Political Committee, NATO Parliamentary

Following the visit of the Director General of the Chinese Ministry of Foreign Affairs to NATO Headquarters in 2007, the political dialogue on senior staff level has been taking place on a rather regular basis. In May 2007, NATO Military Committee Chairman, General Ray Henault expressed that in addition to political relations, NATO wants to establish direct “military-to-military” relations with Chinese armed forces and shake off the embassy-bombing shadow.⁹

The NATO Assistant Secretary General for Political Affairs and Security Policy has visited China twice, looking for non-member partners, with the last visit dating back to July 2010. The political dialogue was further strengthened by the visit of Deputy NATO Secretary General Claudio Bisogniero to China in November 2009. The exchanges with senior Chinese officials, including Chinese Vice Foreign Minister Zhang Zhijun, covered a wide range of issues such as the stability of Afghanistan and Central Asia, the fight against terrorism and the fight against the proliferation of weapons of mass destruction, as well as maritime piracy. This resulted in the agreement that the NATO-China dialogue can contribute to international stability and prosperity, with both sides working together to increase transparency and co-operation.

In contrast to the political exchanges that have been going on for several years, there has been little military-to-military contact between China and NATO. However, in June 2010, a delegation of senior PLA officials visited NATO headquarters. Some saw this first visit by a Chinese delegation as an opportunity to build military-to-military relations to enhance confidence building between China and NATO. In March 2011, Chinese navy engaged with NATO navy conducting counter-piracy missions Operation Ocean Shield in the Gulf of Aden.¹⁰ Commander of NATO’s counter piracy maritime forces, Commodore Michiel Hijmans of the Royal Netherlands Navy hosted Commodore Han Xiaoh, Commander of the Chinese Counter-piracy task force on NATO flagship HNLMS Tromp at the sea of Gulf of Aden.¹¹ In January 2012, Rear Admiral Sinan Azimi Tosun, Commander of NATO’s Operation Ocean Shield, and his Chinese counter part, Rear Admiral Li Shihong paid reciprocal visits to each other’s flagships on the same day, while the Chinese Task Group ships were escorting a convoy and the NATO

Flag ship, a Turkish frigate named TCG Giresun, was patrolling through the Gulf of Aden.¹²

Such practical co-operation has included shared access to the MERCURY¹³ maritime information tool and de-confliction and co-ordination of counter-piracy efforts through the Shared Awareness and De-confliction (SHADE) meetings between counter-piracy mission contributors. China has also signaled its intention to take on areas of responsibility in the Internationally Recommended Transit Corridor (IRTC)

Assembly, October 2011.

⁹ “NATO hopes for direct military contacts with Chinese army: Henault”, *Xinhua*, May 24, 2007.

¹⁰ Allied Maritime Command Headquarters News Release, “NATO Flagship Welcomes Chinese Navy Task Force Commander”, March 28, 2011.

¹¹ Atlantic Council U.S., March 28, 2011.

¹² NATO Headquarter Press Release, “NATO and China Cooperate to Fight Piracy”, January 19, 2012.

¹³ EU developed MERCURY network, an IT system that allows navies to jointly assess situation on a minute-by-minute basis.

along the line of the co-ordination guidelines drafted by EU/CMF/NATO.¹⁴ Both NATO and the EU are seeking to developing co-operation with China and remain open to any opportunity to do so.

In February 2012 NATO Director General of International Military Staff, LtGen Jurgen Bornemann, led a delegation to Beijing at the invitation of Chinese military authorities.¹⁵ The NATO delegation met with MGen Qian Lihua, Chief of Foreign Affairs Office of Ministry of National Defense (FAO MND), and General Ma Xiaotian, Deputy Chief of the General Staff of the PLA. The NATO delegation also visited the 3rd Guard Division of the Beijing Military Division. The Program rounded off by meeting with MGen Gao Jingzhou, Commander of Shan'xi Provincial Military Region. Topics included NATO-China military cooperation; reform of Chinese armed forces; NATO reform; NATO operations; situation in Asia Pacific. The result of this meeting was an agreement to deepen cooperation in the number of fields, especially counter piracy, training and education, and to establish annual military staff talks between IMS and FAO MND. LtGen Bornemann invited MGen Qian to visit NATO headquarters early 2013.

Thus contact between NATO and China has mainly developed on the political level. NATO has not established a formal partnership with China and the political dialogue that has taken place discuss NATO's existing formal partnerships.¹⁶ Chinese representatives have participated in a limited number of NATO seminars and conferences, such as NATO's annual conferences on WMD Arms Control, Disarmament and Non-Proliferation. NATO has decided to open courses at NATO education facilities to representatives from countries that have expressed interest, so that for example, Chinese representatives can attend courses at the NATO School in Oberammergau, Germany.

In the view of the NATO Parliamentary Assembly that published an October 2011 report on NATO engagements with China,¹⁷ it would be desirable to strengthen the nascent dialogue between NATO and China. A rising China can play an important constructive role in regional and global security and engage in "co-operative security", one of NATO's three essential core tasks in the Strategic Concept adopted at the Lisbon Summit in November 2010. The report views that China and NATO's common interests in Afghanistan, Central Asia, maritime piracy and WMD proliferation provide a basis for future cooperation.

(2) To what extent do NATO's approaches to China complement U.S. security interests vis-à-vis China? Does NATO engagement complement (or undermine) U.S. interests in light of the National Defense Authorization Act of 2000, which prohibits the U.S. military from engaging in cooperative activities that might enhance the combat capabilities of the PLA?

¹⁴ U.S. led Combined Maritime Force is a multinational naval partnership from Asia, Middle East, Europe and Americas to promote maritime security across 2.5 million square miles of international waters in the Middle East, and is commanded by a U.S. Navy Vice Admiral who also serves as Commander US Navy Central Command and US Navy Fifth Fleet. Deputy commander is a UK Royal Navy Commodore. All three commands are co-located at US Naval Support Activity Bahrain.

¹⁵ NATO Headquarter Press Release, "NATO Military Delegation Discusses Cooperation with Chinese Authorities in Beijing", February 2012.

¹⁶ Assen Agov, "The Rise of China and Possible Implications for NATO", NATO Parliamentary Assembly, October 2011.

¹⁷ Assen Agov, "The Rise of China and Possible Implications for NATO".

As stated earlier, China and NATO mainly have political exchanges at this juncture. NATO's current approaches and objectives towards China as a potential global partner complement U.S. security interests in terms of pooling resources to address issues of mutual concern. These practical areas include maintaining regional stability in Afghanistan and Central Asia, counterterrorism, anti-piracy/maritime security, counter-narcotics, WMD proliferation and energy security.

NDAA 2000 prohibits the Secretary of Defense from authorizing any mil-to-mil contact with the PLA if the contact would "create a national security risk due to an inappropriate exposure" of PLA to 12 operational areas (exceptions granted to search & rescue, humanitarian operations or exercise) including advanced combat operations, force projection, logistical operations, surveillance and reconnaissance and military technology transfer.¹⁸ As such DoD has sought areas of cooperation such as humanitarian assistance, peacekeeping, disaster relief, educational exchanges, and dialogues as ways to enhance understanding and reduce misperceptions. NATO is exploring similar issues for practical cooperation with China. Anti-piracy is already an area of cooperative engagement between NATO, China, EU and other naval powers in the Gulf of Aden, and can be a template for further cooperation in other issue areas.

Benefits of China-NATO cooperation. In an age of fiscal austerity, NATO needs to pursue smart defense of pooling resources together to cut cost, as well as seek new partners to spread the cost of operations. With respect to partners who do not share similar values as NATO members, it is useful to use the analogy of the marketplace to define the terms of the partnership. When two competing firms are in the marketplace, sometimes due to high R&D sunk costs, they would enter into a joint venture or strategic partnership on that particular product area, while still remaining competitors in all other aspects in the market place. As such, anti-piracy and counter-terrorism are product/issue areas for practical cooperation between China and NATO.

NATO can be an alternative forum for U.S.-China engagement, since it is already evolving as a global security forum for dialogue and cooperation with its global networks of partners. Moreover, NATO's anti-piracy operations in the Gulf of Aden and engagements with China as well as other navies the past three years through SHADE (Shared Awareness and De-confliction) model of sharing information, has been a successful model of cooperation on maritime terrorism. SHADE can perhaps be an effective template for cooperation on overland terrorism in AfPak. Whereas with SHADE for anti-piracy in Gulf of Aden involved U.S. led Combined Maritime Forces (CMF), NATO, EUNAVFOR, and other navies, SHADE for anti-terrorism in AfPak could involve U.S., NATO/ISAF, EU, China, SCO and other

¹⁸ Section 1201 (a) of National Defense Authorization Act of FY 2000 (PL 106-65); Shirely A. Kan, "U.S.-China Military Contacts: Issues for Congress", CRS Report RL32496, February 10, 2012. The 12 restricted areas are: (1) Force projection operations; (2) Nuclear operations; (3) Advanced combined-arms and joint combat operations; (4) Advanced logistical operations; (5) Chemical and biological defense and other capabilities related to weapons of mass destruction; (6) Surveillance and reconnaissance operations; (7) Joint warfighting experiments and other activities related to transformations in warfare; (8) Military space operations; (9) Other advanced capabilities of the Armed Forces; (10) Arms sales or military-related transfers; (11) Release of classified or restricted information; (12) Access to a DoD laboratory.

stakeholders.

SHADE can also be a template for central clearinghouse for anti-terror operations. China, U.S./NATO, and Pakistan are concerned about FATA (Federally Administered Tribal Area) being used as a launching pad by TIP (Turkistan Islamic Party), al Qaeda, Taliban, Haqqani network to attack Xinjiang, Afghanistan and Pakistan. China is considering setting up military bases in FATA¹⁹, where its insurgents are already fighting Pakistan forces as well as U.S., NATO and Afghan forces in Afghanistan. As such, similar to the Gulf of Aden where various navies are fighting piracy and clearing their information through SHADE, various troops fighting insurgents in Afpak could also clear their counter-terror information through a SHADE type forum.

NATO's objective of working with China to stabilize Afghanistan supports U.S. interests vis-à-vis China in Afghanistan. China's influence over Pakistan and as a neighbor of Afghanistan plays an integral role in Afpak post 2014 when NATO combat forces depart. China, with its \$3.2 trillion war chest, can also contribute to the NATO-ANA (Afghan National Army) Trust Fund or UNDP's Law and Order trust fund mainly funded by Japan to help train ANSF, since China benefits greatly from an effective ANA/ANSF to maintain Afghan stability and help protect China's massive investments in the country.²⁰ China is already engaged in limited training with ANA and ANSF for mine clearing, and in 2010 Chinese defense minister Liang Guanglie offered Afghan defense minister Abdul Rahim Wardak for PLA to train them after NATO forces depart.²¹

Risks of China-NATO mil-mil. There are of course risks associated with increased Chinese PLA access to NATO, such as possible intelligence and defense technologies flowing to China, especially in light of the recent cyber attack of using a fake Facebook page of NATO SACEUR to target NATO officials' personal information as well as cyber attacks against NATO ISAF headquarter in Afghanistan that may have compromised NATO logistics and troop movements.²² Joint counter terrorism efforts may require shared intelligence/classified information, surveillance and reconnaissance, and possible military technology transfer which would violate NDAA 2000 restrictions. As such, any NATO-China counter-terrorism cooperation would most likely need to be confined at the dialogue and coordination level, such as what's been taking place through SHADE with anti-piracy operations in the Gulf of Aden.

¹⁹ Amir Mir, "China seeks military bases in Pakiston", *Asia Times*, October 26, 2011; Christina Lin, "How Pakistan's Unstable Tribal Area Threatens China's Core Interests", *China Brief*, Vol. 12, Issue 1, January 6, 2012; *Xinhua*, September 27, 2011; "China and Pakistan: Evolving Focus on Stability Within Continuity", *China Brief*, November 30, 2011

²⁰ Campbell Clark, "NATO allies eye China in Afghan security cash crunch", *Globe and Mail*, February 3, 2012; CR Radin, "4 threat Matrix: Funding the Afghan National Security Forces", *The Long War Journal*, September 16, 2011; NATO, "Afghan National Security Forces (ANSF): Training and Development", December 2011.

²¹ "China pledges military co-op with Afghanistan, Nepal", *Xinhua*, March 25, 2010; Jeff Stein, "Report: Chinese Court Afghanistan's Karzai", *Washington Post*, April 30, 2010.

²² Anna Mulrine, "Computer Virus Hits U.S. Military Base in Afghanistan", *U.S. News*, November 28, 2008; Lucian Constantin, "Cyber-Attack Cripples Critical U.S. Military Networks", *Softpedia*, December 1, 2008; "West accuses China of cyber attacks against U.S. personnel in Afghanistan", *The Hill*, June 3, 2011; Emil Protalinski, 'Chinese spies used fake Facebook profile to friend NATO officials', *Znet*, March 11, 2012; Nick Hopkins, "China suspected of Facebook attack on Nato's supreme allied commander", *The Guardian*, March 10, 2012; Jason Lewis, "How spies used Facebook to steal Nato chiefs' details", *The Telegraph*, March 10, 2012.

There is also risk of third party transfer of intelligence and military technologies to rogue regimes, state sponsors of terrorism and their terrorist proxies such as North Korea, Burma, Iran, Hamas and Hizbullah. As a further negative spillover, this would increase fears of Japan, South Korea, Taiwan, Vietnam, Philippines, and other countries in East Asia and South East Asia of an altered Asian military balance in China's favor, and the possibility of threatening U.S. soldiers and military assets with Chinese weapons produced by NATO allies.

Additionally, there is a risk of China using its access within NATO to drive a wedge between U.S. and its European allies. A UPI article in 2008 revealed an internal Chinese document of such a plan to take advantage of NATO's "internal contradictions", especially via targeting France and Germany, strengthening China-Europe economic and trade relations, and split Europe from U.S. to acquire EU support on Taiwan, technology transfer and lifting of EU arms embargo.²³

There are also risks to NATO with China cooperating with NATO members bilaterally, not under a NATO banner. As such, NATO members need to be aware and exercise due diligence that their interactions with China do not conflict with NATO regulations and concerns. For example, China's air combat exercise with NATO member Turkey in October 2010 poses a risk to NATO, although it was not under a NATO banner. It risked NATO combat tactics and intelligence flowing to China. China has also targeted Eastern European NATO members such as Poland and Romania or those in the waiting room such as Macedonia for military cooperation.²⁴ For example, in 2009 Polish Defence Minister Bogdan Klich inked accord with Chinese Defence Minister Liang Guanglie to cooperate in military training, medical services and research, and to observe each other's military exercises, as well as cooperate in peacekeeping and aid missions. In February 2010 Romanian Defense Minister Gabriel Oprea, Secretary of State for Defense Policy and Palnning Viorel Oancea and chief of General Staff Admiral Dr Gheorghe Marin received a delegation headed by General Ma Xiaotian, deputy chief of General Staff of PLA. Talks agenda included integration of Romanian armed forces into the military structures of NATO and EU, as well as armed forces modernization, and mutual teaching and training of exercises.

(3) How do NATO efforts to protect the global commons (space, cyberspace, maritime space, the Arctic) reflect and address relevant developments in China?

NATO's efforts to protect the Arctic and cyber space were originally driven by Russia. Russia in 2007 staked Arctic territorial claims by placing a flag in a titanium capsule on the ocean floor, and resumed

²³ Andrei Chang, "Analysis: NATO Keeps Eye on China", *UPI (Hong Kong)*, February 8, 2008; Marta Dassu and Roberto Menotti, "How China could divide the West", *Europes World*, Autumn 2005.

²⁴ Jorge Benitez, "Could China fill a power vacuum in eastern Europe?" *The Atlantic Council*, November 21, 2009; "China, Austria pledge to further military ties", *People's Daily*, January 21, 2010; "China, Poland Sign Military Cooperation Deal", *AFP*, December 27, 2009; "Chinese military delegation welcomed at Romanian Ministry of Defense", *Financiarul (Romania)*, February 2, 2010; "China, Macedonia agree to strengthen military ties", *Xinhua*, December 15, 2011.

strategic bomber flights in the region.²⁵ It views the energy sources as a centerpiece of its next generation energy policies.²⁶ China is increasing its activism with four Arctic expeditions since 1999 and seeking to be an observer of the Arctic Council, but as a non-Arctic state it is difficult to advance its national interests in the region. As regards maritime policy, China is not viewed as challenging NATO's immediate concerns in North Atlantic, the Mediterranean, and increased piracy in Gulf of Aden, but NATO does acknowledge China's increased aggression in the Asia Pacific Rim and South China Sea.²⁷ NATO envisions playing a role to help politically to shape rules that are being challenged, and help keep Global Commons secured and their access assured.²⁸

NATO factors China more in its addressing space and cyberspace, although NATO currently does not have a space policy.²⁹ It has focused more on cyberspace. NATO began to address cyber defense after suffering attacks from Serbia, Russia and China in 1999 during Operation Allied Force in Kosovo.³⁰ These incidents included denial of service attacks and defacements of the webpage for the Supreme Headquarters Allied Powers Europe as well as U.S. military, after NATO's accidental bombing of Chinese embassy in Belgrade.

In 2002 NATO adopted the Cyber Defense Program and issued subsequent guidance, but it was not until the 2007 Russian cyber attack that disabled the Estonian government for 3 weeks that NATO stood up institutions³¹ and enhanced capabilities to counter cyber attacks. In 2011 NATO started to formulate a rapid reaction team concept to assist member states under attack.³² The creation of this team was the result of NATO cyber defense policy revised by defense minister in June 2011 after Estonia and Georgia experienced cyber attacks from Russia. However, NATO is cognizant of cyber attacks from China and increasingly paying heed to this threat, such as the 2009 NATO Review video entitled "China and the West: keyboard conflicts?".³³

(4) How does China view the role of NATO as it begins to draw down its operations in the Af/Pak theater?

²⁵ Eddie Walsh, "How Norway Sees the Arctic", *The Diplomat*, February 22, 2012; "Russia opposes 'mini-NATO' in Arctic", *Xinhua*, September 15, 2011;

²⁶ Stephen Blank, "Putin piles on Arctic pressure", *Asia Times*, January 4, 2012.

²⁷ Brooke Smith-Windsor, *Securing the Commons: Towards NATO's New Maritime Strategy*, NATO Defense College Research Paper, No. 49, September 2009; ACT Workshop Report, "NATO in the Maritime Commons" September 30, 2010.

²⁸ ACT Workshop Report, "NATO in the maritime Commons", September 30, 2010 in NATO Allied Command Transformation, *Assured Access to the Global Commons – Final Report*, 2011.

²⁹ NATO Allied Command Transformation, "Assured Access to the Global Commons Final Report", 2011; Major Thomas Single, USAF, "NATO Space Operations Assessment", Joint Air Power Competence Centre (JAPCC) Revised January 2009; Thomas Single, Major (USAF), "Considerations for a NATO Space Policy", ESPI Perspectives No. 12, September 2008.

³⁰ Jason Healey and Leendert van Bochoven, "NATO's Cyber Capabilities: Yesterday, Today, and Tomorrow", *Atlantic Council Issue Brief*, February 2012.

³¹ Cyber Defense Management Authority (CDMA) and Cooperative Cyber Defense Center of Excellence (CCDCOE) in 2008.

³² "NATO Cyber Defence Rapid Reaction Team operational by end 2012", Cyberwar Zone, March 30, 2012.

³³ Jorge Benetiz, NATO warns of Surge in Cyber Attacks from China", Atlantic Council, March 8, 2010; Jason Miks, "Facebook Attack Hits NATO", *The Diplomat*, March 14, 2012.

China does not want a permanent NATO military presence in AfPak, but envisions NATO still playing a residual role to address the continuing threat of terrorism. China's Foreign Minister Yang Jiechi stated in the December Bonn conference on Afghanistan that China would like SCO to play an increasing role as NATO is decreasing its role, and Chinese scholars have even proposed NATO-SCO cooperation in counter-terrorism, as well as having an alternative forum for U.S.-China engagement in AfPak and Central Asia.³⁴

A Chinese scholar from Shanghai Academy of Social Science recently proposed a NATO-SCO mechanism to enhance U.S.-China cooperation and reduce conflicts in Central Asia. The liaison mechanism is to begin with coordinating anti-terror issues between US/NATO and the SCO, which could be progressively upgraded to SCO + U.S. (SCO + 1) dialog or SCO + U.S., EU (NATO), Japan (SCO + 3) dialog, and eventually upgraded to SCO Regional Forum (SRF) like ASEAN Regional Forum (ARF).³⁵ NATO already has cooperation with all SCO members except China (e.g., PfP with Central Asia and NATO-Russia Council with Russia), so it seems logical that NATO engages with China as well in AfPak.

