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China Denies USS Kitty Hawk Access to Hong Kong Harbor

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## In a Fortnight

By L.C. Russell Hsiao

### TOKYO-BEIJING ADVANCES “STRATEGICALLY RECIPROCAL RELATIONSHIP” THROUGH “WARSHIP DIPLOMACY”

On November 27, Japanese Prime Minister Yasuo Fukuda, when asked by Chinese reporters about the current state of Sino-Japanese relations, characterized the relationship in the following response: “I believe spring has already come to Japan-China relations. I want the spring to continue as long as possible. Because when summer comes, something that could ignite tempers could happen again.” The response was considered by commentators as a positive but veiled reference to his predecessor Junichiro Koizumi’s controversial behavior, whose visit to the Yasukuni Shrine, a Shinto memorial erected to honor Japan’s war dead, severely strained ties between China and Japan during his years in office (China Daily, November 28; Japan Today, November 28).

Chinese Premier Wen Jiabao also said that the Japan-China relationship has reached “an important turning point” (China Daily, November 21). Mr. Wen made the statement immediately following a meeting between the two leaders on the sideline of the ASEAN +3 Summit in Singapore in early November.

At a press briefing with foreign media, Mr. Fukuda responded to Chinese press reporters’ question concerning China-Japan relations in his administration’s foreign policy and the “strategically reciprocal relationship” (zhanyue huhuei) between the two sides, the approach of developing Sino-Japanese relations agreed upon by former Prime Minister Shinzo Abe and Chinese President Hu Jintao last year.

“The Japan-China relation is the most important bilateral relation for both sides,” Mr. Fukuda said. “Former Prime Minister Abe’s official visit to China improved Sino-Japanese relations. [After] Chinese Premier Wen Jiabao visited Japan in April, Chairman of the Chinese People’s Political Consultative Conference (CPPCC) Jia Qinglin also visited Japan, these efforts are toward the strengthening of a strategically reciprocal relationship.”

According to Japanese television media, Mr. Fukuda also referred to a phone conversation the two leaders had in September. He said, “I am very surprised to hear that it was the first time a Japanese and Chinese leader spoke directly on the phone. There are so many important things to do that both sides need to maintain a relationship where everything can be discussed.”

#### CHINESE WARSHIP “SHENZHEN” DOCKS IN TOKYO

Prime Minister Fukuda’s comments came just days before the first People’s Liberation Army Navy (PLAN) warship “Shenzhen” docked in Tokyo harbor on November 28 for a four-day friendship visit, at the invitation of the Japanese navy. This is the first visit to Japan by a Chinese military warship since World War II.

In 2000, China and Japan had agreed to reciprocal warship visits, but China cancelled the visit in 2002 after former Japanese Prime Minister Junichiro Koizumi irked China by visiting the Yasukuni Shrine, which China sees as a symbol of Japan’s past militarism.

The largely symbolic event is widely hailed as a sign of thawing ties between Japan and China.

In an interview with Japanese Defense Agency Chief Shigeru Ishiba, Mr. Ishiba hailed the visit as an important starting point for confidence building between the two militaries and said that following this visit the Japanese navy will also visit China. (Xinhua [Tokyo], November 26)

Mr. Ishiba pointed out that Japan and China have different national systems and national interests. The basis for the development of a strategically reciprocal relationship between the two sides should be based on the recognition of these differences.

PLAN Vice Chief of Staff Zhang Leiyu also said the warship visit will ultimately advance the “warming” of Sino-Japanese relations, and promote the development of long-term, stable and good neighborly cooperation.

