

THE CENTRE OF GRAVITY SERIES

WHAT SHOULD WE DO ABOUT CHINA?

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June 2013



Strategic & Defence Studies Centre
ANU College of Asia & the Pacific
The Australian National University

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Centre of Gravity series paper #8

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EXECUTIVE SUMMARY

- 5 years after a major report on US-China relations it's worth revisiting our assessments.
- Most judgements remain valid, but some have changed significantly.
- Taiwan has moved from a primary issue to second order, though not forgotten.
- China's regional assertiveness is concerning and should be examined closely.
- China's economic development model has run its course; Beijing needs to provide leadership to usher in reform.

POLICY RECOMMENDATIONS

Australia and the USA should focus on a blended policy of cooperation with China, along with an insistence on international norms, and maintenance of alliance and military strength. Regular evaluations of China's shifting capacity and interests, to identify what issues are of rising or declining significance for Beijing will be needed to be effective in engaging China and building a better future for the region.

Just over five years ago Carla Hills and I co-chaired a major independent task force, sponsored by the Council on Foreign Relations on U.S.-China relations¹. We were not the first to observe, as we stated early in the report, 'China is so large, populous and complex that almost anything one might assert about Chia is "true." China was then, and remains now, a sprawling work in progress, developing at a pace and breadth that are unprecedented. It was, and still is, difficult to distill the essential trends from the mass of data, observations and anecdotal evidence. Five years on, it is worth revisiting the conclusions and recommendations of that task force, to determine if the events of recent years have given any cause to revise them.

Our task force found much that was positive and encouraging about developments in China - the lifting of hundreds of millions of its citizens out of poverty, the determination not to repeat the excesses of the Mao era, the growing openness of many sectors of the society, a few nascent signs of participative government at the local level and an international policy of peaceful development. We also found much of concern - continued repression of political dissent, heavy-handed enforcements of social policies and growing international assertiveness punctuated by bouts of xenophobic nationalism. We recommended a blended set of policies towards China, with an emphasis on the positive. We called for continuing to do business with China, while encouraging it to improve performance on compliance with World Trade Organisation (WTO) norms and to shift to a consumption-led economy; we favored including China in both formal and informal international bodies to deal with common concerns from halting the spread of nuclear weapons to dealing with climate change to handling North Korea. At the same time, we recommended the maintenance of American alliances and its military capability to handle China's rapidly growing naval and air capability off its coasts.

During that five years since the publication of that task force report, China's double-digit economic growth has continued, based on booming exports, continued foreign direct investment, and heavy capital spending on infrastructure. That economic performance was sustained despite a worldwide economic recession that sharply reduced growth in most other countries. Business by foreign companies in China has continued to grow, but has become more difficult, with the theft of intellectual property increasing, especially by cyber means, and corruption growing; China has cautiously increased its cooperation in international efforts to deal with Iran, and has sent more troops to UN peacekeeping missions, but its assertiveness in the South and East China seas has spiked.

Developments of the last five years have not provided support to those who would argue that as it becomes more prosperous, China is inevitably becoming a benevolent and trusted member of its region and the world; conversely, China has not provided conclusive support to those who claim that there has never been a fundamental change of global power without conflict, and that the world must either acquiesce to China's rise or fight it. China's development is dynamic, contradictory, and its future path is uncertain.

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So the fundamental prescription of our task force five years ago remains valid - a blended policy of cooperation with China, along with insistence on international norms, and maintenance of alliance and military strength. However the events of the past five years can give us more detailed insights into the challenges and opportunities other countries face in applying those policy recommendations effectively. Three major sets of developments have been the most important: the China-Taiwan relationship; China's assertiveness with its neighbors: and China's domestic economic weaknesses.

One of the most striking developments of the past five years has been China-Taiwan relations. Five years ago Taiwan was the single most important factor in the US-China relationship, and had been so for the previous decade. However Ma Ying-jeou's election in 2008 started a new era in China-Taiwan relations. President Ma's predecessors had tested the limits of both the Taiwanese electorate's support for and the Chinese government's tolerance of steps towards independence. It was clear that the Taiwanese people were more interested in practical steps towards better relationships with China than they were in symbolic gestures that antagonized it. On the other hand, China had learned that heavy-handed attempts to intimidate the Taiwanese people with military demonstrations, to blackmail Taiwanese businesses and endorse specific parties and candidates, were counterproductive. Both sides were ready for a new phase in their relations, and President Ma's policy of the 'three no's' (no unification, no independence and no use of force) provided a sound basis for a fresh start. Since then China and Taiwan have made steady progress on a series of agreements in transportation, financial and cultural links that have removed many of the impediments to much greater business and personal contact across the Taiwan Strait. It is striking how Taiwan has moved from the central place in China's international concerns to a secondary position. Before 2008 the first half hour of any meeting of a foreign leader with a Chinese official would be devoted to a Taiwan; now there are meetings in which the subject never comes up.