Moreover, Chinese writings have referred to Central Asia as China's Dingwei, or Lebensraum as espoused by Hitler on being entitled to having additional living space for its population.³⁶ So China does not want NATO to leave abruptly, but has an interest in NATO maintaining residual capabilities and support to ANA/ANSF to combat terrorism as SCO transitions in while NATO transitions out. This NATO-SCO cooperation mechanism would allow China to maintain border stability in AfPak—its strategic frontier zone—which affects both its internal security of Xinjiang as well as external security of Central Asia. As such, SCO would allow China to expand influence on its new “Xinjiang” of AfPak—“Xinjiang” means “new frontier” in Chinese. Masako Ikegami from Stockholm University has observed China's different concept of sovereignty from the West. The Chinese concept of an expansionist sovereignty is based on the “strategic frontiers doctrine” of flexible territorial borders that expands or contracts according to national power projection, which differs from the western Westphalian concept of sovereignty based on stationery borders.³⁷ Thus as SCO increases its role in AfPak, this would allow China to project influence on its Dingwei.

³⁴ Zhang Haizhou, “SCO can play ‘bigger role’ in Afghanistan”, *China Daily*, December 6, 2012; Chris Dalby, “Afghanistan offers common cause for SCO and NATO”, *Global Times*, June 19, 2011; Christina Lin, “China’s Silk Road Strategy in AfPak: The Shanghai Cooperation Organization”, ISPSW/ETH Zurich, June 2011; Richard Weitz, “Building a NATO-SCO Dialogue”, European Dialogue, March 14, 2011; “Where Russia and China Support NATO”, *Strategy Page*, March 30, 2012;

³⁵ Pan Guang, “China and US in Central Asia: Role of the SCO and Possibility of Cooperation in Afghanistan”, *China US Focus*, September 7, 2011.

³⁶ Tariq Mahmud Ashraf, “Afghanistan in Chinese Strategy Toward South and Central Asia”, *China Brief*, Vol 8 Issue 10, May 13, 2008; Nicklas Swanstrom, “China’s Role in Central Asia: Soft and Hard Power”, *Global Dialogue*, Vol 9 Issue 1-2, Winter/Spring 2007.

³⁷ Masako Ikegami, “Neo-Imperialism: China’s Quasi-Manchukuo Policy toward North Korea, Mongolia, and Myanmar”, *Tamkang Journal of International Affairs*, Vol XIC, No IV, April 201a, p. 93; Shigeo Hiramatsu, *Chugoku wa Nihon wo Heigo suru* [China’s Annexation of Japan] (Tokyo: Kodan sha International, 2006); Owen Lattimore, *Inner Asian Frontier of China* (Beacon Press, 1962).

(5) The Commission is mandated to make policy recommendations to Congress based on its hearings and other research. What are your recommendations for congressional action related to the topic of your testimony?

Based on the analysis above, I would like to submit the following recommendations:

1. U.S. within NATO needs to be proactive in shaping NATO's approach towards China.

- With China's rise on the global stage coupled with U.S. and European fiscal austerity, it's inevitable that NATO will need to engage China. Given this, it is incumbent upon U.S. within NATO to help set the terms of reference and engage European allies and partners regarding U.S. and East Asian partners' concerns vis-à-vis China in the Asia Pacific and Central Asia regions.

2. Use NATO as a global security forum for U.S. and Asian partners such as Japan, South Korea, Australia, New Zealand, Mongolia and others to have a dialogue with European partners to help them understand security issues in the Asia Pacific.

- Europeans and the U.S./Asian allies tend to have a threat perception gap regarding China. Europeans do not have a security stake in Asia similar to U.S. as a security guarantor, and tend to view China through economic lens while U.S. views China through a security lens.
- Japan has already been proactive in educating NATO regarding Asian security concerns via the NATO-Japan Dialogue, and this type of dialogue could be expanded to include other Asian partners. This will help reinforce NATO members and partners solidarity as a value-based alliance and approach China via a policy that furthers NATO interests without compromising NATO's values upon which the alliance was founded.

3. AfPak is a good case for NATO-China cooperation, especially in counter-terrorism. The successful SHADE model for counter-piracy cooperation in Gulf of Aden could be a model for counter-terrorism cooperation in Afpak.

- U.S./NATO and China cooperation in counter-terrorism in Afpak could be based on the Shared Awareness and De-confliction (SHADE) approach currently being employed in the Gulf of Aden. Initially China refused to cooperate with the U.S.-led Combined Maritime Forces (CMF) on antipiracy efforts, but Beijing became more willing to participate once the issues were addressed within a multilateral SHADE forum that brought in the EU, India, Russia, Interpol, and various oil companies alongside the U.S. and NATO. The SHADE model can offer best practices and lessons learned that can apply to a SHADE type model of cooperation in counter-terrorism in Afpak.

4. At DoD, U.S. EUCOM/NATO should submit Chinese defense contact requests to OSD and coordinate with OSD/USDP on China policy. These contacts can be included in the annual China military power report to Congress.

- DoD should establish cross-COCOM coordination with PACOM-CENTCOMEUCOM/NATO working group and coordinate with OSD/USDP on China. Whether it's fighting piracy in Gulf of Aden, maritime disputes in South China Sea, or fighting insurgents in Afpak, CENTCOM and EUCOM/NATO can benefit from coordination with PACOM.
- U.S. military within NATO should be cognizant of NDAA 2000 restrictions so it does not violate U.S. domestic law regarding Chinese defense contacts. U.S. should ensure NATO allies understand NDAA 2000 restrictions for U.S. military and de-conflict defense contact requests by China.

Asian states such as China need to consider cooperation with partners at the global level to address regional problems associated with globalization. In this regard, partnership with NATO should not be excluded. Also, if NATO is going to engage with the Asia region as part of its new strategy of addressing emerging security challenges such as terrorism, piracy and energy security, any engagement strategy should follow a balanced approach that not only targets China, India and Japan, but other interested parties via regional organizations. China's increasing ties with NATO presents a good opportunity for the U.S. to exercise strategic leadership and lead from the front once again, and help shape the trajectory of an Asia whole and free in the 21st century just as it helped shape an Europe whole and free in the 20th Century.

Thank you again for the opportunity to testify, I welcome your questions and comments.

PANEL II: QUESTIONS & ANSWERS

HEARING CO-CHAIR BLUMENTHAL: Thank you very much to all of you. Very provocative and useful testimony.

Commissioner Wortzel.

COMMISSIONER WORTZEL: Dr. Stumbaum, thank you very much for including that great SIPRI table of what our European allies have actually done to arm the People's Liberation Army in your written testimony.

I suggested to Congressman Rohrabacher that the U.S. Congress prohibit European companies that sell such equipment and articles to China from being part of any defense cooperation with the United States. Now, Congressman Henry Hyde actually introduced such legislation about a decade ago.

This would force individual companies, not states, to make business decisions. What effect do you think an approach like that would have on NATO alliance relations?

And then for Dr. Tunsjo --I think it's Article 5 of the NATO Treaty that is essentially the collective defense one, you know, attack on one is an attack on all. Do you believe that that extends into Asia?

DR. STUMBAUM: Thank you very much, Commissioner Wortzel.

So I get your question like if it's reasonable to have legislation to prohibit any kinds of arms sales from the European side to China by sanctioning.

COMMISSIONER WORTZEL: Oh, we couldn't prohibit it.

DR. STUMBAUM: No, by threatening--

COMMISSIONER WORTZEL: Influence it.

DR. STUMBAUM: Yeah, by threatening the sanction, and these kind of laws have already been introduced in 2005 when there was the transatlantic clash about the arms embargo, and it had the effect that the arms embargo was not lifted.

I think when it comes to today's arms sales, those arms sales are not going to take place anyway. As I outlined before, the one reason, because the companies themselves, as you rightly pointed out, make their own decisions, there is no interest for them to jeopardize their access to the U.S. market, and I spoke to several European defense companies about this, and they made this

very clear to me.

On the other side, I think those issues that are still delivered, if you look at this table, most of them date back right before the arms embargo, even to the 1970s. So it's just the very final equipment that has been delivered.

So I think, in general, your point is already well-taken, that there are no real defense exports to China because the companies have taken the decision because of those regulations already in place.

COMMISSIONER WORTZEL: Thank you.

DR. TUNSJO: Thank you. I don't know the technical wording of the Article 5. If my memory serves correct, I don't think it extends to Asia. I think, in particular, the U.S. in the late 1940s was concerned about defending European colonies around the world. So that French or British colonies in Asia or Africa, if the British forces were being attacked, that would sort of lead to an Article 5.

I have to check, but I don't think that this is the correct interpretation so if, for instance, the U.S. would be attacked in the Taiwan Strait, I don't think that that will automatically initiate an Article 5. I might be wrong on that.

But I do think the whole Article 5 is interesting; I think what you might be seeing would be a coalition of the willing. The British sent about, I think it was, 90,000 soldiers to the Korean War in 1950. I don't think that would happen today. I think this comes back to the threat perceptions that are not shared by Europe and the U.S.

So if you had a conflict on the Korean peninsula, the Taiwan Strait or the South China Sea today, that would not cement transatlantic relations in the same way as it did in June 1950.

But maybe I will be corrected when it comes to Article 5. I don't think it extends into Asia.

COMMISSIONER WORTZEL: Appreciate your interpretation.

COMMISSIONER BLUMENTHAL: Commissioner Fiedler.

COMMISSIONER FIEDLER: Following up on that, I would sort of explore the threat perception question a

little deeper. If there is no threat perception, and that is sort of a widely held view among political leaders in Europe, then perhaps Europe is living in "splendid isolation" already, by which I mean it's a statement that essentially we don't value the threat to the United States; we think it's sufficiently different to ignore it.

I mean that's the logical conclusion, right? The question becomes where along the line somebody says, well, it is a threat? So the global commons appears to be a threat problem for everyone. Perhaps the Middle East is, and Iran may be a threat problem involving China. North Korea is not a threat perception problem, is a threat problem? Is that what you're saying actually? North Korea is not perceived as a threat problem in Europe?

DR. TUNSJO: I think history would help. At the height of the Cold War, the outbreak of the Korean War and the British decision to send troops to the Korean peninsula, at the same time, Bevin, the Foreign Minister, sent a telegram to Acheson at that time, two weeks after, on the 14th of July 1950, sent a telegram strongly criticizing the U.S. decision to interpose the Seventh Fleet in the Taiwan Strait.

The British did not see why the U.S. should contain China in that way although they were willing to send soldiers to Korea. And this was at the height of the Cold War. They all shared in the threat perception of Communism as a global threat, and this led to the British, early in the 1950s, extending diplomatic recognition to China and so forth.

It was a very different take on China than the U.S. had, and later on you had the Vietnam War. The Europeans were not involved in that. I think if you had a war on the Korean peninsula today-- even at the height of the Cold War, there was still reluctance by the Europeans, and I think that reluctance is even stronger to commit to a war in Asia today than it was at that time.

And when it comes to all these other issues, when it comes to the global commons, that is a common security concern. The Europeans and the Americans are both encouraging China to be a responsible stakeholder in safeguarding the global commons, and when it comes to Iran, I might leave that to others. But I don't think Europe is

willing to go to war with Iran over Iran's nuclear weapon program.

COMMISSIONER FIEDLER: Okay.

DR. TUNSJO: The U.S. might be.

DR. STUMBAUM: Thank you very much.

I would just like to add to what Dr. Tunsjo said. I think the threat perception, you're right, the EU used to live in "splendid isolation," but I think we're evolving from that position, and we are actually evolving more of a threat perception.

It still differs, but it goes back to the interests of the European Union. So we have about 90 percent of our trade seaborne and a lot of trade actually goes through the Strait of Malacca and the South China Sea. So that is one of the threat perceptions that comes about.

The second thing is that European foreign policy and security policy is about nonproliferation efforts. That's also one of those issues that are being targeted over there. It gets more of a life with the European External Action Service, taking a life now because they actually will be the one to pursue a policy over there.

It will still be a division of labor. It will not be a hard power security. It will involve a soft power security approach, but it will be something that the United States can coordinate with in terms of finding a solution for the region, and they are going to the different countries and trying to find out what they can actually contribute for the region.

So, for example, the East Asian security guidelines are being revised at the moment to have a new outlook on the region.

COMMISSIONER FIEDLER: Thank you.

HEARING CO-CHAIR BLUMENTHAL: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you all for being here.

I'd like to follow up on this line of discussion as well. Dr. Tunsjo, you talked about a new division of labor. It sounds like increasingly separate spheres of influence.

Dr. Lin, in your discussion, you talked about increasing proximity of NATO and Chinese interests in terms Afghanistan. Dr. Lin, how do you view what your colleagues have said regarding Europe becoming more insular, if you will, in this, pulling away from U.S., or the broader

interests?

Dr. Stumbaum talked about the Strait of Malacca and freedom of navigation. What's your view on what your colleagues have said?

DR. LIN: Well, I spoke to some of my European colleagues within NATO, and they're focusing on these emerging security challenges and global commons and maritime security, cyber, energy security, so I don't think that they're pulling away. I think actually they are looking to Asia, and maybe some European countries are pulling away since the EU is made up of divergent countries and interests.

COMMISSIONER WESSEL: Right.

DR. LIN: But I think that with these new emerging security challenges, these are good issues of cooperation, for closer European and U.S. solidarity, especially vis-a-vis China. So from a NATO perspective, I don't think that Europeans are really pulling away, and NATO is really outreaching to different partners in Asia region.

Afghanistan is the starting point, and they're very interested in Central Asia, especially energy security. Energy security is a strategic issue for the European Union. So the EU needs to be engaged in Asia, in Central Asia. Maybe some countries don't, those who are not reliant, like Norway is more independent on energy, now relying on Russia, are pulling away.

COMMISSIONER WESSEL: Right.

DR. LIN: But new European countries, Eastern European countries, Southeast European countries, they have vested interests in maintaining a stake, in maintaining a presence in Asia, especially Central Asia and working with Asian countries.

COMMISSIONER WESSEL: Dr. Tunsjo, did I misread or mishear what you were saying in terms of the new division of labor, what I detected as separate spheres?

DR. TUNSJO: No, I think you nailed it to some extent. What I'm saying is that Europe can better complement a U.S. grand strategy that focuses on Asia-Pacific by being able to maintain stability in Europe, and if they have any extra capacity, to maintain stability in Europe's neighborhood.

If they could be able to do that, for instance, if

European powers could be able to do Libya-type operations, low-intensity type humanitarian operations basically, without the help of the U.S., I think that will complement the U.S. strategy that focuses on China, and it will complement that strategy much more than sending a frigate to the South China Sea to counterbalance China because, frankly, and that goes back to the question I received earlier, there aren't many in Europe who want to pick a fight with China over Taiwan, for instance.

So it might be a coalition of the willing if push comes to shove, but that's not what the European position encourages. So what I'm saying is it's not that Europe will be isolated in any way, but that if, and this is not new, that Europeans--I mean the Americans have been telling the Europeans this for a long time, that they should take more responsibility for their own defense, but I do think that the kind of systemic changes, the geopolitical shifts that we're witnessing, might push Europe more in that direction because, frankly, the U.S. may not be able to operate in two theaters.

It doesn't mean that the U.S. is turning its back on Europe, but it means that Europe may have to take more responsibility.

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR BLUMENTHAL: Thank you.

I'd like to get all of your reactions to this thought, the thought of "splendid isolation." Obviously you've expanded on what you mean by that, which is more take care of your own neighborhood and so on and so forth.

A couple of things strike me, though. One is that every time we think NATO is dead, in "splendid isolation," they do something like lead the way on Libya, as you mentioned. They put forces in Afghanistan even though it was we and not Europe that was attacked.

It seems to me, and Dr. Lin touched on this, that the Chinese, and again I just want a reaction, the Chinese challenge to the United States, in terms of great power politics, impinges upon Europe in the following way: if China is able to essentially take a wrecking ball to the current world order that the United States dominates, then it affects everybody.

So if China is able to frustrate U.S. capabilities

to keep the peace in the Persian Gulf, to keep the peace in the Asia-Pacific, to keep the sea lanes of communication open, and the Malacca Strait and the Strait of Hormuz, if it frustrates U.S. ability to denuclearize Iran, it seems to me that there is no way that NATO can or Europe can operate in "splendid isolation."

It seems to me that this becomes a systemic challenge in terms of what the world order looks like. So, again, the interconnectedness of it all, as Dr. Lin mentioned, in terms of China moving into the Mediterranean and other places, seems that it would be very difficult, if not impossible, for Europe to not be engaged in helping the United States uphold the order against China's challenge.

I'd like your reaction.

DR. TUNSJO: No, I absolutely agree, but I think we need to agree on what is the primary objective of NATO and that is maintaining stability in Europe. If there are spare capacities, so to speak, yes, contributing in counter-piracy operations, as they do today, in the Gulf of Aden is a good thing, and all the other things.

But in the end, I don't see a global NATO being a reality basically. I don't see the resources there, and I don't see European countries being willing to commit to that. So if they are going to be willing to commit to anything, it will be to maintain stability in Europe and in Europe's neighborhood, and that is a major challenge.

You may say that NATO contributed in Libya, but the two great powers in Europe, France and Britain, they ran out of munitions after two weeks, and that was a low-intensity conflict. So if you're facing a high-intensity conflict with China in the South China Sea or the Taiwan Strait, of course, you have a third world war, things will be very different, but that is not a question about international order.

So we have to keep this separate, and I think NATO can do more on maintaining international order, but this is about engaging China. This is shared global common goods, the same with global governance through the U.N., and the other thing is, of course, the Europeans are reluctant to -- well, let me first say that China doesn't have an alternative order to put forward. So there might be a long time until there is an alternative to the order that we

presently have.

But then, for instance, take energy security and the International Energy Agency, the European states are reluctant to bring China on board as a full member. I'll leave it now to my--

HEARING CO-CHAIR BLUMENTHAL: Yeah. Dr. Stumbaum.

DR. STUMBAUM: Yes. Thank you.

Just a very short remark to add to this. I would slightly deviate from what Dr. Tunsjo said. I think that European Union member states are not, in general, unlikely and unwilling to contribute. I think it will be selected fields where the European Union member states can be of help. On the European Union side, there is a clear indication that they want what they call "state relevance."

Catherine Ashton, the High Representative of Foreign Security Policy, said that we need to become more active in the Asia-Pacific in order to be relevant for our main partner, the United States, and also when it comes to NATO. I think NATO primarily is a mechanism for joint action, and the fields where they operate are still to be chosen.

So I would deviate from this opinion; I think the European Union and its member states, and also within NATO, will never come to rival U.S. power, but it will probably complement in some areas that might be of use.

Thank you.

HEARING CO-CHAIR BLUMENTHAL: Chairman Shea.

CHAIRMAN SHEA: I want to thank all three of you for being here. It's nice to see three doctors all lined up in a row.

But this is for Dr. Tunsjo. We're not picking on you. I'm sorry, but--

[Laughter.]

CHAIRMAN SHEA: It's about China and the Arctic, and you mentioned very briefly in your testimony that the gradual melting of the Arctic may allow China to diversify its trade routes and I suppose, to help address its so-called "Malacca dilemma."

Could you tell us about the potential viability of Arctic trade routes? What capabilities would a country need to have in order to take advantage of those particular trade routes? What are China's capabilities?

And then after that, you mentioned here, "With no authoritative Arctic strategy published by the central government, it appears that alarmist voices have been allowed to shape China's public debate over its Arctic policy."

What are you referring to there?

DR. TUNSJO: Let me just take the last one first.

CHAIRMAN SHEA: Sure.

DR. TUNSJO: The last one first. Well, I haven't found, I haven't seen any official Chinese Arctic strategy.

CHAIRMAN SHEA: Neither have we.

DR. TUNSJO: Excuse me?

CHAIRMAN SHEA: Neither have we.

DR. TUNSJO: Yeah. It might indicate, and this is only speculation, that it's not a priority basically, but rumors are that they are working on one, and it's currently with the Ministry of Transportation, who is integrated with other ministries.

So I wouldn't be surprised if something comes out in a few months or a year or something, but, yes, this is a vacuum, and some pundits, some military officials--

CHAIRMAN SHEA: In China?

DR. TUNSJO: --in China have sort of strongly advocated in alarmist terms about what China's position should be in the Arctic. The few official statements I've seen say that they do respect the sovereignty rights of the Arctic states and the Law of the Sea and UNCLOS as the legal framework for Arctic.

And if you do that, most of the Arctic resources are located within the EEZ or the continental shelves of the coastal states. So there isn't that much to really fight over.

When it comes to the trade, well, the routes--and it's interesting because this has also been hyped--first of all, are very limited now. Of course, there is a huge potential there, but even the sort of best scenarios construe the ice melts, you will still have floating ice; you would have six months of darkness; you would have very harsh conditions; you'll have limited infrastructure. It is a difficult area to operate.

As a shipping company, you will have to pay high insurance premiums. I haven't seen the numbers of those

shipping companies involved, whether they can make a profit or not. They're still in the early stages. Big container shipping companies like Maersk are saying this is not a business opportunity because they rely on punctuality, which means that even though the route is shorter and they can save time and fuel, it doesn't mean that they will save money because--

CHAIRMAN SHEA: Contingencies.