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## China’s Secret War Games and the Kitty Hawk Affair Flip-Flop

By Willy Lam

Large-scale air and naval maneuvers off China’s southeast coast last week demonstrated the post-17th Party Congress leadership’s determination to project hard power in view of escalating tension in the Taiwan Strait. The week-long war games, which coincided with Beijing’s sudden cancellation of the USS Kitty Hawk battle group’s Hong Kong port call, are also meant to convey Beijing’s displeasure with Washington’s recent decision to sell weapons to Taiwan and to honor the Dalai Lama. Moreover, this show of force reflects the commitment of President Hu Jintao, who was re-elected Chairman of the Central Military Commission (CMC) at the Congress, to speed up the modernization of the People’s Liberation Army’s (PLA) already formidable arsenal.

The military drills, which started on November 19, covered a wide swath of the Pacific, including sensitive terrain east of Taiwan and north of the Philippine archipelago. While official PLA media have been reticent about the exercises, Hong Kong papers and military-related websites in China noted that their purpose was to simulate a “pincer attack” on Taiwan as well as a naval blockade. Elite battalions from PLA Air Force (PLAAF) units under the Guangzhou and the Nanjing Military Regions, as well as the East and South China Sea Fleets, were involved. They deployed hardware including Russian-made Kilo-class submarines, Sovremmy-class destroyers and indigenously developed Flying Leopard jet-fighters. Among new weapons tested at the maneuvers were 022 stealth missiles and Russian-made SS-N-27 “Club” anti-ship cruise missiles. (Ming Pao, November 24; [www.tiexie.net](http://www.tiexie.net), November 24; United Daily News, November 25)

Several hundred commercial flights along China’s southeast coast—the majority of which originated from airports in Shanghai and Guangzhou—were postponed during the exercises. It was not until last Saturday that the East China Civil Aviation Bureau lifted the highly disruptive aviation control (People’s Daily, November 26). Li Jingao, an official of the CAAC East China Air Traffic Management Bureau, claimed: “The delay was resulted from a backlog caused by the control in previous days.” Military analysts noted that PLA authorities did not want the Kitty Hawk battle group—whose 8,000-odd sailors had earlier planned to spend Thanksgiving in Hong Kong—to be in the vicinity. This is despite the fact that during his visit to Beijing earlier this month, U.S. Defense Secretary Robert Gates and his hosts made new pledges to boost confidence-building

measures, including establishing a military-to-military hotline. On a deeper level, the Kitty Hawk incident reflected Beijing's anger at Washington's plan to sell Taiwan a \$940 million upgrade to its Patriot II anti-missile shield. Beijing apparently also wanted to protest President Bush's presence at a Congressional ceremony last month honoring the Dalai Lama, deemed a "splittist," or leader of Tibet's pro-independence movement (Washington Post, November 23; Associated Press, November 23).

There are also indications that this stupendous muscle-flexing was targeting more than the usual suspects; for examples Taiwan and the United States. Parts of the exercises took place close to the disputed Paracel Islands, including the Hoang Sa and Truong Sa archipelagos in the South China Sea, a few islets whose sovereignty are claimed by Vietnam. Last Friday, the Vietnamese Foreign Ministry pointed out that the war games were a "violation of Vietnam's sovereignty." Le Dung, the Ministry's spokesman, said that "It is not in line with the common perception of senior leaders of the two countries as well as the spirit of the recent meeting between the two prime ministers on the sidelines of the 13th ASEAN Summit in Singapore" (Vietnamese News Agency, November 23).

A Beijing source close to the Taiwan policy establishment said the CMC and the Communist Party's Leading Group on Taiwan Affairs—which was also headed by Hu—were worried about possible "tricks" played by the Democratic Progressive Party (DPP), the pro-independence ruling party in Taiwan, in the run-up to the presidential elections scheduled for next March. The source said that Beijing was most worried that the Taiwan army might engineer a "military crisis" with the PLA, which would then serve as a pretext for the DPP administration to postpone the elections or even to impose martial law. Last Sunday, Taiwanese President and DPP Chairman Chen Shui-bian indicated that proclaiming martial law was an option if the opposition Kuomintang (KMT, or Nationalist Party) continues to side-step electoral procedures for the upcoming Legislative Yuan elections (Taipei Times, November 27). While Chen later withdrew his threat, Beijing remained concerned that the DPP leadership might again resort to wild cards given the fact that the KMT presidential candidate Ma Ying-jeou has consistently outpolled the DPP's Frank Hsieh in island-wide surveys.