However this absence of the barking dog is less reassuring than it seems. The issue of sovereignty between Taiwan and China has been postponed, not resolved. According to polling data, the citizens of Taiwan are less and less thinking of themselves as Chinese, and fewer every year actually believe that they are part of 'one China'. They have no desire to cede to Beijing the influence that, for example, the citizens of Hong Kong have been forced to accept. China, as it grows in economic and military power, increasingly believes that others, especially Taiwan, will have to bend to its will and China in future will probably be less willing to concede to Taiwan a *de jure* recognition of the *de facto* autonomy it now enjoys. Taiwan, for its part, is probably willing to put off any discussion of the issue indefinitely, but China is not. The other countries in the region need to be thinking through the actions they would take should the China-Taiwan relationship heat back up and resume center stage in China's external strategy. Better yet, the countries in the region should be thinking through a more positive approach than waiting and hoping.

If the Taiwan issue was surprisingly quiet over the last five years, China's relationships with its neighbors in the South China Sea and in the East China Sea were surprisingly confrontational. In the chapter on 'China's Approach to the World' our task force report included the South China Sea in a Chinese 'Zone of Peace' and we were optimistic about continued improvements in Japan-China relations. What happened?

The Chinese claim that it was more aggressive pressing of their territorial claims in the South China Sea by Vietnam and the Philippines, in particular, that derailed the peaceful progress of prior years. They claim that it was Japanese actions in the Senkakus (or Diaoyus, as the Chinese call them) - arrest of a Chinese fishing boat captain and the purchase of the islands themselves by the Japanese government - that upped the ante there. Most other countries claim that it was China's more aggressive military and diplomatic actions to push its claims that caused the cycle of confrontation and crisis of the past several years. However it started, the cycle of military deployments — fortunately to date all shows of force rather than uses of force — diplomatic claims and intense media focus in all countries, has now been firmly established.

China's behaviour during this period, however, has been a rude shock to those who believed that its commitment to peaceful development was absolute. In Southeast Asia in particular, China's economic and diplomatic strategy had been generally admired as masterful. It used access to its own import market for influence with more advanced countries like Singapore, Thailand and Vietnam, and generous development projects for the poorer countries like Cambodia and Laos. It sent skilled diplomats to ambassadorial posts who presented the most benign possible picture of China's intentions and actions. In 2002 it had signed a declaration of principles for the settlement of maritime disputes in the South China Sea that renounced the use of force in favor of negotiated peaceful settlements.

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Yet in July of 2010 another face of China showed itself at a meeting of the ASEAN Regional Forum in Hanoi, as foreign minister Yang Jiechi lectured his fellow diplomats in strident tones, 'China is a big country and other countries are small countries and that is just a fact.' For months previously, Chinese diplomats had been telling their interlocutors that its maritime claims in the South China Sea - and those claims extended down to Indonesia - constituted a 'core interest' of China, that is, an interest on the level of Taiwan and Tibet. Several factors, it seems, formed this different and more aggressive Chinese approach. At the heart of it seemed to be a Chinese idea that rather than its interests and ambitions being stable and limited, they grew commensurately with Chinese relative power. By 2010 China had not only weathered the world economic recession, but had assisted other Asian countries to do so also. That recession, which had spread to much of the world, had been started by the United States, and the United States and Western Europe had not yet recovered from it. China's GDP had surpassed Japan's and predictions of the date of its overtaking the United States were shortening. Much of China's military buildup had gone into its Navy and Air Force units in the south, where the South China Sea was their operating area. The Chinese acted as if this greater economic and military power in Southeast Asia meant that other countries owed them new concessions on old issues.