DR. TUNSJO: --if the container ship arrives like two days earlier, that's not good for business because the whole logistics chain is just waiting for it to come in on a particular day at a particular time. So, and then very large crude carriers, well, the Bering Strait is between 100 and 160 feet deep, it will be challenging to maneuver very large crude carriers through that Strait. If you have an oil spill in that region, it's an environmentally fragile region, you're basically bankrupt. So there is a lot of risks here, and I think there will be some time until there will be a strong commercial trading route.

And let me just finish on this Malacca dilemma. I just finished a book on China's energy security policy, and China does not face a Malacca dilemma. First of all, if any power, and it's only the U.S. who can blockade the Malacca Strait from China's oil import, then you're talking about a war between the U.S. and China. There's nothing China can do about the Malacca Strait because they don't have a Navy to challenge the U.S. on the high sea.

When it comes to a blockade, a terrorist attack or an oil spill or a collision or something like that, you have alternative routes. You can go through Sunda, Lumbang-Makassar, circumnavigate all the way around Australia for that sake.

But the key point here is that China has done a number of things to manage that particular peacetime risk. So they're not really vulnerable, and then the final point here is that they have enough oil domestically. They produce four million barrels a day. In 2004, when the U.S. waged war in Iraq and Afghanistan, they spent 395,000 barrels a day. So China, they produce ten times more oil than the U.S. needed to wage two wars and maintain military activity all around the globe. So it's not a question about waging war with China.

Thank you.

CHAIRMAN SHEA: Thank you very much.

HEARING CO-CHAIR BLUMENTHAL: Commissioner Bartholomew.

HEARING CO-CHAIR BARTHOLOMEW: Thanks very much.

It's interesting, and it's interesting even with your different views to think about different futures for Europe.

Just one comment, Dr. Tunsjo. When you mentioned that China does not have an alternative order, I would note that certainly there are people in Africa who believe that the Chinese model is a good idea. For example, the recent opening of the African Union Headquarters in Addis, a building that was designed by Chinese architects, made out of Chinese material, and built primarily by Chinese labor, will be maintained by China: the president of Ethiopia actually was on record saying that the Chinese model was a really good model, and he thinks that that might be the future of Africa.

So that doesn't mean that everybody agrees. I'm sure Robert Mugabe agrees with it, and there are a number of other countries that do. It's just something to keep an eye on as autocratic or governments that might be leaning autocratic find that they can do some economic growth without having to do rights. Just a comment.

A question, though. First, there's the whole issue of freedom of navigation, and does Europe end up being free riders as the U.S. maintains freedom of navigation and what does that all mean?

Congressman Rohrabacher was talking about Russia, and I found myself thinking as you were all testifying, what does it mean for Europe if there is a much closer alliance between Russia and China because it really does bring things to the back door of the EU? Do you think that, Dr. Tunsjo, your scenario would change if there's a closer alliance? And the rest of you, I'd be interested in your comments on it.

DR. TUNSJO: Yeah, I feel that I'm occupying--I'll let May-Britt also weigh in on this--but on Russia, I very much like Representative Rohrabacher's statement. I think Russia is a key player in this strategic game.

The China-Russia strategic partnership is not

really there. They started out with a strategic partnership in the 1990s as sort of asymmetric great powers. Today, there is no symmetry between China and Russia in East Asia. China is dominating East Asia, and the Russians are becoming concerned about it.

And also when you look about arms trade, for instance, you know, it's been dropping. Since 2006, I don't think there has been many major deals going on, mainly because the Chinese are copying Russian military technology and also because they are competing with them internationally in the international market.

When it comes to oil trade, energy relationship, they have been struggling, although they have the pipeline came about a year ago or something. When it comes to sort of the three evils, things are falling apart. The U.S. was a sort of unifying thing to try to push U.S. out of Central Asia; now they're leaving. China is becoming a concern for Russia and Central Asia. They have become a dominating, sort of actor in Kazakhstan, in Tajikistan, signing oil deals with these countries and gas deals with Turkmenistan, in particular, which is undermining Russian interests.

So there is a lot of uncertainty about the relationship. It can go either way. It could actually go the way that Rohrabacher pointed to, that Russia actually links up more a Russia card, not a China card, but a Russia card. You know, if U.S.-China relations become more tense and rivalry and conflict become stronger, then sort of, not an alliance with Russia, but closer diplomatic relations between the U.S. and Russia is not unthinkable in order to balance against China's dominating position in Asia.

So I wouldn't be surprised about it, but, of course, it could go the other way around. The Syria case points to this, but China is very concerned about this development, and I think what they did in Syria, one of the reasons, was that they showed the Russians what a strategic partnership means today by, you know, we can support you on this particular issue. Syria means more to Russia than it does to China, and so they sort of found an argument for strategic partnership. Whether that would hold for a long time, I can't say.

Finally, on Europe, a strong China-Russia relationship, a robust strategic partnership, may leave

Russia more of a free hand in Europe. They can put more pressure on the Baltic states in East Europe, especially as the U.S. is going down to sort of a one-and-a-half grand strategy.

And the other way around, I think, is more that they're actually going, not going to cement their strategic alliances is more likely.

COMMISSIONER CLEVELAND: Dr. Stumbaum.

DR. STUMBAUM: Thank you.

Two very short remarks. One, about your comment about that China has an alternative model. Yes, but it hasn't really presented an alternative world order model. So there are academic exchanges at the moment about global governance with Chinese characteristics, but it hasn't gone beyond this.

Secondly, just to complement what Dr. Tunsjo just said, I think the relationship between China and Russia has been as close as it gets, and I don't really see this in the near future to become much closer for two reasons.

One reason, as he said, there is a dynamic balance in terms of competition between both the sides, and if you look at the Shanghai Cooperation Organization, this organization has served very well to keep that rivalry unbloodied, but not really to make this a real partnership. One of the reasons why the SCO is not a new NATO, as it was heralded in the beginning, you see further cooperation on issues such as Syria, but for example, in the arms cooperation, this has gone down increasingly.

Arms exports from Russia to China have fallen dramatically. They once made up about 80 percent of all Chinese imports, and they're now to a very low level. There have been no new deals since 2005, primarily because China demanded more technology transfer and Russia was just not willing to grant that.

DR. LIN: I don't really see a strong China-Russia strategic partnership towards Europe in any near future, and like my colleague said, it's more strategic cooperation in Central Asia that is their strategic backyard. China wants to maintain non-aligned "stans" so it's using SCO to protect its power, and there's a balancing. Russia is using CSTO to try to sort of retain power in its sphere of influence and also trying to build a Eurasia Union.

And then there's another player. There's Sino-Russia competition, but I think there is also Turkey which is emerging as a very important power in Europe and also in Central Asia, across Eurasia, and not many people realize this, but Turkey, Pakistan and Iran are the founding members of ECO, Economic Cooperation Organization, which was founded in 1985, and then they expanded to include the Central Asian, the Muslim countries in Central Asia and Caucasus. It includes the five Central Asian republics, Afghanistan and Azerbaijan, and they were admitted in 1992.

So there is quite a bit of overlapping and cooperation between ECO and SCO, especially in transport corridors across Eurasia, sort of China's version of the New Silk Road. It's slightly different from the U.S. version of the New Silk Road Initiative. So ours is sort of going from Central Asia, South Asia, sort of top down, and then to Europe, and theirs is just kind of east-west. So they're building these transport corridors, ECO projects from Xinjiang.

So it's like an Islamic corridor from Xinjiang in China through Afghanistan, in the Herat, and in Iran and Turkey and on to Europe. So there are a lot of these transport corridors happening in Central Asia and Eurasia. So Turkey is very active. It's not just Russia and China.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

HEARING CO-CHAIR BLUMENTHAL: Commissioner Cleveland.

COMMISSIONER CLEVELAND: Dr. Lin, I have three questions for you based on your testimony on page six. You note that China is considering setting up military bases in FATA. How realistic do you think that is? And what would the risks be?

In the next paragraph, you talk about the Chinese, in light of recent cyber attacks, using fake SACEUR Facebook page, and then cyber attacks against NATO ISAF Headquarters. What was behind that? What do you think the motivation was and what were the Chinese testing?

And then the third question is in the last paragraph, you talk about a risk of China using its access within NATO to drive a wedge between the U.S. and its European allies, and report on a recent Chinese document that reflects a plan to take advantage of NATO's internal

contradictions, especially targeting France and Germany and strengthening China-Europe trade relations.

Can you elaborate a little on that as well? Thank you.

DR. LIN: Thank you.

On the first question about FATA, this may happen in the future, though I don't know about setting up. There are bases, Pakistan bases, in FATA. There are some writings on that, but at this stage, it is speculative. I mean there's Chinese writings on it, and they already have deployed XPCC sort of paramilitary troops in northern Pakistan on construction projects. XPCC is Xinjiang Production. So they already have some sort of paramilitary and military troops in Pakistan.

And they've already deployed their elite counterterrorism force, the Snow Leopard, to Afghanistan. They're small in numbers, but they're in Afghanistan protecting Chinese embassy in Kabul and other assets.

So if Pakistan is unable to clean up its backyard and get a-hold of TIP, and if TIP continues to launch these attacks in Xinjiang, I think China will be compelled to seriously consider setting up joint bases with Pakistan in FATA or in FANA where they have already have some troop presence.

The second question on cyber, just from what I found in my research, the Facebook, that was, they call it social engineering, and that was just trying to collect information of NATO officials. I mean they're very good at bundling different information throughout time to build dossiers or to find some nuggets and tidbits of information that would help them.

And regarding the attacks in NATO ISAF Headquarters in Afghanistan, from what I read, the information that was exported in the computers in Afghanistan were on troop movements and logistics. So I don't know if they were giving that information to other groups, Taliban or Pakistan, but--

HEARING CO-CHAIR BARTHOLOMEW: When you say you don't know, you mean you don't know, but you think it might have happened or--

DR. LIN: I read some reports; I'm speculating that they may have been giving some information to Afghan

Taliban. China has good relations with Afghan Taliban, not so much with Pakistan. In the 1990s, China had a modus vivendi with Afghan Taliban too--Huawei was laying fiber-optic networks, in exchange for Taliban denying Afghanistan as a launching pad for ETIM to attack Xinjiang, so they have a legacy relationship with Taliban.

There was also a report in December 2010 about China training some Afghan Taliban on use of infrared SAMs. So it's kind of a tricky situation.

[Laughter.]

COMMISSIONER CLEVELAND: And the third question?

DR. LIN: Oh, sorry. Third question.

COMMISSIONER CLEVELAND: That just stunned us all.

[Laughter.]

COMMISSIONER CLEVELAND: But the third issue, the third point was on the China's use of access to drive a wedge.

DR. LIN: Oh, yeah, that was, it was a UPI article about this. China has been targeting NATO with the transatlantic divide, and they're trying to exploit that. I haven't seen the report, but it was just based on this UPI article talking about it. And other media, Chinese media, have always talked about trying to drive a wedge between U.S. and the big European countries.

So they may try to do that. That's a risk we need to consider when NATO upgrades its engagement with China.

HEARING CO-CHAIR BLUMENTHAL: Round two.
Commissioner Fiedler.

COMMISSIONER FIEDLER: What sort of cyber damage has China done to Europe? In the United States, we've received open testimony about massive theft of business technology. We've also received open testimony about targeted attacks on U.S. defense contractors. We talked a little earlier this morning about cyber, but we didn't get into any sort of damage debt.

Can you, do you have anything to contribute to that discussion?

DR. STUMBAUM: Thank you very much for this question.

We've already had this in the previous panel about cyber attacks, and in the security realm, cyber attacks on ministry and on governmental networks have been identified

as one of the major threats, and China is number one and Russia is number two on that. It's actually one of the major efforts, particularly by the Ministries for Interior, Security that are looking after this.

There are also some attempts to solve that issue. For example, the EU has started up an EU-China task force to address this issue. There are also other task forces and conferences, including representatives of the United States, of China, of Russia, of several EU member states, to discuss the problem of cyber.

You might ask why do you want to talk with them if you think that they are the perpetrators, but the idea is basically to find out a bit more about what the other side is doing by also revealing some information on yourself and probably a bit comparable to previous nonproliferation/disarmament issues when you basically spoke to the outside knowing that they had those warheads that you tried to get rid of but still try to find a common solution.

So in the moment, this is how we try to get about this. It's a relatively new phenomenon, and it's not been talked about so openly in public, but for the security services, it's one of the major problems currently.

DR. TUNSJO: I have something on that.

COMMISSIONER FIEDLER: Yes, please.

DR. TUNSJO: I'm not a cyber expert, but it just strikes me that cyber space is one area where Europe and the U.S. can cooperate quite strongly. So, for instance, and even in the security area, I mean we would be naive to think that if the Chinese would launch a preemptive attack on any U.S. military installations in East Asia in a Taiwan conflict or any hypothetical conflict in the South China Sea, that they would not strike sort of NATO and other U.S. allies. I mean that would be, I think that would be a sort of measures that NATO should be prepared to counter.

And I also think that cyber is one area where NATO actually can contribute in cyber attacks against China. So, I would imagine it's easier to do cyber attacks against China than to actually move European troops to Asia. So in that sense, I'm not a cyber expert, but I do think that this is actually an area where Europe and the U.S. more easily can cooperate in the security field.

COMMISSIONER FIEDLER: Let me ask one technical

question or knowledge question. In our last hearing, General Cartwright testified that in at least one instance the United States demanded, or asked, the Chinese to shut down a particular server that the United States had identified as being a miscreant of some kind, and that it was done, that they actually did it.

Have you ever heard of a European, a French request, a UK request, a German request, to do something similar?

DR. STUMBAUM: No, I haven't heard of any similar request. There were attacks, for example, even to the German Chancellery, and so there were complaints from the government sides, but I haven't heard of any of those requests nor that they have been followed.

COMMISSIONER FIEDLER: Thank you.
That's all.

HEARING CO-CHAIR BLUMENTHAL: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you.

A question. We just talked about cyber, and we've talked about quite a bit else today. I would like to get your views on space. Space clearly as a domain is increasingly important to the United States. There have certainly been stories lately regarding NATO operations. We talked about munitions limitations and targeting, which is increasingly dependent or reliant on U.S. assets.

How does the EU look at space as a domain? How reliant are they? And what concerns, if any, do they have about Chinese space activities? Dr. Lin, do you want to start?

DR. LIN: I don't know about EU, but NATO doesn't have a space policy. But in their papers discussing trying to have a space policy, they did mention China, that it's very active in space, but NATO actually has focused more on cyber defense in mentioning China rather than in space. They haven't done much work on space.

COMMISSIONER WESSEL: Okay. Others as to European interests? Please.

DR. STUMBAUM: Yes. Thank you very much.

I wrote a study once about cooperation in space technology between the EU and China, and the complication with the United States, and the problem I guess for the European Union, space was primarily a commercial endeavor

and not so much a strategic endeavor, primarily because EU was initially based on integration and trade fields and just talking about the strategic notion bore a lot of difficulty.

So they started this as a commercial endeavor, and it was done with the Commission, and then more and more they made the transition to call it a strategic effort. One of the spinoffs of that was that there was a cooperation with India, with Brazil, but particularly with China, on the Galileo Project, and when the European Union aiming to put up 36 satellites to rival the GPS system, but primarily to make the EU independent on that technology, that included China in all kinds of aspects.

They were also part of the so-called Galileo Joint Undertaking, which gave them access to a lot of information, and it failed. China pledged to give 200 million euros to the project. They only donated about 60 million euros before the EU and China fell out on this issue, and as of today, since 2008, there has been no further cooperation done on both sides.

So, in a nutshell, the EU learned it the hard way that probably it not just be seen as a commercial issue but also as a strategic undertaking, and there has been put in place an EU space policy which at least gives some kind of idea of what space should be about, but I think it's still not comparable to the U.S. perspective on this.

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR BLUMENTHAL: Okay. Well, thank you very much. Commissioner Cleveland.

COMMISSIONER CLEVELAND: When I was out of the room, did anybody ask about the status of the Thales case? Do you have views on that? The Thales case? ITAR satellite case?

DR. STUMBAUM: I can only give you anecdotal evidence that I collected while writing the study on this. Basically I conducted a couple of interviews in France, and at that time, at least, Thales had put about 20 million euros to develop a system that is ITAR-free. The idea about this was Thales has given up on its chances about the U.S. market anyway. So they were looking for the Chinese market, and that was one of the ideas how to get to the Chinese market and as they develop the Spacebus 4000 on

this. That is as far as I got on any kind of information. Sorry.

HEARING CO-CHAIR BLUMENTHAL: Okay. Well, I want to thank all of you very much. I think we really learned a lot, and had some very interesting discussion, and obviously provoked a lot of thoughts. So thank you very much for coming here and for this panel.

We're going to break for lunch until 1:15 when we do our last panel. So, again, thanks a lot.

[Whereupon, at 11:55 a.m., the hearing recessed, to reconvene at 1:13 p.m., this same day.]

PANEL III: RELATIONSHIP IN THE FOREIGN POLICY CONTEXT

HEARING CO-CHAIR BARTHOLOMEW: Two minutes early. Welcome back, everybody, and I'm pleased to introduce our third panel, which is going to talk about the China-EU relationship in the foreign policy context.

We are joined by Dr. Jonathan Holslag from the Brussels Institute for Contemporary China Studies. His work focuses on political economy and regional security in Asia.

In the past, he has served as team leader of a multidisciplinary research group that prepared several reports on China's foreign policy for the European Parliament, evaluated the EU's Asia strategy for the European Commission, and was invited by the European Parliament to provide advice on China's economic transition.

He studied political science at the Vrije Universiteit--did I pronounce it correctly--in Brussels and completed additional programs on geopolitics and international security.

And we're also joined by Dr. Gudrun Wacker from the German Institute for International and Security Affairs. Her research focuses on a wide variety of topics including: Chinese foreign and security policy; China's domestic development; Internet censorship; cross-Straits relations; and security arrangements in the Asia-Pacific region.

Previously, she was head of the Asia Division at the German Institute for International and Security Studies, and she's also served as a research fellow at the Federal Institute for Russian, East European, and International Studies.

We've also received a statement for the record from Ms. Michal Meidan, an analyst in Eurasia Group's Asia practice. Her statement may be found on our Web site and will be entered into the record.

So with that, we'll begin. Dr. Holslag, could you go first, please?

**STATEMENT OF DR. JONATHAN HOLSLAG
HEAD OF RESEARCH
BRUSSELS INSTITUTE FOR CONTEMPORARY CHINESE STUDIES
BRUSSELS, BELGIUM**

DR. HOLSLAG: Thanks a lot, Madam Chairman, and thanks to the Commission for inviting me to participate in this session.

I was asked to elaborate on the state of EU-China-Africa interaction. What I will do first for my brief presentation is to give an update of what it has been all about. Secondly, also, to give some explanations for why this cooperation between EU and China on Africa affairs hasn't gone anywhere. And then, lastly, to come up with some broad recommendations or repercussions, if you want, for the United States.

So, in the first place, the expectation to engage China over African affairs is not a new thing. It has been going on since 2006, mostly with the Commission coming up with the idea to establish a trilateral dialogue 2007-2008. Also an important communication that was issued in 2008 that provided a very ambitious agenda to collaborate with China on Africa on all sorts of issues: security; agriculture; infrastructure; and also resources, raw materials.

Now, I think overall 12 key issues on the sort of trilateral agenda can be identified. In my written statement, I give an overview of those 12 issues and where we are with collaboration, with synergies.

Overall, you could say that on the 12 topics at stake, we have managed to have some sort of dialogue, some sort of interaction with the Chinese, but when it comes to China's adjustment to our expectations, we only have very few number of issues where we actually made progress, and if it comes to very tangible cooperation and synergies, it's only on two issues that we have some partial approach, for instance, on illicit timber via the FLEGT, and since recently we also have a joint project on illicit arms trade and the External Action Service has greenlighted quite a big budget to cooperate with China on tracking small or light arms in Africa.

But still remains to be seen whether it is also going to have an impact on China's export policy on small arms. If we would look at the annual dialogue that we have at the EU level with China nowadays, you could basically summarize it as an exchange of declaration, not much of discussion that really aims at identifying areas where we could advance our cooperation.

Overall, you could say that one of the main stumbling blocks for EU-China cooperation is that still there is a lack of coordination between not only member states and the European institutions, but also amongst the European departments, the DGs of the European Commission and the External Action Service.

With the Lisbon Reform Treaty, the hopes are very high that this might be improved, but we see, for instance, between the trade agenda and the development angle that not much progress is actually being made.

Also, perhaps interesting to elaborate a little bit on the role of private European companies. Initially, when we started to talk about China's rediscovery of Africa, there was this huge apprehension that China would push European companies to the sidelines. There is still a concern about that, but we see still that most of European firms nowadays are trying to bend China's presence into an opportunity, even have a tendency to jump on the China bandwagon, if you would put it that way.

Mining companies have established various joint ventures with Chinese companies, and they report those synergies, all in all, are fairly successful. Contractors and construction companies, for instance, that lost the battle with China in gaining contracts from African countries, our governments nowadays try to serve Chinese contractors as consultants, and there are many more examples.

I think that overall, still overall at this moment, European firms consider China's growing presence in Africa as an opportunity that they want to be part of.

On security, we have security on the agenda of trilateral cooperation, and it has also been stated at various summits in various communications that we want to intensify cooperation with China on security matters in Africa, but all in all, in that field, there isn't a lot

going on in peacekeeping.

We don't have any mature exchange at the EU level, but also on individual trouble zones like Libya, like the rift between the two Sudans, communication is highly limited. Whether it is in Brussels between the European delegation, in Beijing and MFA there, or whether it's in New York within a U.N. framework, there is really not a lot going on.

What are the explanations? Very quickly. Of course, there is the issue that there is still a large divergence in terms of political values, and we don't observe that this is going to change. We also have still diverging beliefs about the extent to which political and governmental variables can be influenced, and I think here still if you talk to Chinese officials, Chinese believe, for instance, that some corruption, some bad governance is just part of Africa, and that one needs to learn to live with it.

Also, the Chinese remain very skeptical about the ability of European development cooperation with Africa to make changes or to generate changes in governance, and the overall political climate in China and Chinese officials then to be fairly confident about the degree to which their more tangible development cooperation is more effective in making a change for the better in Africa.

Another element is that Europe is not seen as being very serious in championing its values in Africa, that the promotion of democracy tends to be a pretext for political interference, and that the use of liberal values that the EU is sort of synonymous with is used for protectionist purposes to sideline China in Africa.

And perhaps another element which is quite important is that the Chinese despite some setbacks still are pretty confident that their Africa policy works. So we could, of course, enter into detail about a discussion how they assess new security threats, but all in all, they are still comfortable with their Africa policy as it stands.

So these elements for me explain why there hasn't been much of a success between the EU and China on African affairs.

What it then means for the U.S., and in the first place where it is worth to consider closer cooperation with

the EU on engaging China in Africa, I think we should be very cautious with that. In the first place, we have to ask ourselves whether it's possible to have a more productive partnership or understanding with U.S. on those matters.

In the first place, we have to recognize that exchanges at this moment with Washington on African affairs is very poorly developed, and that there also does not seem to be a lot of interest from the U.S. side to make that change.

A lot of companies also state that competition with American firms in mining is as harsh as competition with China, not because of their access to large credit lines, but because they are technologically more advanced, for instance, for activities in deep waters.

And then also, as I mentioned, the element that European companies, all in all, are quite positive of the expectations for working with China.

Second also is the question whether it is desirable. I'm a bit afraid, so to speak, that if the EU is seen as ganging up somewhat with the United States on African affairs, that it will complicate even more collaboration or certain efforts to draw China out on issues like development cooperation and also security issues in Africa.

So I think it's a very complicated and delicate balancing exercise. There needs to be more coordination for sure. But we have to make sure that it isn't further deteriorating Chinese perception of our intentions in the African region.

Second element is also that we should recognize that China's policies do not evolve in a vacuum. It is in close interplay with other emerging powers, not the least India, Brazil, but also South Africa and the Gulf states. Here we see a lot of pragmatism and free-riding, to use that word, from their side as well. So if we are to engage China in a productive way, I think we need to depart from such multi-polar or multilateral context and essentially also try to channel via African regional organizations.

And then perhaps the last remark is that the U.S. should really encourage the European Union to get its act together to pursue a more robust and active security policy

towards Africa, and then perhaps, referring also to the presentation of Oystein, to be sort of cautious in luring the Europeans to have a bigger role in Asia while it's not even able to uphold its responsibilities in Africa.

So it's a matter of priorities, I would say. And here I would like to conclude. Thank you.

**PREPARED STATEMENT OF DR. JONATHAN HOLSLAG
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The Limitations of EU-China Cooperation in Africa

Testimony before the US-China Economic and Security Review Commission
Hearing on the China-Europe Relationship and Transatlantic Implications

19 April 2012

Jonathan Holslag
Researcher, Brussels Institute of Contemporary China Studies

It has been five years now since the EU and China vowed to pursue a partnership on African affairs. While it is evident that both sides have common interest in the region and progress has been made in setting up different kinds of dialogues, they are not getting anywhere close to a mature partnership. Especially in regard to security issues and development cooperation there is hardly anything to report in terms of synergies. Important impediments are China's reluctance to buy into the sort of standards that the EU deems important for Africa's development and the fact that the EU is not considered a reliable partner. It would be counterproductive, though, to put all the blame on China. If the West is to promote stability and development in Africa, it needs to recognize that China's Africa policies mature in an environment that is characterized by distrust and competition among many players, which is skillfully exploited by local regimes. Trilateral cooperation is therefore never going to work without a multilateral framework.

1. The state of EU-China cooperation on Africa

It was the European Parliament that set the wheels in motion when it started to organize hearings on China and Africa in 2006. A subsequent report urged the Europe Commission to explore coordination with Beijing and to advance Europe's standards in regard to development cooperation, human rights, and good governance. What triggered this interest were mostly the atrocities in Darfur, the

megalomaniac summit of the Forum for China-Africa Cooperation (FOCAC) in 2006, and the fact that European news media extensively covered China's new quest for raw materials. Most of these concerns were instantly echoed by member states. The French and Italians cautioned that Europe's economic interests were in peril. Germany's Chancellor Angela Merkel stated that Europe and Africa had to stick together. The UK, the Netherlands, and most Scandinavian members feared that China was undermining Europe's efforts to promote liberal standards in African business and politics.

To the surprise of the Chinese counterparts, the European Commission pushed for clause in Africa in the joint statement of the 2006 China-EU summit in Helsinki. The Commission also launched its new communication on China, in which the latter's behavior in Africa was questioned. In 2007, Commissioner for Development Louis Michel invited a large delegation of Chinese officials to discuss a trilateral dialogue, which Beijing accepted. In 2008, the development directorate of the Commission issued a communication that identified security, infrastructure, natural resources, and agriculture as areas for cooperation. During the drafting process, however, other directorates of the European Commission heavily criticized this policy paper for being a solo initiative that lacked a broader strategic context. China also made clear that it did not wish to be singled out by such paper, "while other powers could behave as they please in Africa".

Topic	Target	Dialogue	Adjustment	Cooperation
Transparency extractive industries	Coaxing China into EITI	yes	no	no
Transparency development aid	Coaxing China into OECD-DAC	yes	no	no
Accountability in foreign loans	Promoting Paris Club Rules	yes	no	no
Curb trade in blood diamonds	Promote Kimberly process	yes	yes	no
Curb illicit timber trade	Via Flegt	yes	yes	partial
Infrastructure development	Bilateral cooperation/EU-AfricaPI	yes	no	no
Agricultural development	Bilateral cooperation Cooperation/Joint corridor	yes	no	no
Cooperation on anti-piracy	CMF/Atalanta/Shade	yes	no	no
Cooperation on UN peacekeeping	Bilateral cooperation	yes	no	no
Curbing illegal arms trade	Bilateral cooperation	yes	yes	partial
Combating terrorism	Bilateral cooperation	yes	no	no
European Peace Facility Fund	Chinese financial contribution	yes	no	no

Table 1. An evaluation of European policy objectives in regard to cooperation with China in Africa.

How much of the objectives in the 2008 communication have been achieved? The European Commission and the Chinese MFA have set up an annual dialogue. During that dialogue, both sides exchange views on the situation in specific countries. Since 2010, broader issues – such as piracy, the

African Peace and Security Architecture, and unconstitutional changes of government – and are discussed as well. Those meetings take place in a fairly amicable climate, but they have not generated a lot of tangible synergies. In 2008, the Commission and the MFA agreed to task their delegation and embassies to identify specific development projects on which they could cooperate, but that did not take off. Officials from both sides reckon that the two parties are still at the stage of “sharing experiences”. We do not find evidence that this sharing is also leading to convergence. China has been adjusting different parts of its cooperation for Africa, often for the better, but it does not give Europe any credit for it. When it comes to development cooperation, studies of Europe’s aid practices drafted by Chinese think tanks often conclude that China cannot afford to follow Europe’s example. The same goes for interaction with individual member states. At least seven member states maintain their own Africa-oriented dialogues with China, but none of them got anything operational out of it.

Private European companies, in the meantime, increasingly sought to jump on the China bandwagon. It is true that Chinese companies challenged European many firms in construction, transportation, and mining but, by and large, the latter now seek to turn it into an opportunity and to service China’s quest for the African market. European oil companies have established joint ventures or sold concessions to Chinese companies. European mining companies in central Africa sell the majority of their ores to Chinese customers. Areva, the French national champion in nuclear energy, has established cooperation with China National Nuclear Corporation in exploiting uranium mines in Niger. Contractors that lost the battle in the construction business, now try to sell knowhow to Chinese construction firms. Transportation companies seek to position themselves as intermediaries between Africa and Eastern Asia. KLM and Air France, as an anecdotic note, now even operate a cargo service between Guangdong and Kenya with “hunting for business” in Chinese characters on their planes’ tale. The European business community appears thus to be adjusting to new realities in Africa. Moreover, it has showed itself rather reticent in regard to the Commission’s raw materials strategy or calls of some lobbyists to counterbalance China’s success in infrastructure by setting up a European equivalent of China’s loans-for-resources scheme.

Security has attracted particular attention. During the EU-China dialogues, both sides have stated their concern about the tensions between the two Sudans, Somalia and Nigeria. In case of Somalia, China has praised the EU police mission onshore and called for even more robust engagement. Europe has encouraged China to participate in the combat against piracy. There have been several exchanges between Chinese and European navy ships, but China declined to join forces in patrolling one single corridor. Chinese officials stated their concern that operation Atalanta was under strain because member states frequently fell short in committing sufficient ships. Chinese officials also showed

themselves unimpressed about the ability of the European Military Staff to handle exchanges. This was also the case with the Libya evacuation during which China turned to France and NATO for briefings and Greece for logistic support, but left the whole EU architecture aside. The Libya intervention has largely been interpreted by China as yet another indication that the EU is unable to play a leading role in its backyard – including Africa – and that the US is much more to watch when it comes to the security and stability of the African continent.

2. Explanations

The lack of progress in EU-China cooperation does not mean that there are no congruencies in terms of interests. As a distant trading partner China needs stability in Africa as much as Europe. Both sides have recognized the importance of sustainable development in Africa, the necessity to get the region out of the commodity trap, and the need of converting investment into opportunities for the broad African society. They also emphasized the central role of African regional organizations in promoting peace and security as well as the importance of regional infrastructure. Even in the field of energy and raw materials, Europe has an interest in China's willingness to spend giant sums to boost output in light of growing international demand.

The lack of cooperation could rather be attributed to the different ways in which Europe and China are using influence to fulfill their objectives. Obvious differences remain over political values, although there also remains a wide gap between the liberal standards of the European Union and the inclination of some member states to maintain close relations with political elites in key partner countries – however crooked they are. China also remains more inclined to pursue economic cooperation, instead of offering aid. But here as well, questions are asked about how much it pays off to provide in budget support and social infrastructure – two growing components of Europe's aid – when basic infrastructure is absent. As much as Chinese officials and experts start to question the overtly state-centric nature of cooperation with Africa and its infrastructure bias, European think tanks and policy makers more and more assert that Europe's cooperation with Africa has shifted too much into the opposite direction to be effective.

This clash between pragmatism/realism and idealism has been partly the product of diverging beliefs about the extent to which political and governmental variables can be influenced. While the debate about this notion is gaining traction, most Chinese genuinely assume that as long as China creates opportunities for Africa to grow, it automatically contributes to political stability. It is also widely accepted that some corruption is inevitable in Africa's economic take-off and that governance will only improve after social and economic conditions have ameliorated. Again, this is not just a normative

expedient do deflect criticism. Officials are largely unimpressed by efforts of the EU to address corruption in developing countries and reckon that their way of providing “tangible” services to Africa – in return for commodities – is more beneficial than, so to speak, conditions without engagement. With the latter, Chinese interlocutors usually refer to the modest volume in investments from Europe and the limited amounts available for financing infrastructure.

In addition, it is often held that the West is not serious about the values that it champions in Africa. In many conversations with European interlocutors, Chinese officials stress that the promotion of democracy tends to be a pretext for political interference, interference to the advantage of Western interests instead of African societies. It is also broadly shared that Western and particularly European countries use liberal values to criticize China, and, in a protectionist mood, to counterbalance China in their backyard. Chinese officials and experts asserted that Western governments were taken in tow by NGOs, which, without any responsibility, pursued dubious interests. This lack of credibility and the distrust of Europe’s intentions are key to understand China’s reticence.

China has also become more confident in its Africa policies because it has not been confronted with major setbacks and because African leaders have frequently expressed their appreciation. While there have been instances of civil society disaffection, general views of China still tend to be quite favourable among the African public and elites. To be sure, China has frequently ended up in the epicentre of instability and violence, but it has not led decision makers to the conclusion that policies need to be altered or adjusted. At best there is a straddle between the strand of officials and experts who believe that non-interference becomes untenable and that China needs a more robust security policy. On the other hand, and this still seems the majority, it is maintained that China should adjust to contingencies, eventually evacuate workers whenever it is necessary, and that, in the end, China is an inevitable partner for any African leader that wants to stay in power. This debate is of course not static, but for now it still helps to explain why China sticks to its traditional posturing.

A last impediment is the incoherence of European and Chinese policymaking. Inevitably, Chinese officials lament that the European Commission is good in putting proposals and ideas on paper, but that it lacks the wherewithal to implement or to convince member states to join forces. The entry into force of the Lisbon Reform Treaty is not really changing this. The other way around, the Chinese Ministries of Foreign Affairs (MFA) and Commerce (MOFCOM) are often not sufficiently informed to explain behaviour of state-owned companies, arms shipments, the activities of the PLA, or even projects initiated by local governments or CPC-bodies.

In sum, the disappointing state of EU-China cooperation on African affairs is the consequence of a combination of a mutual legitimacy deficit, a lack of trust, and the complicated institutional nature of the EU and China's Africa policies. This renders it more difficult for both sides to advance their goals of stability and profitable yet durable economic cooperation. Crucial in this regard is also to recognize that the EU matters much less for China in Africa than the United States, emerging powers like India, and individual European member states like France. China will continue to adjust its policies more to the pragmatic behaviour of those players than to the declarations of European institutions. It also portends that it will continue to perceive Africa as a playground of new power politics in which it has to strike a balance between, on the one hand, a growing penchant for broadening cooperation beyond national elites and winning the hearts of the African people by giving in to some of their demands, and, on the other, the need to stay ahead of competitors in the race for resources and influence by fostering close relations with elites.

3. Implications for the US

The EU's efforts to "socialize China" with its norms have largely failed. That is not a reason though, to single the PRC out as a power that is intended to undermine European interests in Africa. It is surely challenging Western influence, but that is as much a consequence of the failure of European policies as of China's success. With the disappointing results of five years of engagement, there is growing concern that Europe could find itself entirely sidelined. This could encourage closer cooperation with the United States. In any case, there is not much reason to expect closer US-EU cooperation to make a huge difference. In the first place this is because exchanges with Washington on African affairs tend to be as poorly developed as those with Beijing. Second, European energy and mining companies maintain that – for the time being – they have a harder time competing with US counterparts than with Chinese. Third, this will add to China's distrust and complicate coordination even more. Last, it does not make sense to form a tacit alliance against China's growing clout without trying to compete first. Europe in particular has asserted to easily that it does not make a change to compete with China because it ties big loans to resources-for-infrastructure barter. There is no ethical or economic cause that prevents Europe from doing the same, though. What explains China's progress is not the very formula, but the fact that it has a virtual monopoly over it. The main objective should thus be to find ways to stay in the game, rather than to stage some tacit balancing act. Fourth, Europe might just be too divided to streamline strategies across the Atlantic. Some member states have already made it clear that working with China in Africa is more lucrative than resisting it. Balancing is thus neither desirable nor feasible.

Both Europe and the US should anticipate that what happens in Africa is a reflection of the changing global order. India, Brazil, South Africa, the Gulf States, and others will all try to secure a part of the pie and there is no indication that those emerging powers are more inclined to buy into the inconsistent European/Western norms. If a new scramble for Africa is to be avoided, Europe and the US should support the role of regional and sub-regional organizations in setting standards for all Africa's partners. Attempts by the African Union have not yet taken off, but merit sustained support.

It would be in the interest of the US to encourage the EU to develop a more solid and consistent security policy towards Africa. This implies a greater contribution to peacekeeping, maritime security, the combat against the illicit trade in small arms, humanitarian relief, and the tackling of organized crime and terrorism. If Europe is to weigh on the emerging powers, it will be through a greater security role in its neighbourhood, not via a thin global engagement. The more it has to offer to distant partners of Africa in terms of security, the more it could demand in return and assist African initiatives to consolidate. It does not make sense to request Europe to play a more active role in maritime power plays in the Pacific, if it does not have the credibility to play a constructive security role in instable areas closer to home.

This briefing note is based on the following research papers:

Holstag, Jonathan, 2012. China's Evolving Behaviour in Africa and the Options of Cooperation with Europe. *Journal of Current Chinese Affairs*, 40, 4, pp. 3-16;

Holstag, Jonathan, 2011. China and the Coups: Coping with Political Instability in Africa. *African Affairs*, 110, 440, pp. 367-386;

Holstag, Jonathan, 2011. The Elusive Axis: Assessing the EU-China Strategic Partnership. *Journal of Common Market Studies*, 49, 2, pp. 293-313;

Holstag, Jonathan, 2008. Commerce and Prudence: Revising China's Evolving Africa Policy. *International Relations of the Asia-Pacific*, 8, 3, pp. 325-352.

HEARING CO-CHAIR BARTHOLOMEW: Thank you very much.
Dr. Wacker.

**STATEMENT OF DR. GUDRUN WACKER
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DR. WACKER: Yes, thank you. First, I want to thank the Commission for inviting me and giving me the opportunity to testify here.

So far I think it has been a quite interesting day, at least for me. I don't know about the others.

I was given some broader questions on the EU foreign policy, and I will for the purpose of this seven minutes or whatever I need, I only want to highlight three points.

First, about the foreign policy goals that China pursues with respect to the EU and vice versa. Secondly, the question of the "divide and conquer strategy" of China, which has been touched upon this morning already. And finally, the question of the alignment between the U.S. and the EU.

In my written statement, you will also find something about how the EU coordinates its China policy and it's probably more than you ever want to know about coordination mechanisms within the EU. And I try to make some recommendations.

So, first point, on the foreign policy goals, you have heard this morning, and I agree with, that the European focus is on domestic development in China, and the same is true with respect to China's foreign policy goals vis-a-vis the European Union.

There are very clear economic interests: EU as a market for Chinese goods; the EU as a source of investment; and the EU as a source of modern technology. So it has all to do with China's modernization and transformation process.

And the other main foreign policy goal is that the EU and its member states support the territorial integrity

of China. So we speak about Tibet, Xinjiang, and, of course, the Taiwan issue here. More generally, the Chinese want the EU to avoid any activity that undermines Chinese interests in the Asia-Pacific region. So it's pretty much the same expectation that the U.S. would probably also have with respect to the EU.

But this regional aspect is, I would argue, quite weak. So you have a focus on the domestic issues.

Globally, I think that China at least has hoped for awhile that the EU will develop into an independent and strong international actor that would sort of counterbalance the United States. This hope was probably strangled in 2003 to 2005. There was a lot of frustration about that, and the financial crisis might have killed the hope all together. Also they saw through what pains we went with the Constitutional Treaty and integration, et cetera.

So you have a domestic dimension and a global dimension, so to speak, and the same you can say about the EU side. There is a strong focus on the domestic development in China because the EU always looked at China through this is a developing country lens, and it's very hard to get away from this position for the EU.

So it's about an open society, rule of law, sustainable development. These, I would say, are the three topics that drive the European foreign policy goals with respect to China's domestic development, and there is a lot of practical cooperation going on in that respect.

And then you have the global issues--climate change, energy and resources, the global financial architecture, nonproliferation. These are all areas where the EU is involved and engaged with China and where the EU would like China to become a responsible, reliable and predictable partner.

Also, you see that, again, this is domestic focus and international or global focus, and that the regional focus, which is pursued through the Asia-Europe meeting, this is sort of the weaker aspect. It's sort of the middle has fallen out of this relationship.

Second, on the "divide and conquer." My first point is that the EU is a very peculiar animal, and every outside partner, whether it's China or the U.S. or Russia,

has to deal with this fact, that there is no center of decision. In every other country, you have in the end one decision-making center, but in the EU, this is not the case because you have different centers on different kinds of decisions.

And despite our common and foreign and security policy, this is only as coherent and unified and strong as the member states allow, and they don't allow so much as probably even European citizens would like.

Also, no other country can ignore the relationship with the individual member states because you meet them everywhere. They are represented in the international organizations, in the U.N. Security Council, in the G8, in the G20, everywhere you have European member states, and this, of course, also furthers the fact that the bilateral relationships still have to be, yeah, been going on.