The reaction of China's neighbors was to band together to oppose Chinese demands, to increase their defense spending and acquisitions, and to turn to the United States for support. Seeing this reaction, China seemed to realize that it had overplayed its hand. State Councillor Dai Bingguo published an authoritative article reiterating China's commitment to peaceful development, President Hu Jintao on his January 2011 trip to the United States did the same in all his public statements, and the immediate crisis passed. However the memories of 2010 remain vivid in the minds of China's neighbors. In addition, Chinese military deployments in both the South China Sea and around the Senkaku/Diaoyu islands have increased and targeted economic measures against the Philippines, Japan and Vietnam have continued. Yang Jiechi has replaced Dai Bingguo as State Councillor. These episodes of the past several years reinforce the recommendations in our task force report to maintain alliances and military strength in the Asia-Pacific region. This military strength has not been used for offensive purposes by the United States and its allies since the end of the Vietnam War, but it provides the incentive for peaceful negotiation of differences in the region and the capability to resist Chinese enlargement of its core interests.

Economic developments of the last five years are perhaps the most significant of all. Behind the impressive overall numbers problems are arising. China's economic growth began in 1979 when it decided to open to the rest of the world. It followed the path already blazed by its neighbors in Asia - Japan, South Korea, Taiwan, Singapore, Hong Kong - freeing the private sector of the economy, welcoming foreign investment, exporting manufactured goods, and investing in infrastructure. This formula worked well, resulting in roughly 10% GDP growth rates, moving hundreds of millions of China's citizens out of poverty, and providing a justification for its continuing grip on power for the Chinese Communist Party, which had abandoned both its ideological justification and its responsibility to provide planned and reliable jobs, goods and social services to its citizens.

However it has become clear to thoughtful Chinese in the last few years that the economic development model of the past thirty years has run its course. It has resulted in income inequality and corruption that are among the highest in the world, and major sources of domestic discontent. It has resulted in damage to the environment - foul air in major cities and polluted rivers in many regions - that arouses citizen anger and calls for action. The foundations of sustaining the old model have been undermined. Wages are rising rapidly throughout the country, adding to the cost of exports; import markets in the developed world are shrinking, and aggressive Chinese policies of indigenous innovation, protection of a low exchange rate for its currency and use of punitive economic measures for political purposes are provoking backlash in its former export markets. Capital expenditures on infrastructure, a major component of GDP growth in the past, have exhausted their purpose and are not productive any longer. Despite the gains of the past, there are more Chinese below the poverty line today than there were in 1979, when the current burst of development began.

In the face of all these imperatives for change, the Chinese political leadership system has grown more conservative, careful and slow. It relies on consensus, and the circle of those who must give their consent to major policy decisions represents entrenched political and economic interests in the country with large stakes in the current system. It is difficult to imagine that another Deng Xiaoping, or even another Zhu Rongji could emerge with the personal stature and authority to take the unpopular decisions that are needed to shift to a consumption-based economy with a private sector that is growing again, much less to institute the democratic reforms that would root out corruption and inequality in the party itself and in the country. The Xi Jinping government shows no sign of being able to do so.

What happens within the economy and domestic governance of China will be the most important indicator of the course of its future, and those of us in countries that deal with China should watch closely. The safe bet is that China will muddle through in the near future, with reduced but still significant economic growth and slow progress on its many problems. A dramatic shift to consumption-based economic growth and strengthening of more open media and social communication and the independent rule of law would be welcome; greater repression to control instability resulting from continued high levels of inequality, corruption, pollution and lower levels of growth would keep Chinese leadership attention focused at home, but would be bad for the Chinese people, with the potential for domestic violence and tension in the region.

In conclusion, the last five years of Chinese developments have reinforced the importance of a blended policy for other countries dealing with China: an emphasis on continued engagement with China to cooperate on common challenges and to follow international norms of financial and commercial practices; but also strong bonds with traditional allies and maintenance of military capability. The Chinese themselves will decide their future, and the limited influence that other countries can bring to bear should favor a better future for the region, but have the resilience to handle adverse developments.

POLICY RECOMMENDATIONS

Australia and the USA should focus on a blended policy of cooperation with China, along with an insistence on international norms, and maintenance of alliance and military strength. Regular evaluations of China's shifting capacity and interests, to identify what issues are of rising or declining significance for Beijing will be needed to be effective in engaging China and building a better future for the region.

1 Carla A. Hills, Dennis C. Blair & Frank Sampson Jannuzzi *U.S.-China Relations: An Affirmative Agenda, A Responsible Course* (New York: 2007) Council on Foreign Relations

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