And there also are areas where the EU has no competence or no jurisdiction. For example, military contacts with China are on the member states' levels. So France, Germany, the UK, they all have some sort of military contacts going with China.

During this day, I wondered how much we overestimate or assume that China is this unitary actor that has a big strategy vis-a-vis the EU. I doubt that, and probably what we see about the European debt crisis, you have different interests of the political leaders, but the People's Bank of China will probably have a totally different take on that and make itself heard.

I think we have to also take into consideration that on the Chinese side, there is not this grand strategy vis-a-vis the European Union.

So if it comes to the divide and conquer, I would say the balance sheet for China is very successful on the divide side because the divisions are there already within the EU, and a lot of economic issues, we have different interests. So China has been successful on the divide side, but on the conquer side, I would say the success has been very limited.

This is because also the European states themselves play this game. I think this morning, it was alluded to that some states would sort of signal to China we want to move on the arms embargo, and we will, you know, put in a

strong word at the EU level and probably get something in return or not, but this is cheap talk. They don't have to follow up on that. I mean so I think it's a two-way game. It's not only a game played by China.

And on the two central issues of market economy status and the arms embargo, there has been no movement at all. This is not what I call a successful conquering strategy because division in this case means there will be no change, and no change is not in China's interest on these issues.

We can talk about Dalai Lama and Liu Xiaobo, where I think China has been slightly more successful on the Dalai Lama issue, the meetings, but this is very much a domestic policy issue within Europe.

Finally, on the transatlantic alignment, I think one of the problems is where the EU has traditionally looked at the U.S. through a transatlantic lens and not seen the U.S. as a Pacific power except for, let's say, academic circles. On the government level, this changed only with the arms embargo, I would argue, when the Europeans suddenly realized that, you know, the U.S. is reacting very negatively to something that we want to do.

But this lack of interest was also there from the American side because before the arms embargo debate came up in Europe, the Europeans were considered as sort of mostly harmless and, therefore, not relevant for U.S. interests.

I think as a positive outcome, these security guidelines that were mentioned by May-Britt that explicitly acknowledge that the Europeans have to be sensitive to U.S. interests and U.S. allies' interests in the region are important at least as a general framework that Europeans can refer to.

Second point, on the transatlantic alignment, there are a lot of issues where the EU and the U.S. are aligned, human rights in China, also some international issues like Myanmar or Zimbabwe or other countries, where we would probably like to go through with stronger sanctions, but China is holding it up, together with Russia or whatever. There is an alignment without a lot of coordination I would say.

But there is this fundamental difference that was

also mentioned in the morning that Europeans have a different perception of China's rise, and they don't see China as a threat to their own national security.

In the U.S., this has been a constant debate for the last, at least, 20 years, I would say. It's also not that everybody has the same opinion here. In Europe, I would say it's very clear that most governments see no alternative to engaging China on every level and in every respect they can because this is basically the EU approach to resolving conflicts in their own history, so, by default, they try this integration and engaging approach in the hope that it will have the same socializing effect on China. Whether this will be the case or not is a different matter.

Final point, we can talk a lot about the alignment of U.S. and EU interests, but there is also an alignment sometimes between U.S. and Chinese interests, at least from our perspective. Whether this is coordinated or not, I think the majority know. But it's, of course, an obstacle for closer transatlantic cooperation vis-a-vis China.

Already mentioned was the emission tax on flights to and from the EU, but there is also climate change where the Europeans and the U.S. are on completely different pages, and on some international issues like the International Criminal Court or the ratification of the CTBT, we also find each other in different camps.

So then you raised the world order notion this morning in your final remark, I think. I think we also have to be aware that there are some differences between Europe as a middle power, and the U.S., and their ideas about world order. We are striving for this rules-based world order, and if the U.S. and China are on a page where they say no criminal court, no this, no that, this is sort of then difficult also for our negotiation position vis-a-vis China. Thank you.

**PREPARED STATEMENT OF DR. GUDRUN WACKER
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April 19, 2012

Hearing on the China-Europe Relationship and Transatlantic Implications

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

Preliminary Remarks

The topic assigned to me is “EU-China relations in the foreign policy context”. It should be noted that economic and trade relations have been the centerpiece and foundation of the partnership between China and the EU, as well as between China and the EU member states. Moreover, economic and political issues are intertwined and cannot be totally left out of the considerations below.

China’s EU Policy/ies – the EU’s China Policy/ies

China cultivates its relations with the EU as a whole as well as with individual member states. Beijing knows where the competences of the different EU institutions (Commission, Council, Parliament) lie, where the governments of the member states have a say on EU decisions, and what can or cannot be negotiated with individual member states. China might try to mobilize individual EU member states to speak in favor of China’s interests at the Brussels level. China has traditionally seen individual or groups of member states as attractive cooperation partners in special fields. For example, France has been considered as the strongest supporter within the EU of the concept of a multi-polar world (in contrast to a unipolar world order dominated by the US). Scandinavian countries and Germany were seen as models for establishing social security systems. The UK has been seen as an ally of China with respect to granting China Market Economy Status due to its liberal economic model.

The biggest EU member states are important partners for China in the context of international organizations (e.g. the UK and France in the UN Security Council) and more informal groupings

(e.g. Germany, France, the UK and Italy in the G8 plus and G20). In these cases there are more opportunities to foster bilateral relations through high-level meetings in the context of international events.

China has been systematically cultivating relations with member states through high level visits. For example, Chinese Prime Minister Wen Jiabao visited Switzerland (Davos), Germany, the UK, Spain and the EU headquarters in Brussels in 2009³⁸¹, Hu Jintao travelled to France and Portugal in 2010, and Xi Jinping, who will most likely take over the positions as China's No. 1 in fall 2012 and spring 2013, visited Ireland and Turkey after concluding his trip to the United States in February this year.

At the EU level, a broad range of dialogue mechanisms exist at different levels. With the EU, an annual summit meeting has been held since 1998³⁹², a High Level Economic and Trade Dialogue (HED) was started in 2008 (modeled after the China-U.S. Strategic Economic Dialogue) and a High Level Dialogue on Strategic and Foreign Policy Issues was established in 2010⁴⁰³. In more than 50 so-called sectoral dialogues the EU and China meet regularly on the working level, covering not only economic issues (including consumer product safety, customs, IPR...), but also political and security topics (non-proliferation, illegal migration, energy...). Most of these working-level dialogues were initiated by the European side, since they usually reflect an EU interest. Twice annually, the EU holds a Human Rights Dialogue with China, which started in 1995.

Regular meetings on different issues also take place between China and almost all EU member states. Most of these dialogues are focused on economic issues, but some member states (France, Germany, Sweden and others) have also been conducting military exchanges with China, aiming at improving transparency and confidence building. Several member states of the EU hold their own human rights dialogues with China (UK, Germany, Sweden, etc.). Efforts to mainstream all these dialogues and to get a clearer focus as to what they intend to accomplish have been underway in the last two years.

Exchange of information and coordination between the EU member states on Asia and China policy takes place in Brussels in so-called COASI meetings where Asia directors or, depending on the topic, representatives from foreign ministries come together. Expert staff of the EU

¹ This trip of Wen Jiabao was called „Tour de France“ because it left out France, most likely as a reaction to French President Sarkozy's meeting with the Dalai Lama a few months earlier.

² Two exceptions have been made in the annual rhythm: The summit schedules for December 2008 was “postponed” by China because of a planned meeting of French President Sarkozy with the Dalai Lama; and the summit 2011 was postponed by the European side because of an emergency EU summit on the European sovereign debt crisis.

³ See “EU-China Political Dialogue”, http://eeas.europa.eu/delegations/china/eu_china/political_relations/pol_dialogue/index_en.htm [access April 2, 2012].

representation and of member states' embassies in Beijing also holds meetings on a regular basis. This includes meetings of the Heads of Mission and their Deputies.

Despite all these information exchanges and consultation mechanisms on the European side, politicians of member states do not always convey the same message to Chinese counterparts (see below). Both sides have declared in 2003 that their relationship is a "strategic partnership"⁴¹⁴, but so far only the Chinese side has offered a definition of such a partnership – according to Wen Jiabao, it is comprehensive, long-term and transcends ideological differences.

Key Diplomatic and Foreign Policy Objectives

China's key diplomatic issues in the relations with the EU and member states beyond the economic ones (markets for its goods, source of investment and technology) are explicit support for China's territorial integrity (Tibet, Xinjiang, and most importantly Taiwan). In general, Beijing expects that the EU will do nothing in the Asia-Pacific region that would undermine China's interests. (The latter is also a central U.S. expectation when it comes to the EU's role and activities in the region.) The two main obstacles cited again and again by China for improving relations between the EU and China are Market Economy Status and the 1989 arms embargo, which – contrary to China's hopes – was not lifted in 2004-5. Meetings of European leaders with the Dalai Lama are another cause of criticism on the Chinese side.

At the same time, China hopes that the EU will develop into a counterweight to the US on the international stage. Beijing was optimistic in this respect when preparations for the Constitutional Treaty and EU enlargement were underway (2003-5), but subsequently became more skeptical in light of the EU's struggle for deeper political integration (failing of the Constitutional Treaty) and, more recently, the European sovereign-debt crisis.

When the concept of a "G2" started to appear in US publications, Chinese politicians and academics reacted with skepticism and mistrust to this concept. They underlined the important role of the EU in international/global affairs. So the EU was seen as an international actor that could help China get out of what was by many in the Chinese elite perceived as the "trap" of a G2.

The EU itself officially states the following priorities of its China policy:⁴²⁵

- To engage China further, both bilaterally and on the world stage, through an upgraded political dialogue.

⁴ Both, the EU and China, have many "strategic partnerships".

⁵ See website of the EU: "The European Union and China: A Maturing Partnership", http://eeas.europa.eu/delegations/china/eu_china/political_relations/index_en.htm [access April 2, 2012].

- To support China's transition to an open society based upon the rule of law and respect for human rights.
- To encourage the integration of China in the world economy through bringing it fully into the world trading system, and supporting the process of economic and social reform that is continuing in China.
- To raise the EU's profile in China.

Beyond pursuing economic interests, the EU and its member states would like to see China develop into a constructive, predictable and reliable partner on international issues (such as Iran, Sudan...) and on global challenges (such as energy, climate change...).

Does China Pursue a “Divide and Conquer” Strategy?

The Chinese “divide and conquer” strategy should not be overestimated in its actual effect. Of course, such a strategy would not work if the EU and its member states would consistently speak with one voice. However, European member states have different economic interests, are divided over many issues, and there is sometimes a lack of coordination and/or solidarity within the EU as well as a lack of institutional memory. All China has to do is use these weaknesses and inconsistencies within the EU to its own advantage.

China mainly uses economic sticks or economic incentives to “punish” or “reward” decisions or actions of individual European member states, although it is not always clear what is a “normal” bureaucratic hold-up and what is a deliberate decision to delay. Another instrument of “punishment” is to cancel planned visits of delegations or temporarily freezing the regular exchanges with a member state (not unlike the suspension of mil-mil exchanges with the U.S.). In 2008, China even cancelled (postponed) the EU-China summit as a reaction to French President Sarkozy’s plan to meet the Dalai Lama. Since France had at the time the European presidency, basically the entire EU was taken hostage of the French decision.

As mentioned above, China does not really need to apply a “divide and conquer” strategy when European member states are divided on certain issues to begin with. EU member states have different economic interests with respect to China. But there have also been examples of political rifts or dissent within the EU:

- In relations to China: there was no unified opinion on lifting the arms embargo in the years 2003-5, and there is no unity on granting China Market Economy Status.
- Other issues with relevance for EU-China relations: For example, the EU was divided over the military intervention in Iraq 2002-3 (Germany and France against) and, more recently, the

resolution on no-fly zone in Libya (Germany abstained in the UN Security Council) – in these cases China usually underlines which of the member states shares China's concerns.

1. Despite the EU's steps towards a Common Foreign and Security Policy (CFSP), each EU member states – and especially the big ones (EU-3) - still pursue their own China policies which focus on the respective member state's perceived particular interests. For example, Germany as the biggest trading partner of China within the EU (responsible for almost 40 % of EU-China trade) has recently (in 2011) elevated its relationship with China by establishing so-called "inter-governmental consultations."⁴³⁶

2. Member states sometimes fail to stick to agreed positions or formulas in their dealings with China. Such deviations from the agreed language do not necessarily signal a change in policy, but can be an honest mistake, for example due to a lack of institutional memory. However, in some cases, individual member states display a special position due to their own historic or current experiences. For example, Spain, Greece and Cyprus almost by default tend to express their support for the territorial integrity of countries that face (like themselves) challenges from separatist forces in one form or another. This explains why these countries have been more reluctant to speak out on Tibet or had initially put up some resistance against a visa waiver for Taiwan.

3. In some cases, the problem of disunity is a lack of solidarity between member states rather than a result of a deliberate Chinese strategy of "divide and conquer." For example, Germany and France traditionally compete with each other in the economic field in China. French President Sarkozy made a state visit to China in fall 2007 briefly after German Chancellor Angela Merkel had met the Dalai Lama. Sarkozy did not use this opportunity to make a statement defending the German decision to meet the Dalai Lama. Instead, he underlined that Tibet was a part of China.⁴⁴⁷

When the French president came back from this visit with business contracts over 20 billion euro (mainly for Airbus and two nuclear power-plants), part of the (German) media presented these deals as "rewards" for the French statement on Tibet and for the lack of support for Angela Merkel. However, we can safely assume that these contracts had been in the pipeline for a long time. Moreover, Airbus is not a French company, but a European one. By implying a causal connection that on closer inspection is not very convincing, (national) media contribute to the impression of a "divide and conquer" tactic on the Chinese side.

4. If China has applied a "divide and conquer" strategy, the success has been rather modest. After all, decisions on the two major issues of granting China Market Economy Status and lifting the arms

⁶ The only other non-European countries Germany has been holding such consultations with are Israel and Russia. In 2011, Germany started such a mechanism with India as well.

⁷ That Tibet is a part of China is officially accepted by every government in the EU.

embargo require consensus among the member states, and as long as there is disagreement among member states, nothing will change (and change would be in China's interest). On issues like meetings with the Dalai Lama, however, more solidarity within the EU would be desirable.

Competition in Third Countries

Competition in third countries due to different foreign policy approaches of the EU and/or member states and China has mainly become manifest on the African continent. Since Jonathan Holslag will testify specifically on this topic, there is no need to go into details here. The central issue is that most Western countries (OECD) have agreed on certain conditions for granting foreign aid / ODA, while China as an emerging donor has so far remained outside this framework.

A sort of competition can also be seen with respect to countries like Zimbabwe, Sudan or Myanmar⁴⁵⁸, where the West – mainly the US and the EU/member states – has pushed for sanctions as a reaction to human rights violations. In most cases, China has been reluctant to support sanctions and has either worked to water down the text of the resolution or prevented resolutions in the UN Security Council by using its veto power (usually in tandem with Russia). However, even though China presents a very principled position on non-interference, its actual behavior has been more pragmatic and flexible than its rhetoric would suggest.

US-European Alignment

There are many issues with respect to China where positions of the US and the EU (including most member states) are closely aligned, even without a lot of consultation and coordination. First of all, this has been the case with respect to human rights and the rule of law in China. The EU and the US might focus on different human rights – the US more on religious freedom and on freedom of expression, the EU more on administrative detention, ratification of the UN Covenant of Civil and Political Rights and the death penalty – but there is clearly a shared basis of values and norms. On the international level, U.S. and EU more or less agree on how to approach the nuclear program of Iran and North Korea, on Sudan, Myanmar and Zimbabwe, or on Libya and Syria, while China (and Russia) might subscribe to the desired outcome, but not necessarily on the concrete steps to get there.

One obstacle for closer US-European exchanges and cooperation in the past was the lack of interest on the American side – due to the lack of hard power presence of the Europeans in East Asia

⁸ On Myanmar, European sanctions are expected to be lifted within the next weeks.

they were (and still are?) largely considered as an irrelevant actor in the region. Despite several academic initiatives for a transatlantic dialogue on China (and East Asia) starting in the late 1990s, it has been difficult to generate interest on the US side for the EU's China policy and/or activities in East Asia. The first clear sign of interest was as the (negative) reaction to discussions in Europe about the possibility of lifting the arms embargo against China in the years 2003-5. This period has led to more exchanges and consultation between the US and the EU or some member states, at least on the working level. Moreover, the EU has outlined its position on security in East Asia and has clearly stated that the EU needs to be sensitive to the special interests of the US and its alliance partners in the region.⁴⁶⁹

In one fundamental respect, the US and the EU/member states differ in their perception of China: The EU does not see China as a military threat to itself. And despite some negative changes in the perception of China in Europe and a course correction that asks for more reciprocity in the (economic) partnership with China, Brussels (and other European capitals) see no real alternative to engaging China on every possible level and on every possible topic with the aim and in the hope of making China a “responsible stakeholder”. However, one “camp” among US China experts and officials also argues in favor of engagement of and cooperation with China.

It is also important to mention that there are some issues where US and Chinese interests and positions seem to be aligned. The most obvious example is climate change, where the US position has certainly not been in accordance with the European one. The summit on climate change in Copenhagen was a frustrating experience for the EU, since it felt sidelined by an alliance of BASIC⁴⁷¹⁰ and the US which in essence negotiated the final document. On the issue of carbon emission tax on flights to and from the EU there have also been similar reactions in the US and China: China's government forbade its airlines to pay the tax; the US House of Representatives also passed a bill against these provisions in October 2011 and a similar bill was introduced in the Senate in December 2011.

⁹ Cf. Council of the European Union: *Guidelines on the EU's foreign and security policy in East Asia*, full text of the version of December 2007 available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/misc/97842.pdf. Originally, the “Guidelines” were drawn up in 2005, but not published at the time. In 2007, a revised version was published. A new revision is apparently underway. The relevant passage reads: “The US's security commitments to Japan, the Republic of Korea and Taiwan and the associated presence of US forces in the region give the US a distinct perspective on the region's security challenges. It is important that the EU is sensitive to this. Given the great importance of transatlantic relations, the EU has a strong interest in partnership and cooperation with the US on the Foreign and Security policy challenges arising from East Asia.” [p.3] Documents like the “Security Guidelines” are important since they define an agreed frame of reference which makes it easier for the EU to react to events in East Asia without long debates.

¹⁰ The BASIC group (Brazil, South Africa, India and China) had formed shortly before the Copenhagen summit.

Other examples for similar stances of the US and China are the International Criminal Court and ratification of the CTBT.

On these issues, the EU and most of its member states are on a different page than China and the US and makes transatlantic coordination difficult if not impossible.

Recommendations

1. On the government level, mechanisms for exchange and consultation have been in place between the US and the EU. However, topics should be expanded. There should be a special focus on global public goods like freedom of navigation.
2. More exchanges between parliamentarians from the US and European countries could improve mutual understanding of the respective positions on China and the Asia-Pacific in general.
3. Trilateral US-China-EU exchanges could be intensified. So far, they have been limited to academic conferences.

**PREPARED STATEMENT OF MS. MICHAL MEIDAN
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April 19, 2012

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

Hearing on *The China-Europe Relationship and Transatlantic Implications*
Panel on "Relationship in the Foreign Policy Context"

European views on China's relationship with Iran

Over the last year, European member states have managed to maintain a united front in their efforts to adopt an oil ban on Iran, despite resistance from some member states. This, in turn, has led to greater convergence of views between Europe and Washington on the threat posed by Iran's nuclear program and the need for sanctions. But while Europe is united in the recognition that concerted efforts need to be made to engage China in order to ensure the effectiveness of international efforts to denuclearize Tehran, its ability to coordinate with Beijing on the matter remains limited. In this testimony, I will focus on three main factors that have made the EU's cooperation with Beijing on Iran difficult.

1. The challenges of identifying and coordinating with the numerous stakeholders involved in China's Iran policy

China's Iran policy is highly fragmented and informed by a number of influential stakeholders each pursuing different objectives. The extent to which the different European member states (most notably France, Germany and the UK) and European bodies (such as the Commission) have identified the different stakeholders and pursued an ongoing and active engagement with them varies highly. French, German and British efforts are most likely the most persistent and advanced in this respect, with representatives from the Commission and the External Action Service (EAS) raising the issue with their Chinese counterparts less frequently and more as a matter of protocol during EU-China summits.

Indeed, sustained engagement on China's Iran policy would require ongoing cooperation with

* Written Testimony Only

different parts of the Ministry of Foreign Affairs, the military and China's state-owned energy companies. The multiplicity of actors is further complicated by the fact that their interests in Iran and their assessment of the implications of a nuclear Iran vary. Finally, even though none of these actors are the final decision-makers on China's Iran policy, they are instrumental in informing debates and subsequent policy choices.

The broad principles of China's Iran policy are made at the Ministry of Foreign Affairs' (MFA) West Asia and African Affairs (which devises the specific Iran policy and the wider Middle East policy), but the nuclear non proliferation/UN sanctions aspects fall under the department of Arms control and Disarmament, and the department of International Organizations and Conferences respectively. Moreover, insofar as the Iranian nuclear issue also touches upon Sino-US ties, the Department of North American Affairs (one of the more powerful departments) is also involved.

Yet even within the foreign affairs community there is a debate regarding the threat that a nuclear Iran poses to China's interests. Some argue that Tehran's nuclear program and brinkmanship are an additional threat to instability in the Middle East—China's largest source of oil imports and consequently China should take active steps to mediate between Tehran and Washington. Moreover, the MFA's department of North American Affairs is extremely sensitive to the strain that Beijing's ties with Iran are placing on its bilateral relations with Washington. Pressure from the Obama administration holds considerable weight in Beijing's calculus. The same cannot, however, be said for Brussels or for Paris, Berlin or London.

But Beijing remains skeptical of the efficiency of sanctions and eliciting cooperation from China on comprehensive sanctions will remain challenging. While Beijing has in the past supported UN sanctions on Iran, this was achieved due to a number of factors including pressure from the US and Saudi Arabia, but more importantly because sanctions had limited impact on China's economic interests in Iran, namely, oil purchases from the country and future investments in the oil and gas sector. Cooperation on sanctions that undermine China's energy security will therefore be much more difficult to achieve. Moreover, in light of internal debates on the future trajectory of China's foreign policy, with some in China advocating for more assertive diplomatic stances, it will be very difficult for Beijing to comply with sanctions imposed unilaterally by Washington or Brussels (without wider UN approval).

Cooperation with the MFA on Iran is possible and is pursued more regularly by European countries rather than by EU institutions, but European member states are unlikely to hold regular ties with counterparts in all the relevant departments. Cooperation with the corporate and military stakeholders is, however, more complicated.

China's national oil companies (NOCs) and their supporters in the government view energy security as a more pressing concern than Iran's nuclear activities. For CNPC, China's largest NOC, maintaining a foothold in the Iranian upstream has been a strategic goal as the company looks to

its future investment destinations. Sinopec and CNOOC, China's second and third largest NOCs also have considerable interests in Iran. While all three companies have slowed down their operations in Iran, and have avoided "backfilling" projects abandoned by European and Japanese firms, they are delaying executing these projects rather than abandoning them all together. The lure of the North American and European markets, and their growing interest in investing in these markets, has also been an important driver in their decision to delay their investments in Iran.

Chinese traders, Unipec—a subsidiary of Sinopec—and Zhuhai Zhenrong, also buy Iranian oil. Both traders reduced their imports from Iran in early 2012 due to a commercial dispute and were able to lift crudes from other sources, but this was done at a premium and will likely become more difficult and costly if the global oil markets tighten toward the end of the year when the EU import ban kicks in. Both traders have since resolved their disputes with Iran and have signed contracts for 2012. And China's diplomats have stressed that normal trade relations and economic cooperation with Iran will remain separate from the nuclear issue. Energy security is therefore a concern that is shared by diplomats and economic policy makers, and supported by the NOCs. For economic policy makers, the prospect of reduced oil flows from Iran (10% of Chinese oil imports in 2011), combined with current outages in oil production from Sudan and Syria, are a real concern since soaring international crude costs will increase the domestic economic burden and could fuel inflationary expectations. Coordination with corporate entities would be useful for the EU and for member states but is much more difficult to initiate and maintain.

Finally, cooperation with the Chinese military, the People's Liberation Army (PLA) and the Commission for Science, Technology and Industry for National Defense (COSTIND) which lies at the heart of China's military-industrial complex and oversees military ties with Iran is the most difficult. European member-states have ties with the military but neither PLA or COSTIND are likely to discuss their views on Iran with their European counterparts nor is an ongoing dialog likely, even if European countries were to press the issue and elevate it to a strategic priority.

2. Difficulties in identifying and maintaining an ongoing engagement with the actual decision-makers

Yet even engagement with these actors cannot ensure cooperation with China at the highest level. Ultimately, decisions regarding China's Iran policy are likely made by a select number of leaders within the foreign affairs leading small group. These include President Hu Jintao, Vice President and president-in waiting Xi Jinping, Defense Minister Liang Guanglie, the Party's International Department head Wang Jiarui, Foreign Minister Yang Jiechi, Minister of Commerce Chen Deming, and State Councilor Dai Bingguo—the most senior official in charge of foreign policy, among others.

Since the composition and the meetings of the leading small group are not made official, there are limited channels to institutional engagements with it. For a European institution such as the

Commission or the EAS to cooperate it with it would be virtually impossible. Even maintaining ongoing ties with the key members specifically on China's Iran, or its broader Middle Eastern policy, would also be unlikely. While some of the member states including France, Germany and the UK may nurture ties with these leaders individually, it is also unlikely that they cooperate regularly on China's Iran policy.

3. Structural barriers to China-EU cooperation on foreign policy

While the fragmented bureaucratic makeup and the diversity of interests make it difficult for any partner to coordinate with China on Iran, the EU has had a weak track record of engaging with China more broadly.

The diverging interests of individual member states have created notorious difficulties for the EU to speak with one voice as each member state has different priorities in its bilateral ties with China. Moreover, while Europe has some leverage over China on economic questions, it is far more limited on foreign policy issues. Europe is not part of China's neighborhood and has never been a strategic actor in Asia, and it does not have the strategic leverage of the US.

Even though the past year has seen greater unity in European positions on Iran and the need for sanctions, the willingness and ability of each member state to press the matter with Beijing varies significantly. Debt-ridden European countries seeking Chinese financial support will be more reluctant to include China's Iran policy on the bilateral agenda, whereas France, Germany and the UK, for example, will be more inclined to broach the matter. But thus far, the EU and the key member states have failed to make Iran a strategic priority in their relations with China.

Cooperation with China on its Iran policy may be limited, but the European Unions' decision to impose a ban on Iranian crude from July 1 and the increasing difficulties in paying, shipping and insuring Iranian oil, are increasingly complicating China's relations with Iran and its ability to purchase Iranian oil. This does not, however, mean that China will necessarily scale down its oil purchases from Iran. Already, the agreement between Chinese traders and the Iranian oil company will likely mean increased Chinese imports from Iran in the coming months, reaching anywhere between 400,000-500,000 bpd, slightly lower than 2011 import volumes. Moreover, when the EU ban kicks in in July, the financial squeeze on Tehran could lead it to offer Beijing discounted barrels. Some reports suggest it is already offering attractive credit terms to its remaining buyers. Chinese traders will then find it difficult to resist increasing purchases of Iranian oil.

Beijing is likely to maintain a two-pronged approach to Iran: Insisting on safeguarding (even at the cost of delaying) its commercial and energy ties with Tehran, continuing its oil purchases from Iran, while collaborating with the international community on denuclearization efforts stressing its preference for pursuing negotiations rather than sanctions. Any deeper form of cooperation

will likely be limited.

China's decision regarding future oil purchases from Iran will, however, depend on a number of factors: First, the US' position and the extent to which Iran remains an important item on the bilateral agenda. As Beijing heads toward its leadership transition and Washington gears up for elections, both sides will want to keep a lid on potential tensions. On the whole, China's ties with Iran are not strategic enough for Beijing to allow them to derail ties with Washington but Beijing has a difficult balancing act domestically. With the rise of foreign policy hawks in China, especially ahead of an already tense leadership transition, Chinese leaders will want to avoid moves that could be interpreted domestically as bowing to international pressure and sanctions.

Second, concerted international efforts will increase the pressure on Beijing, which wants to avoid being isolated internationally and still seeks to portray itself as a responsible stakeholder. Even though the EU has on the whole limited leverage over China, clear and consistent signals that Iran is part of Europe's strategic interests will raise the cost of non-compliance for China. Washington and Brussels should, however, define their expectations for Chinese support on denuclearization efforts. They are more likely to prompt China to adopt a limited mediation role than they are likely to convince China to use oil imports as a means of squeezing Iran. Energy security is seen by China's leaders as a strategic interest, suggesting that Beijing is unlikely to significantly curb its imports from Iran or relinquish its commercial and energy ties with the country.

Third, the technical barriers to importing Iranian crude oil will also be a determining factor. But in this respect, both the EU and the US should consider whether the ultimate goal of sanctions is to squeeze Iran financially by forcing it to offer discounts on its oil to the few remaining buyers, or to take Iranian oil off the market which could result in tighter oil supplies and higher crude costs for all consumers.

PANEL III: QUESTIONS & ANSWERS

HEARING CO-CHAIR BARTHOLOMEW: Thank you, both, for your very interesting testimony. We'll start with questions. Commissioner Blumenthal.

HEARING CO-CHAIR BLUMENTHAL: Thank you.

I have two questions. One is what is now, in your opinion, the European position on both position and assessment of cross-Straight relations and Europe's relationship with Taiwan? I suspect, from where you stand, it's a different assessment than we have here in the United States.

But it struck me in traveling in Europe that, at least among the parliaments inside the countries, there's a lot of sympathy for Taiwan on human rights grounds rather than on security grounds. I just wanted to get your assessment on that.

The second question is, it seems like the EU and the U.S. are completely on the same page when it comes to Iran, sanctioning Iran, which obviously goes to my belief that we have more in common than not, particularly with respect to China. I'm wondering if you are seeing the Chinese try to make any cracks in those joint efforts?

DR. HOLSLAG: On the cross-Straits relations, first, I think it's important to somewhat summarize how we look at the evolution of cross-Straits relations, and in Brussels there are certainly people are extremely optimistic, and I would say even a little too optimistic that there is a strong political momentum to advance stability and also that economic interdependence is going to lead to some sort of settlement.

I would say that this view is increasingly common amongst the officials. I like a bit a critical attitude towards the evolution of the cross-Straits relationships nowadays.

Now, what's first and foremost on the agenda nowadays, I would say, is the economic dimension. We certainly would like to find ways to get closer relations with Taiwan in the economic realm although here the Chinese are very much on their guard and caution us whenever some new initiatives are raised.

I think it's also clear that we continue to support meaningful presence of Taiwan in international organizations.

And the last angle perhaps which is important is the impact of the financial crisis on how member states look at Taiwan. What I pick up from the Taiwan mission in Brussels is that countries like Portugal and Greece are nowadays much more reluctant in their discourses to stick to the EU line and also much more willing to give in to Chinese pressure not to make statements on, for instance, the issue of meaningful presence in international organizations.

I've not done very specific research on that, but I hear these statements from the Taiwanese and also already a few times from EU officials.

On Iran efforts, from the side of China to make cracks in our policy, I'm not really familiar or aware of any such items.

HEARING CO-CHAIR BLUMENTHAL: Thank you.

DR. WACKER: Okay. On the cross-Straits relations, I think mostly the Europeans just hope that the problem will go away, and they were relieved with Ma Ying-jeou won his second term, but so was the United States. So I mean, you know, rocking the boat is in nobody's interest.

I think that there is a little bit more awareness because the EU was also involved in a Track 2 or 1.5 effort with the Chinese to talk about cross-Straight relations.

There is still this consensus that the "big five" from Taiwan cannot visit. I think this would be something that the Europeans should probably address, but they need a unified line on that. If a single country stops, I mean invites one of the "big five," it will be punished by China. But if all decide to go in that direction, it would probably help.

There has been--

HEARING CO-CHAIR BLUMENTHAL: I'm not familiar with the "big five."

DR. WACKER: The "big five" is the president, the prime minister, the foreign minister, the defense minister, and the fifth, I don't remember.

HEARING CO-CHAIR BLUMENTHAL: Premier.

DR. HOLSLAG: The vice president.

DR. WACKER: The vice president; right. So no movement on that. So far what has happened is visa-waiver for Taiwan. I think this is a big step forward, and I want to use this as an example because the resistance against this visa waiver was brought up mainly by Greece, Cyprus and Spain, and I think this reflects their own problems with separatism that almost blindly lets them react in this way.

Because we have a separatist problem, we want to support nothing that has to do with separatism in another country. It might seem absurd. Here the Lisbon Treaty helped because the qualified majority was in the end enough to push the visa waiver through, but this is important to understand that sometimes these almost post-colonial reflexes on the specific situation or experience of a country informs issues like that.

I think there is more explicit EU support for membership of Taiwan in certain international organizations since Chen Shui-bian has left the scene because it's much easier with Ma Ying-jeou where you know this is a pragmatic approach, and he will not exploit to the utmost the political capital he can get out of that. So the European Commission has been, or Lady Ashton has been, more forthcoming in declaring support for international representation of Taiwan.

And on Iran, I'm not sure that the EU and the U.S. are completely on the same page. On sanctions, maybe yes, but the prospect of a military intervention does not look too attractive and appealing to the Europeans.

I don't know whether China tries to make cracks in these negotiations, but I think the five-plus-one format, I heard that the Chinese are not playing a disruptive role in the negotiations. So they're in the boat, and I think that's very important to have China and Russia, who can block everything at the U.N. Security Council level, to have them in the boat with the negotiations.

Yeah. So don't know whether there are cracks. If there are, you know, the cracks are probably already there.

HEARING CO-CHAIR BLUMENTHAL: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: So the previous panel we

started this discussion about threat perception, I want to be a little more explicit here. What in your view or in the view of leaders of Europe would be a Chinese threat to national security or European security or individual states?

And there's obviously differences. It's not monolithic what's the threat. Is it--I mean where I'm going, you can see--is there anything that the Chinese would do that could be perceived as a threat to European national security? It's got to be talked about. I mean let's sort of lay it on the top.

[Laughter.]

DR. HOLSLAG: It's quite a difficult question.

COMMISSIONER FIEDLER: Well, I mean that's why I asked it actually.

DR. HOLSLAG: Yeah, no, but sure, I think mostly when we talk about China as a threat or parts of China's rise as a threat, at the best we see some risks and challenges. But very, very clear-cut security threats, there isn't one really crossing--

COMMISSIONER FIEDLER: No, no. I mean I'm not talking about--I'm not talking--

DR. HOLSLAG: I know, but from what the leadership perspective--

COMMISSIONER FIEDLER: All right. Could they, if they decided to shut down the Straits of Hormuz themselves, that would be a threat; right?

DR. HOLSLAG: But let's say in this little community called Brussels, I certainly do not believe that officials, commissioners, or folks at the External Action Service leave their sleep over a potential close down on the Strait of Hormuz.

COMMISSIONER FIEDLER: No, I know that.

DR. HOLSLAG: Or eventually, for instance, major instability in East Asia. It's just not figuring prominently on the agenda.

What is perhaps becoming increasingly seen as an important challenge is China's potential influence over European economies. We hear increasingly our member states' officials and EU officials talk about sort of the repercussions of eventually growing and expanding Chinese investments over, in the first place, of course, critical

know-how, also, the diplomatic maneuverability of states, but you couldn't really see that as a very consistent identification of China as a threat.

COMMISSIONER FIEDLER: Thank you.

DR. WACKER: When I talked about the threat, I did not talk about the military threat because I think this is where China is not perceived as a threat by the European Union--as a military threat to European states.

I think if you want to imagine a scenario, where we would see China as a threat, if they would do something to disrupt, for example, global public goods like the freedom of navigation, this would be seen as quite a threat, because this really is a threat to our interests.

But I think there is a difference between threats to our economic competitiveness, a military threat, a political threat, or a threat to the international order. This we so far do not see.

COMMISSIONER FIEDLER: What I'm--actually I'll tell you what's disturbing me. The world is increasingly interdependent. It's a global economy. And you're describing a situation where European leaders are taking a narrow view of the world as opposed to a broader view of the world.

Now, I understand in terms of power and the ability to do anything about it, you may be limited, but that doesn't necessarily mean you should be unconcerned. So everybody is articulating to me today an isolationist view. I mean we were talking about "splendid isolation." What you're describing, without using the term, is a narrow isolationist view, like we don't really care if they were to get into a war with Japan. Forget the United States.

So that's why I asked the question--what--so nobody said to me, oh, we're concerned if they invade Taiwan. Nobody. We're concerned if they go to war with three countries in Southeast Asia over oil. We're not concerned about whether or not they take over half of East Africa with Mugabe. There's almost nothing, and that disturbs me. Almost nothing that would move the European leadership to action that you folks know of. I mean--

DR. WACKER: I think that's a misunderstanding.

COMMISSIONER FIEDLER: That's an exaggeration on my part?

DR. WACKER: No, I mean now you talk about concern. Of course, the Europeans are concerned about--

COMMISSIONER FIEDLER: No, would they do anything about it?

DR. WACKER: Well, to be realistic, yes, they would probably do something in terms of trying what they have done in several cases where the U.S. has led a war that we did not want to get involved in. We would probably take over tasks in Europe or give you overflight rights and give logistical support and stuff like that.

On the Taiwan, I mean I don't--

COMMISSIONER FIEDLER: Let me--

DR. WACKER: --see us militarily intervening in a Taiwan scenario.

COMMISSIONER FIEDLER: No, no. That's not what I was saying.

DR. WACKER: But we are concerned about that.

COMMISSIONER FIEDLER: Let me, I'll give you an example because in the Clinton administration, whenever I was in the White House, and I was agitating some people in the White House at the time, they were always concerned about Europeans filling a business vacuum in China because the U.S. did something.

So, for instance, if there was an international incident, the United States were to take some sort of action to limit their business, would you fill the hole that was created by the vacuum of the United States failure to do business?

So let's say that they invade Taiwan and we say "uh-oh," no more shipping to the United States for shoes. Would you guys take all the shoes? I mean that's an oversimplified. You probably haven't got enough feet for that, but capital equipment, technology. I mean you understand my point.

DR. WACKER: The Italians would probably say we are happy to produce the shoes.

HEARING CO-CHAIR BARTHOLOMEW: If they have the capability anymore.

DR. WACKER: I really think that's a misunderstanding. I mean it really depends on what kind of incident happens, you know. Everybody says we didn't lift the arms embargo because of U.S. pressure, but there was

another factor that played a role, and that was the anti-secession law. Because the Europeans said the Chinese have now done something that we cannot accept, and they have just prevented us from--if the U.S. pressure was not enough, this pushed us over the edge.

So there is concern about these issues. As I said, we would not probably send military there, but I'm sure that you would have tried to agree on sanctions against China if an incident like that happened; right?

COMMISSIONER FIEDLER: We would, yes.

DR. WACKER: Or would you just say we're not going-

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COMMISSIONER FIEDLER: We certainly would. I was asking the question whether you would accept--

DR. WACKER: --we don't want your shoes anymore and not talk to the Europeans about it? I mean it's also a matter of consultation.

DR. HOLSLAG: I for one venture to say that a lot depends, as Gudrun also argued, on how much we see Chinese aggression or revisionism or however you want to call it as being the cause of violence and instability in Asia.

A second complicating factor is also that different stakeholders in Europe, not only member states, but also the agencies in Brussels, have different interpretations of the complexity of, for instance, territorial disputes, cross-Straight relations. That's the second element.

And a third factor is decision-making. I'm pretty sure that when it comes to responding to, for instance, a cross-Straight conundrum and considering certain sanctions on China, that the 28 are going to have pretty diverging readings of what happens and also how it feeds into their economic interests and political calculation.

So that again brings us to the very, very identity of Europe as an international actor. You shouldn't expect from Europe what you expect from a nation state.

Overall, and that has been the crux of your question, China as a sort of destabilizing factor in global affairs, some layers can be identified. Global governance. Europe has been somewhat obsessed with effective multilateralism and global governance. I think that clearly we see China as a challenge in the U.N., in the global trade and economic regimes, in climate change, name

it.

But it's not the only challenge. As also Gudrun mentioned, we have as much difficulties with the viewpoints of the U.S. at times or India as with China.

Second, and it's also important is our neighborhood--Africa and the Middle East. For sure Africa and China's behavior in Africa figures very, very prominently on the agenda and the radar screen of all agencies in Brussels, European Parliament, External Action Service, also member states. We have tried to engage China. It has failed. Largely the question is what is going to be the next step?

But then on the Middle East, for instance, besides Iran, a lot of decision-makers in the EU find part of America's policies there as disturbing as some of China's presence. So it's a bit complicated, a combination of institutional constraints and then also the fact that our interests geopolitically and just politically, economically, do not always converge automatically with the U.S. You shouldn't expect an instant and automatic alignment.

DR. WACKER: May I add one comment briefly? You said narrow and broad. I think the problem is that you have the narrow and you have the ultra-broad in Europe. You have the global level and you have the bilateral level. But the level in between is kind of missing.

And if you look at Europe--probably this is what Oystein was also driving at--it's like concentric circles. The further away you get, the less attention is there because the capacity is not there. If you look at our foreign ministries, they probably spend 60 percent of their time dealing with intra-EU stuff, and then you have 40 percent left for all the rest of the world, and then, of course, you have the neighborhood policy, and this is the priority.

Anyway, but probably this was what he tried to say. It's not isolation. It's a focusing on the Europeans. So far they are lacking some of the military capabilities like air transport and stuff, but there's a focus on the immediate neighborhood.

It's not isolation, and it has nothing to do with broad and narrow. It's a different perspective than the

U.S. perspective that is a global one.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner D'Amato.

COMMISSIONER FIEDLER: Thank you.

COMMISSIONER D'AMATO: Thank you, Madam Chairman, and thank you both for your statements.

I want to narrow it down to one issue, two issues, actually. The first one, the question of whether there is geopolitical convergence between the Europeans and the U.S. on the South China Sea? That to me is a pretty concrete example.

PLA generals every once in awhile declare the whole place to be a core interest of China. We've got interests there and the other littoral states on the South China Sea.

My question is how strong have representations been made by the Europeans as to the need to retain sovereignty of freedom of navigation and so on in the South China Sea? And have they protested about the various incidents that have occurred with Chinese fishing vessels and other nations' fishing vessels, and the escalating number of those events that are very worrisome?

So the question I think is a good example of whether or not there is a convergence of interests and alignment of policy positions stated by the Europeans with the U.S. on this matter.

DR. WACKER: You want to?

DR. HOLSLAG: Okay. Well, in the first place, we do not really consider/identify China's policy towards the South China Sea entirely with this so-called dashed-line that encompasses most of the South China Sea.

Just to make it very specific, as far as I know, at this very moment, there is one official spending a few hours on a monthly basis on figuring out what the South China Sea dispute is about in Brussels. That's reality.

COMMISSIONER D'AMATO: One hour for--one official for a few hours a month?

DR. HOLSLAG: Yes, absolutely.

COMMISSIONER D'AMATO: Hopefully, not many incidents will occur.

[Laughter.]

DR. HOLSLAG: But that's how it works. That's the capacity that we have to follow up on such important

issues.

Now, on our position towards the South China Sea, I think we have made very clear time and again that we support a multilateral solution, that we also encourage the ASEAN countries to work together on that, and that we call for restraint on both sides. So I think that is pretty clear sort of signaling our concern about individual incidents.

We haven't really done that also because often it's very hard to discern whether the Philippines, the Vietnamese or the Chinese have been the cause of all the anxiety.

So it's a matter of capacity, and it's also a matter that we do not really understand or have deciphered for ourselves what it is all about.

DR. WACKER: Yeah. Nothing much to add. I think there has been no comment on any of the specific incidents in the South China Sea from the EU, but this probably is one of the areas where I also would say there is room for more cooperation or at least for more exchange of information because if you look at European interests, there are security interests in East Asia.

They are secondary because they derive from the economic involvement in the region, and I think freedom of navigation is one of the issues that is really at the heart of the Europeans. So maybe it would be worthwhile to engage them more on these global public goods like freedom of navigation.

Again, I have to say it would probably be easier to be on the same page on these issues if the U.S. had ratified the U.N. Convention on the Law of the Sea.

COMMISSIONER D'AMATO: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Shea.

CHAIRMAN SHEA: Thank you both for being here and for your very interesting testimony and your spirited responses.

I hate to do this to you, but I'm going to do it to you anyway, put you on the spot as sort of the representatives of Europe here. I mean that's sort of what you've become here.

What is your view or the European view, to the extent there is one, on what China's internal challenges

are? This is also a bit off subject. And what do you make of the recent apparent arrest of Bo Xilai and the controversy surrounding the succession of power in China? What do you think it says about political stability in China?

DR. HOLSLAG: Let me try to reflect a little bit on the discussions we had of late with some EU officials on political transition in China. I can give you my viewpoints, but I think it's more interesting to summarize that.

Most of all, the sort of conclusion of that meeting was that we are going to head towards a period where there are going to be more political divisions that will make it more difficult to pursue the reforms that have been on the agenda for a long time, whether it's economic liberalization, political reform or whatever.

Conclusions were also that we, most of the officials present, estimated that this sort of growing or increasing fault lines at the level of the national leadership in China are likely going to feed populist and nationalist sentiments, and that might lead to entrenchment in terms of the whole response to unrest, and also make China a more difficult actor to handle on the international scene.

So overall, you could sort of summarize it as quite some concern about the course of political events that we expect for the next few years.

DR. WACKER: I can only give my personal opinion here.

CHAIRMAN SHEA: That's fine. That's great.

DR. WACKER: I'm a European after all.

[Laughter.]

DR. WACKER: I think the challenges have been clear for quite awhile. I mean never in the history has a country set out to do industrialization, urbanization, and informatization at the same time on such a scale, and this whole growth model of China has run into a problem of sustainability, and I think this is where the present leadership has, in a way, failed despite the fact that they tried to restructure the growth model. This has not happened. And I think environmental problems, et cetera, are now so big that it's simply unsustainable.

So these are the challenges. I don't know whether the incoming leadership will do a better job. We have never in the last decades experienced such a political uproar like the one with Bo Xilai, and I think it says something about this leadership. Even the last one was already trying to find a consensus, was a collective leadership, which does not let out conflicts that exist within this group.

But Bo Xilai would not be possible without rifts within the innermost leadership, I think. So the question is, what will this lead to? It's probably too early to predict something. Some people say the fact that Bo Xilai is now out of the picture means there will be a push for more reform, and there are certainly forces that would like to go in that direction, and this World Bank report, which was written together with a Chinese institution, points in that direction, that there is a strong force within China.

And if you talk to anybody, any intellectual in China, in the Party school, they all will tell you political reforms will have to come. They will have to come. And so the question is how this whole scandal with Bo Xilai, whether they will be able to rein in the consequences because a lot of things are coming out now about the level of corruption, et cetera, which will be hard to all pin on Bo Xilai and not lead people to wider considerations about the rest of China's leaders.

That was probably a bit confusing, but--

CHAIRMAN SHEA: No, not at all.

DR. WACKER: It's not clear yet how the Bo Xilai thing will play out in the end for me. Whether it's really a push for the reform forces or whether we will see a backlash from the other camp--

CHAIRMAN SHEA: So your view, it's more of, it's an ideological struggle as opposed to sort of a power? Personal?

DR. WACKER: It's not ideology. It's probably about the right way for China to go forward with one camp saying we need to do structural reforms, we need to have more transparency, we need to have rule of law. We maybe even have to have something like a division of powers in order to make this development sustainable. And there is another camp that says no. This is grossly oversimplified,

of course.

CHAIRMAN SHEA: Thank you very much.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

Commissioner Reinsch.

VICE CHAIRMAN REINSCH: Thank you.

Some of my questions have already been asked, which is going to save us some time, which is good.

I think I want to pursue a little bit what may be a useful lesson here for us, which both of you have commented on, which is, in a sense, the distinction between the EU as a juridical entity and the member states and what lies within the competence of each.

Most of my background is on the economic side where a lot of the international competence has been transferred to the Commission, but we're in an area now where that's not so, and I guess the question I'd ask is, take the various issues that we've been discussing here, the actions that the Chinese might take that would have strategic implications of one level or another, or actions that we might take that the EU would then be in a position of having to respond to, as sanctions or something like that.

Is the EU really equipped structurally to make a collective decision on those kinds of issues? Or are we functionally really back dealing with member states on either military, foreign policy, or strategic questions?

DR. WACKER: What kind of decisions?

VICE CHAIRMAN REINSCH: Well, South China Sea was one. I missed the dialogue on that. In Iran, if we were to take fairly aggressive sanctions/actions against the Chinese because of their failure to cooperate with sanctions that we have imposed on Iranian oil, for example, but we decided to do something to the Chinese companies directly, and does anybody in Europe decide that? Is that an EU decision? How likely is it that there would be--I mean there would certainly be pressure from us for a response.

I'm just interested in whether there's a structure there to produce a collective response or whether it's every country for itself?

DR. HOLSLAG: Well, the Iran case, of course, is hypothetical, but let--

VICE CHAIRMAN REINSCH: Yes.

DR. HOLSLAG: But let's continue along that line. In the first place, this is going to be raised at the COREPER, which is a Committee of the Permanent Representatives in Brussels. And usually that's not the kind of setting where you're going to have major breakthroughs.

So then you probably would wind up in a lengthy spiral of consultations with the member states, with the capitals, which might take a very, very long time. But it's certainly not the case that the External Action Service is going to lead on those things. It has neither, I think, the human resources, the institutional capability, nor the legitimacy at the moment to do so.

But as you are an economic expert, I think we shouldn't confine this entirely or only to security issues. The question is also how we are going to handle potential repercussions of China against some of the measures that we might take, and we have the issue of planes and green tariffs, but there are also some interesting antidumping cases in the pipeline, and the Chinese have already made it very clear that if we would sort of go ahead with them, that there would be some very significant countermeasures.

They have approached individual member states with their views, and those individual member states have already come back to the European Commission, and quite a few of them have signaled that they don't want to have this on the agenda and don't want to damage relations with China.

So there, as well, you see a collective action problem, and I think that the collective action problem is more imminent, is more important, in the realm of economics than strategic issues. We are not going to be able to manage an escalation of trade tensions, contrary to the U.S. probably.

VICE CHAIRMAN REINSCH: But it sort of is structurally different. In the economic case, you're going to have a problem because the EU is capable, is structurally charged with making a decision, but it may be incapable of coming to a decision.

DR. HOLSLAG: No. I don't really think so. Formally, of course, the Commission is in charge. Since Lisbon, DG Trade has a full mandate to negotiate on these

matters. But I can assure you that, for instance, on one big trade case that is now in the pipeline, it's because of member states' political influence that it is blocked.

VICE CHAIRMAN REINSCH: Okay.

DR. HOLSLAG: And they then go--either the President of the Commission, but also--and it gets stuck there. So it's not that Commissioner De Gucht has full scope to do whatever he wants.

VICE CHAIRMAN REINSCH: I understand. Dr. Wacker, I cut you off. I'm sorry. Go ahead.

DR. WACKER: No, that's no problem. I wanted to point to the past. I mean look at the Iraq War, look at the Libyan resolution, and look at--no, Syria is not a good example because for once the Europeans all voted in the same way on the resolutions. But on Libya, the no-fly zone, Germany abstained. Right. So no EU position.

And very different behavior in the U.N. Security Council, and on the Iraq War, I mean this is the time when China believed that the Europeans would emancipate themselves from this transatlantic relationship because there was the rift within the EU with some very strong European member states saying no, we're not going to act in solidarity with what the U.S. is about to do.

So I think there is no general answer. There will be no kind of act of solidarity by the European Union. We are in Afghanistan because the U.S. as a NATO member was attacked in a way. And I think that the U.S. invoked Article 5 on that, but this is all not the case when we talk about a war between Japan and China or over Taiwan as long as China does not attack the U.S.

So there is no general answer. You would really have to look at it case-by-case, and my colleagues who are much better specialists on the EU than I am, they would argue that the Lisbon Treaty has not made it easier to get to a decision. It just makes it easier to implement it once it is reached, but you will not get there faster.

And sanctions, you have to see at what level, in what organization do you want to agree on sanctions. It would have to be negotiated between the U.S. and the European Union with its member states, but I mean it's really, there is no guarantee for European unity.

HEARING CO-CHAIR BARTHOLOMEW: Okay. Thank you.

VICE CHAIRMAN REINSCH: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Cleveland.

COMMISSIONER CLEVELAND: I'm interested in the comment that you just made that the EU doesn't make it easier to make the decision, but it does make it easier to implement it. I'm looking at a table in your testimony, Dr. Holslag, on transparency and accountability. And I'm wondering about the fact that it reflects consensus in Europe on EITI, OECD-DAC rules, and Paris Club rules when it comes to transparency and accountability for extractive industries and development aid.

The table shows that, yes, there is a dialogue, but there has been no cooperation and no adjustment in Chinese policy, if I'm reading this correctly. Is that so? Can you talk a little bit about whether or not the "divide and conquer" strategy is, in effect, influencing the outcome on those three particular initiatives, or what's at play when it comes to securing Chinese agreement on EITI, and DAC and Paris Club rules?

DR. HOLSLAG: Well, on EITI, the Chinese just flatly said that they wouldn't like to be part of it. So that was the end of the dialogue.

On OECD-DAC, we support interaction between China and OECD in a committee of specialists. We've also invited Chinese experts of various think tanks to do studies on how we deliver aid to Africa. Quite interesting is that most of their conclusions went into the direction of advising China not to follow the European example and to say that it is not the interest of China to buy into the OECD-DAC criteria.

On the Paris Club rules, well, we have, as far as I recollect, mentioned this or discussed this two or three times at the annual dialogue without much results. The Chinese just said we are at a different stage of development. We have economic interests that we have to look after. So it's a different approach that we inevitably continue to follow.

The other aspect of your question, whether it reflects fault lines within the European Union, I wouldn't really say fault lines. The member states, the External Action Service, and the Commission go ahead with these

initiatives, but the problem is, of course, that their own practice in development cooperation, granting aid to Africa, and also involvement in extractive industries in Africa isn't always reflecting what is on the table at the EU level and that this is frequently invoked by Chinese officials as an argument that we just measure with two standards.

That we should first live up to our own rules before we engage China. I think Europe has a very, very big legitimacy and credibility problem when it comes to engaging China on development and governance issues in Africa, and we get the same from the Indians, from the Brazilians, and so forth.

COMMISSIONER CLEVELAND: Dr. Wacker, we talked in the break about the earlier testimony on the Chinese relationship with the Taliban. Would you care to comment on the news reports that they may be exchanging intelligence information or establishing a base in FATA?

DR. WACKER: I think Andrew Small is in a much better position to answer that, but we talked about it in the break, or we were already when this was in the testimony, we were sort of rolling our eyes. It seems to go back to one article-- this military base in the tribal area-- in the Asia Times by one Pakistani journalist, and then through paste and copy, there was this snowballing effect, and if you use your normal rational thinking, you ask yourself why would China go into a region, with a military base, that is uncontrollable even by the state where this region is located?

It makes absolutely no sense to me, and I think that at the end of the Taliban time, China did accept the Taliban as the government, but I would not say that there is a very close relationship. It's just that they don't want to put all their eggs in one basket, and they try to have good relationships with all sides. That's even true in Myanmar where we always think they're only supporting the military junta, but actually they are trying to foster relationships with the other groups and invite the conflicting parties to Beijing.

They do this all very quietly, but on the Taliban, again, why should they share information, sensitive information, when the whole time their concern is that

stability in Xinjiang is threatened by spillover effects from Afghanistan and Pakistan, and the whole radicalization of Chinese or Uighur students who go to Pakistan and then from there to Afghanistan, as it was in the past.

It makes no sense. Again, it makes no sense for them to do that, and I think sometimes this sort of information is totally overblown--maybe there are engineers in Kashmir doing some work, but that doesn't mean that China has military bases there even that engineers come from military units.

I think we have to be very exact and try to really get the information, what is true and what is not, and some stuff just doesn't make any sense to me. I will not swear my life on that, but they're not crazy.

[Laughter.]

COMMISSIONER CLEVELAND: Thank you. I just wanted to make sure there were different points of view on the record on this.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Slane.

COMMISSIONER SLANE: Thank you for your great testimony. It's been very helpful.

If the debt situation in Europe gets much worse, and the European Central Bank has to bail out Italy and Spain, do you see the bank turning to the Chinese, and if so, what price do you think the Chinese would extract for helping out?

DR. HOLSLAG: Well, I would first sort of assert that for China, it's not a question of choice. It's a question of necessity. If you run a surplus in the current account, you have to compensate or get it out on the capital account, which is what China has certainly been doing already quite extensively.

We don't have exact data, but if you look at balance of payment of individual member states, and you look at the portfolio investment, inflows from China are very large. It isn't channeled via the European Central Bank because, of course, officially the mandate of the European Central Bank to bail out is quite modest to say the least.

The conditionalities that are related to that, I am not aware of any meeting at the EU level during which the Chinese explicitly attached conditions to sort of the

purchases of government bonds, of official bonds. Then, though, you had this murky statement of Wen Jiabao that they would like to get market economy status in return. I haven't heard it repeated in the last months.

Usually, mostly what China is doing, I would summarize, is to create very high expectations amongst individual member states about the prospect of getting more gains out of China in terms of not only bond purchases, but also more investment, export opportunities, and political goodwill that it uses for all sorts of issues, being it Tibet, Taiwan, but also access to markets, and it works very well, I would say, in most European member states.

In terms of, for instance, extracting economic returns from member states, I'm not aware of any example in which government bonds purchases were directly related to, for instance, concessions in one of the public sectors or preferential treatment in terms of investments.

Now, it brings us perhaps a bit further, but it's important to highlight that. However, in the short-term, member states might be inclined because of financial distress to jump on the China bandwagon. You also hear increasingly in the capitals and in Brussels that in the long run, China is a major competitor. The solution to the debt crisis is not in piling up even more debt, but is in creating growth, is in creating jobs, and there you can see that even the pair of failed countries single out China as a challenger to their efforts to keep the last little bit of industries that they still have and in the efforts also to build up new sort of sectors of growth.

And that, of course, makes them, being it very subtly and tacitly as well, still somewhat supportive of an assertive trade agenda towards China, but it's very inconsistent. If the Chinese officials or China at some stage weighs in to make that change, then usually capitals aren't so stubborn and do not show a lot of resolve to stick to their line.

It's very complicated, but my assessment would be that in the long run, China would be considered a competitor still rather than some partner that is going to come to the rescue.

DR. WACKER: Maybe we could say investment in greenfield investment, as was mentioned this morning, would

be a way to create employment, for example. As long as China plays by the rules that are prescribed by the country they are investing in, I see no reason why they should not be welcomed.

I also agree that there was this rumor about the political conditions. I think that Wen Jiabao mentioned market economy status because it would have been nice to have it on his balance sheet at the end of his career: I did it; I got market economy status for us.

It's really not that important an issue. It's basically now symbolic and a nuisance because of the antidumping cases, but it has been rarely mentioned, and I think we have lost this instrument. We will get nothing for it, as Andrew mentioned this morning. What the Chinese would like us to do is have euro bonds, but this is something that the Europeans don't want or some do, but others don't, because then we would be really all in the same mess.

But that was an argument from the Chinese from the beginning, when the Europeans said why don't you invest more in the euro to get out of this one-sided dependence on the United States, they said we would. In the beginning the argument was we can't because the euro is so weak. Then the euro became stronger and stronger, and they said we can't because you have no euro bonds, and there is just not the market that can absorb the amount of money.

But they will always play it safe. As I said earlier, the People's Bank of China is also an actor, and they will try to prevent the government from sinking money or throwing it out of the window so they will try to play it safe and go into German euro bonds and not the Greek ones.

DR. HOLSLAG: Perhaps a last comment, if I may. If you discuss these things with people at NDRC or the People's Bank of China, it's really interesting how they see Germany as sort of beacon of stability within the eurozone, and what they say most of the time is that if they would purchase government bonds, then it's mostly a matter of helping Germany to help the peripheral countries. That seems to be, to me, at least, their preferred policy at the moment.

HEARING CO-CHAIR BARTHOLOMEW: Thank you.

Commissioner Wortzel.

COMMISSIONER WORTZEL: Thank you both for your submissions and your testimony.

Dr. Hol slag, in just about the last paragraph of your paper, you have a very interesting statement I think sums up everything that we've heard today, and that's that Europe will avoid maritime power plays in the Pacific. That's a lesson that at least for me has been driven home by the whole day's proceedings.

And Dr. Wacker, you have two points of interest that I'd like to build on. Your final section of your written submission is about areas of U.S.-European alignments, and your very first footnote talks about the importance of maintaining global public goods like freedom of navigation.

So I wanted to see if I could draw both of you out on your thoughts on where Europe and the United States might align broadly on access to the global commons, and specifically, I'm talking about space, the operation of satellites and telecommunications; I'm talking about air traffic as it relates to commerce; I'm talking about freedom of navigation on the high seas; and I'm talking about cyber space and the management of the World Wide Web.

It seems to me if there is an area for alignment--there aren't many--the global commons really may be that, and I'd just like to hear your response to that suggestion.

DR. HOLSLAG: Okay. Well, I'm not able to go too much into detail on what the specific agendas of the EU are vis-a-vis space, cyber, air traffic, but what comes to my mind in the first place, especially with regard to cyber, is that besides one commission, communication at the EU level dedicated to cyber security, there haven't been a lot of initiatives.

COMMISSIONER WORTZEL: Yeah, and that's different from the World Wide Web and whether it remains open and free.

DR. HOLSLAG: Yeah. But that document also referred to the World Wide Web as a global common, and it came to the conclusion that basically the EU was virtually nowhere in, first and foremost, identifying its interests, and in the second place, also coming up with some initiatives and policy instruments that would be able to

defend European interests.

Perhaps last, specifically, on freedom of navigation, in the South China Sea, if you look at it from a European geopolitical viewpoint, do we really have to assume that China is going to cut off its economic life lines to Europe? I think China would probably be the last country that is going to close down the navigation via the Malacca Strait or the South China Sea. It's not in its interest. So I don't think we have to be very much concerned about it.

DR. WACKER: Okay. I think there is a paper by Abraham Denmark that was published by the GMFUS. I thought those were the areas where he proposes that there should be some more transatlantic dialogue to explore the possibilities. If we find out that the EU is again nowhere, okay, so much for the cooperation then.

But I think space, cyber space, freedom of navigation are all issues that could be explored and actually that was one of my recommendations too, that if it's not already talked about--I mean I don't know what are the topics at the government consultations--it should be put on the agenda.

I think because you wrote this, the EU will avoid maritime power plays in the Pacific. There are I think two different issues that have become quite muddled now. One is the territorial issue, and the other is freedom of navigation. And China does not challenge freedom of navigation as such, but it has a problem with surveillance ships from the United States, what is called innocent passage, and stuff like that.

So I think we should again be very clear what issues we are talking about because we are muddling these different problems. I think that this has only happened in the last one or two years, that these two issues were thrown together and the littoral states that also claim parts of the South China Sea sort of jumped this freedom of navigation topic because this flies well with the United States and probably vice versa.

COMMISSIONER WORTZEL: I'd suggest to you that the reason that that came out to the forefront is for about a one-year period China claimed the entire area in the 9-dotted line as its core interest.

DR. HOLSLAG: Did it formally?

COMMISSIONER WORTZEL: Well, it did formally, at least when we met with the Ministry of Foreign Affairs. It did formally when we met with the People's Liberation Army, but I think you're quite right, that Dai Bingguo has backed away from that.

DR. WACKER: Yeah, but I mean there will be stories how this all happened, that it was said in a closed door meeting, and somebody took it outside to the press, and then again you have this snowballing effect. It's out there. The Chinese have no way of reining this in because once the claim is stated, everybody who takes it back appears to be weak. So they can't go back behind this core interest thing, and it takes some time to mellow, so to say, so I think, again, if we blow this out of proportion with the core national interest, and look at the way, how it has come about, they have sort of withdrawn from this whole rhetorical stance.

That doesn't change the claim to the South China Sea, but, again, I think we always should be careful to understand the psychology that is behind the Chinese reaction as well, and in this case, I think they have been given a chance by pressure and by maybe also some incentives to take it back a bit.

COMMISSIONER WORTZEL: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Okay. My turn. Dr. Holslag, I'm interested in your comment about EU private companies working with Chinese companies, and that's how they're getting access to some of these opportunities in China.

But do any of the EU countries or the EU itself have any version of a Foreign Corrupt Practices Act?

DR. HOLSLAG: No.

HEARING CO-CHAIR BARTHOLOMEW: Okay. So what I'm thinking about is, on one hand, we have the OECD encouraging transparency, accountability and good governance, and on the other hand, we have private companies going in with no restrictions on corruption, paying bribes to government officials, anything like that in their transactions; correct?

DR. HOLSLAG: Well, of course, you have also to look at where most of the companies doing business with

China come from. And most of those companies, whether these are contractors, oil companies involved in extractive industries, originate from the certain countries. Scandinavians, as far as I know, are not so heavily involved in a lot of these joint ventures with China, and these are mostly the ones that tend to highlight the importance of transparency and accountability.

But it's again a matter of consistency, and it goes even as far as individual countries, like Portugal, not the least, but also Spain, who now have formal policies to back their companies to work with the Chinese in Africa, to do business together. Portugal has a very, very aggressive policy to put its firms in a good position, especially in contracting and construction, to work with the Chinese. Spain has it now with regard to energy and also, at least, in Gabon in logging.

HEARING CO-CHAIR BARTHOLOMEW: One of the issues of Chinese companies in Africa, of course, is the way that they are treating their African workforce, but then there is also the other issue of them using primarily Chinese workers instead of even using African workers.

Human Rights Watch did a report recently on concerns in the Zambian copper--

DR. HOLSLAG: Yes.

HEARING CO-CHAIR BARTHOLOMEW: Copper mining industry, and the treatment by the Chinese of the African workers. I'm trying to understand or to think about what happens with standards that European companies might have or might need to comply with in their home country versus what kinds of practices they are willing to engage in when contracting with Chinese companies?

Do you think this is just another race to the bottom?

DR. HOLSLAG: Well I've traveled quite a bit in central Africa and in the DRC a few years ago to watch Chinese companies interact with other enterprises from other parts of the world, and I didn't really have the impression that China's labor standards were that much below those followed or championed by other firms.

And in Zambia in the Copperbelt Province, for instance, what I picked up, what I understood --not from Chinese, from labor movements-- was that China, since some

incidents in 2007, has significantly improved its working conditions.

And I think that goes for a lot of countries where you see that if there is a grassroots resentment, if there is some resistance boiling up, that especially the big state-owned enterprises tend to slightly adjust, not eagerly, of course, but slightly adjust their practices for the better. And they're also encouraged to do so by the Chinese government.

Chinese embassies in Africa are very aware of the image of their state-owned enterprise--and while they have difficulties influencing the practice of private Chinese companies in Africa, they do certainly pressure state-owned enterprises to respect local laws. That's now also, I think, common standards, that China is enshrining in its Africa policy, but it all hangs upon the organization, the degree to which civil society in African countries is organized.

If you have a strong, resilient civil society that makes a lot of noise about Chinese migrant workers, then usually Chinese government and Chinese state-owned enterprises are also a little more forthcoming to the--

HEARING CO-CHAIR BARTHOLOMEW: Yeah. I've also heard that there's potential for some small movement on corporate social responsibility issues--

DR. HOLSLAG: Yeah.

HEARING CO-CHAIR BARTHOLOMEW: --with the Chinese state-owned enterprises which then raises another interesting question. If they are willing and able to improve the working standards in mines or in companies where they are working in Africa and are not willing to do the same thing for Chinese workers, how do they manage that kind of inconsistency?

DR. HOLSLAG: Well, because fortunately for them, most of the public opinion in China is ignorant. So they don't know a lot about what the firms are doing in Africa. The only news reports that at times come out in China are those of Chinese citizens being killed or ambushed, but for the last time, I really don't believe that average Chinese workers in coal mines are aware of what the companies are doing in Africa.

HEARING CO-CHAIR BARTHOLOMEW: Great. Thanks.

DR. WACKER: First of all, I think if you look at it, it's the other way around. China exports its own low standards on labor rights to other countries. And that's the starting point of it, and we cannot expect it to apply higher standards when it is abroad, and it's not only the pressure of civil society from below, I think it's a weakness of the Chinese engagement in Africa. It's not people to people. It's mostly government to government, and they try to ignore the grassroots.

But if it's strong, it will at one point make itself heard. But there is also a difference between African states that have good governance and really supervise what is going on and have strict regulations--there is a study on that--and states that have weak government or are failing states to begin with, but I think China is on the learning curve on that one because they lose money.

And I think Libya, Sudan, all these experiences show them if they totally ignore the governance situation in the country they're investing in, they might lose their money, and they might lose their engineers, and they might lose workers because they are then subject of terrorist attacks or, you know, taken hostage or whatever. So I think there is a learning curve.

HEARING CO-CHAIR BARTHOLOMEW: They're in a very interesting situation with the two Sudans: having essentially bet on Khartoum, China is trying to create a new and better relationship with South Sudan. It will be interesting to see how that plays out.

Commissioner Cleveland.

COMMISSIONER CLEVELAND: We've focused mostly on Africa. Would either of you care to comment on the Chinese-European-U.S. interest in Burma?

DR. HOLSLAG: So on Burma, the interaction with China has been nonexistent. We never had serious dialogues or exchanges on Burma. Of course, during the summit meetings, we stated our viewpoints, vis-a-vis Burma, but that was about it. Until one year ago, the only effort that the EU made seriously to have some significant role was via the Three Diseases Fund, but its own commitments towards the transition in Burma has always been very, very limited.

Now what is going to be for the future, again, you

see a scramble of European member states to, in the first place, position their companies for potential business deals and for individual politicians to get on the picture with a certain political leader in that country, but it all lacks consistency, and you see again that the External Action Service is reactive rather than setting the tone.

DR. WACKER: I think that the Europeans were prescient with--yeah--NGOs. For example, the German political foundations, they stayed or they did things in Burma from Thailand or from another country, and now they're all going back in, of course. I think we can expect that the EU will lift most of the sanctions next week--except for the military arms exports--but the rest. I think that the British were the main stumbling block, which didn't hinder them to go in immediately. But it looks as if the sanctions will be lifted--the European ones.

I wanted to, one point because as you just said, we're talking a lot about Africa. Spain and Portugal also have made overtures to China, asking why not cooperate more in Latin America? Because this is what they see as their former colonies. The language is the same, so they make offers to China, why don't we do something together there.

But I think the Chinese have not taken that up very enthusiastically.

HEARING CO-CHAIR BARTHOLOMEW: Perhaps because they don't need it because they're making their inroads into Latin America without--

DR. WACKER: Yes, but the thing in Africa, too, we have the EU publishing a document on, why don't we work together in Africa? Where are the Africans in this thing? Where is ownership? And why should Africa be interested to have these two ganging up?

HEARING CO-CHAIR BARTHOLOMEW: Right.

DR. WACKER: Why not exploit the fact that they're all of a sudden interesting, attractive to both sides? So it was really an EU initiative to try to get this cooperation going because there was this concern that China is undermining our standards there, et cetera.

But I think it was probably well intentioned, but it was ill conceived.

HEARING CO-CHAIR BARTHOLOMEW: All right. On that

note, thank you, all of you, and we still have some of our panelists in the audience, but thank you very much. It's been very interesting. It's been wonderful for those of you who traveled to come to testify. It's been great for us to be able to hear a different point of view.

So we really appreciate it. I also just want to acknowledge the work by our staff, particularly Nargiza Salidjanova, who worked as the lead staff person on this hearing.

So with that, we would like to be able to continue the dialogue with you on a more informal basis and thanks very much for participating.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD**Testimony before the U.S.-China Economic and Security Review Commission**

Hearing on the China-Europe Relationship and Transatlantic Implications

Panel II: Defense and National Security Issues

April 19, 2012, U.S. Capitol Visitor Center, Room HVC-210 Washington, DC

“NATO-China Cooperation: Opportunities and Challenges”

By Christina Lin, Visiting Scholar, Center for Transatlantic Relations, SAIS Johns Hopkins University

Questions at the hearing from Commissioner Robin Cleveland:

1. *What are the risks and prospects of China setting up military bases in FATA?*
2. *What was the reason behind the Chinese cyber attacks against NATO—setting up fake NATO SACEUR Facebook page and attacks against NATO ISAF in Afghanistan?*
3. *What does China mean about taking advantage of “internal contradictions” within NATO?*

(1) Risks: There is a risk China setting up military bases in FATA or FANA may not be politically feasible in Pakistan, and China may face push back as a perceived neo-colonial power. Pakistan is sensitive about asserting its sovereignty especially in the aftermath of the bin-Laden raid, accidental killing of 24 Pakistani troops by coalition forces last November, controversy regarding drone strikes and cross-border ‘hot pursuits’. As such, there has been reporting by Indian intelligence as well as Pakistani journalists that China would most probably set up base sharing on Pakistani military bases in FATA (similar to U.S. base sharing in Afghanistan) without any public announcement.¹

Chinese troops presence in Pakistan would raise the stakes for any unilateral military action from the U.S. or India in Pakistan. U.S. does not want to shoot PLA accidentally in FATA as it did with the 24 Pakistani troops. As such, having SHADE as a clearinghouse for NATO-China and regional cooperation on counterterrorism in Afpak

¹ Saurabh Shukla, “China plans military base in Northern Pakistan, says report”, *India Today*, January 4, 2012; Spencer Ackerman, “China wants bases for an endless war in Pakistan”, *Wired*, October 26, 2011; K.N. Pandita, “China penetrating into Hindu Kush”, *Geopolitics World Citizenship*, October 27, 2011; Amir Mir, “China seeks military bases in Pakistan”, *Asia Times*, October 26, 2011; Amir Mir, “Uyghur militants threaten Sino-Pak ties”, *Asia Times*, August 10, 2011.

would mitigate this risk.

Prospects: The likelihood of China setting up bases in FATA or FATA is strong if violence persists in Xinjiang and Pakistan is unable to control its territory. There have been discussions between China and Pakistan on this issue as well as within Pakistan's military and political leadership. China has been fighting AfPak insurgents for more than a decade, but recent developments are galvanizing China to a more proactive/interventionist stance:

- a) **Chinese Turkistanisation of Al Qaeda.** Since last April, Al Qaeda's top commander of its Pakistan forces and training camp is a Chinese Uyghur named Abdul Shakoor Turkistani, also current chief of Turkistan Islamic Party (TIP) known for his friendly ties with Taliban in Waziristan.² He was appointed top commander shortly before Bin Laden was killed. TIP has close ties with Al Qaeda and Turkistani's predecessor in TIP, Abdul Haq al Turkistani, was a member of al Qaeda's executive council *majlis-e-shura* until an US drone killed him in January 2011.
- b) **Pakistanisation of Al Qaeda.** Some Pakistani analysts observe a Pakistanisation of Al Qaeda. Al Qaeda has established a jihadi network with its Pakistani affiliates to carry on the global jihadi agenda of Osama bin Laden, despite his killing by the U.S. in May 2011.³ Amir Mir, a well-renowned terrorism expert in Pakistan, observed that the growing Talibanisation of Pakistan is being eclipsed by the growing Pakistanisation of Al Qaeda. As such, China not only fears attacks from ETIM/TIP, but now also Al Qaeda across its borders.
- c) **Persistent attacks on Chinese territory/homeland.** China has been very sensitive about Xinjiang stability since the 2009 riots that killed almost 200 people and injured 2,000 more, so after the Kashgar bombings last July ahead of the China-Eurasia Expo under SCO auspices, China allegedly deployed over 200,000 security forces to Xinjiang, which is more than the 140,000 coalition troops in Afghanistan. China is also revising its anti-terror laws to allow for intervention abroad. Last December China deployed over 300 armed police to patrol the Mekong in response to the October killing of 13 Chinese sailors, the first time not under a UN mandate.⁴ It has also deployed its elite counterterror force—the Snow Leopard—to Afghanistan to guard the Chinese embassy in Kabul and other assets. With China's growing investments in Afghanistan since 2008 (e.g., Aynak copper mine, 2011 oil contracts in northern Afghanistan, telecom and transport projects), China has an increasing stake in Afghan stability and preventing insurgents from launching attacks in the AfPak border, as well as preventing TIP from destabilizing Xinjiang.
- d) **Risk of insurgents accessing nuclear weapons in Xinjiang.** This is rarely discussed in the press, but Xinjiang hosts China's nuclear test site Lop Nur and elements of the Second Artillery Corps (2d Arty),

² "China in Al Qaida's sights again?" Times of India, May 11, 2011; Jacob Zenn, "Al Qaeda's Uighur Jihadi: A Profile of the Turkistan Islamic Party's Abdul Shakoor Turkistani", *Militant Leadership Monitor*, Vol 2, Issue 12, Jamestown Foundation, December 30, 2011;

³ "Al Qaeda's roots grow deeper in Pakistan" Zee news, September 9, 2011; "Al Qaeda has become 'Pakistanised' and getting stronger", ANI, September 12, 2011.

⁴ Christina Lin, 'How Pakistan's Unstable Tribal Area Threaten China's Core Interests', *China Brief*, Vol. 12, Issue 1, January 6, 2012.

China's strategic missile force. Some of the 2nd Arty's vaunted tunnels—the so called “underground Great Wall” for hiding missiles and nuclear warheads—also surrounded Urumqi, the capital of Xinjiang and site of the July 2009 riots (See map in Appendix). Just as some fear insurgents accessing Pakistan's nuclear weapons due to instability, China fears Uyghur militant groups accessing Xinjiang's nuclear weapons with persistent unrest.

(2) China setting up fake NATO Sacer Facebook page is to collect personal information and build dossiers on NATO officials (e.g., regarding their families, private email addresses, phone numbers, pictures, possibly even details of their movements). They may hope to obtain proprietary information that is sensitive but unclassified being discussed with Facebook friends.⁵

Last year, China was accused of being behind a similar operation called Night Dragon, whereby hackers impersonated executives at companies in the US, Taiwan and Greece so they could steal business secrets.

In 2008 at least one highly classified network at the U.S. Central Command was compromised with a computer worm. In Afghanistan, it was not clear how much information was leaked from NATO ISAF computers regarding troop and convoy movements. The computer virus infected nearly three quarters of the computers on the base.⁶ Some pundits speculate the information might have been shared with the Taliban, as the Chinese have a legacy relationship with Taliban in Afghanistan since the 1990s, with Huawei building telecommunication lines for the Taliban in exchange for denying a safe haven for Uyghur militants.

Chinese intelligence also has an active presence in Afghanistan. In a December 2010 *Aviation Week* article, a British military official contend that Chinese specialists have been seen training Taliban fighters in the use of infrared guided surface-to-air missiles.⁷ An U.S. senior intelligence official said, “there probably are Chinese there among the Taliban. They may even be offering help of some sort, but they are actually there to gather information and knowledge about the Taliban. It's just good basic intelligence work.”⁸ Chinese military intelligence services, *Qingbaobu* and its civil intelligence service, *Guoanbu*, also reportedly reached out to Gulbuddin Hekmatay, the powerful Afghan warlord who heads Hezb-e-Islami, the fundamentalist organization with close links to Al Qaeda, in support of a possible *rapprochement* between Karzai and Hekmatay.⁹ Chinese intelligence officers and Pakistan military forces also conducted a joint operation in the 2003 killing of TIP leader Hasan Mahrum in South Waziristan.¹⁰

(3) The 2008 UPI article, in discussing China's internal document, highlighted that NATO consists of US and EU members with different perception vis-à-vis China. Although EU and NATO members overlap, they have slightly

⁵ Emil Protalinski, ‘China spies used fake Facebook profile to friend NATO officials’ *Zdnet*, March 11, 2011; “Nick Hopkins, ‘China suspected of Facebook attack on Nato’s supreme allied commander’, *The Guardian*, March 10, 2012.

⁶ Anna Mulrine, “Computer Virus Hits U.S. Military Base in Afghanistan”, *U.S. News & World Report*, November 28, 2008.

⁷ David A Fulghum, Robert Wall, “Weapons Migrate from China to Afghanistan”, *Aviation Week*, December 13, 2010.

⁸ Ibid.

⁹ Jeff Stein, “Report: Chinese court Afghanistan’s Karzai”, *Washington Post*, April 30, 2010.

¹⁰ Christian Le Miere, “Kabul’s New Patron? The Growing Afghan-Chinese Relationship”, *Foreign Affairs*, April 13, 2010.

different goals and thus present an internal contradiction. A large section of the document focused on EU and NATO members' concerns about US 'unilateralism' and competing interests among France, Germany and US. The Chinese analysis stated "Countries such as France and Germany do not like the United States to dictate what they should do. The United States has always tried to use NATO to interfere in affairs around the world, which is in fact to use NATO to serve the interests of the United States. Without France and Germany, Europe could have become a handy tool of the United States a long time ago." France is the one pushing for lifting of the EU arms embargo in 2005 and most recently, and has a tendency to break flanks within NATO although it only recently joined the organization. As such, China's strategy is to target Germany and France to create divisions between the United States and Europe.

Question at the hearing from Commissioner Michael Wessel:

1. What are the implications for Europe if there is a closer Sino-Russian partnership?

A closer Sino-Russian partnership in Europe is unlikely in the near future, as China is deferential to Russia's 'near abroad' in Europe. As regards Central Asia, China and Russia cooperate insofar as to reduce U.S./NATO influence in their strategic backyard. There remains underlying bilateral competition, with Russia bolstering CSTO and an Eurasian Union to counterbalance China-dominated SCO.

However, competition in Central Asia is not just about Russia and China, as Turkey has become a very active player in the region, reasserting its historical ethnic ties with the Turkic community and religious ties with fellow Muslim. If China has SCO and Russia has CSTO, then Turkey has ECO—Economic Cooperation Organization. It is an Islamic organization established in 1985 by Turkey, Iran and Pakistan, and is based in Tehran. In 1992 they expanded membership to include other Muslim countries in Central Asia and the Caucasus: Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Turkmenistan, Afghanistan, and Azerbaijan. There has been close ECO and SCO cooperation in building transport corridors across Eurasia—an Islamic corridor beginning in China's Muslim Xinjiang, through Afghanistan, Iran, Turkey and unto Europe based on the ancient Silk Road. Whereas the U.S. New Silk Road Initiative is vertical—integrating South Asia through Afghanistan and westwards to Europe based on the Northern Distribution Network, China's version is east-west—traversing through Iran.¹¹

Turkey, with a seat in NATO and a possible seat in SCO (Turkey applied to be an SCO dialogue partner last year) will wield tremendous power projection capabilities in Europe, Central Asia, and Middle East. China is targeting Turkey in its cooperation with NATO, especially to obtain NATO technologies since Turkey is outside of EU and not under the arms embargo. Similarly, China's resumption of military cooperation with Israel last August also targets Israeli technology outside of EU arms embargo.

¹¹ Christina Lin, "China's New Silk Road to the Mediterranean: The Eurasian Land Bridge and Return of Admiral Zheng He", Paper presented at U.S. Naval War College, October 27, 2011, ISPSW/ETH Zurich.

APPENDIX

Map: Nuclear Tunnels in China



Source: The Washington Post, November 29, 2011