The Chinese civilian leadership has largely assumed a low profile on the Taiwan issue. In his address to the 17th Congress, President Hu even dangled the possibility of a "peace accord" with Taiwan (China Brief, October 31). Yet the post-17th Congress leadership has been at the same time hedging its soft bet on the KMT by making thorough preparations for what Hu called "military struggles"

against pro-independence elements on the island. As outgoing Defense Minister General Cao Gangchuan put it earlier this month: "Should Chen Shui-bian be bold enough to concoct major events [in the direction] of independence, we shall take drastic measures to uphold national sovereignty and territorial integrity at any cost" (Xinhua News Agency, November 4).

The two most powerful bodies in the polity—the Politburo Standing Committee (PSC) and the CMC—are filled with cadres and generals with long-standing expertise on Taiwan. Three PSC members have served as either governor or party secretary of Fujian, the "frontline province" just opposite Taiwan. They are Chairman of the Chinese People's Political Consultative Conference (CPPCC) Jia Qinglin, Secretary of the Central Commission for Disciplinary Inspection He Guoqiang, and Fifth-Generation rising star Xi Jinping, the front-ranked secretary of the Central Committee Secretariat. The CMC is replete with Taiwan Strait specialists. This include Defense Minister designate General Liang Guanglie, a veteran commander of war games off the Taiwan coast; the newly promoted Chief of the General Staff, General Chen Bingde, a former commander of the Nanjing Military Region; Air Force Commander General Xu Qiliang, who was once based in Fujian; and Naval Commander Admiral Wu Shengli, a former vice-chief of the East Sea Fleet. Since becoming CMC chief in late 2004, Hu has promoted a large number of alumni of the Nanjing Military Region, which has "jurisdiction" over the Strait.

On a larger-scale, last week's provocative exercises tally with the overall pattern of power projection that began early this year with the destruction of an old weather satellite by state-of-the-art PLA missiles. The feat, which apparently signaled Beijing's readiness to join the militarization of space, was followed by the country's successful effort late last month to put a Chinese-made satellite into the moon's orbit. Moreover, the PLA has for the past year deviated from its past practice of keeping newly developed weapons under wraps. Semi-official military websites regularly run stories and pictures that showcase the prototypes or just-completed versions of soon-to-be-deployed hardware ranging from the Jin-class submarine—which is capable of carrying nuclear-tipped cruise missiles—to the nation's first aircraft carrier.

Apart from telling Taiwan independence forces—and their sympathizers in the United States and Japan—that Beijing has the wherewithal to maintain national unity, Beijing is flexing its military muscle in a fashion befitting an emerging quasi-superpower. Referring to the 17th Congress, Chinese Academy of Social Sciences (CASS) strategist Hong Yuan pointed out that "the [defense] concerns of the new

leadership and the force projection of China's military have gone way beyond the Taiwan Strait." Hong sees the coming five years as "a period of rapid development in areas ranging from the PLA's establishment, institutions and hardware to the extent and means of force projection" (Wen Wei Po, October 19).

Moreover, the display of the country's new-found achievements in weaponry and aeronautics serves to strengthen internal cohesiveness, a long-standing Communist Party goal. As Premier Wen Jiabao put it on Monday while displaying the first close-up satellite pictures of the moon: the astronautic feat is a "major manifestation of the increase in our comprehensive national strength and the ceaseless enhancement of our innovative ability." Wen added, "[The project] will have a tremendous significance toward boosting the cohesiveness of the people" (Xinhua News Agency, November 26).

Chinks in the Chinese armor, however, have become apparent in the course of Beijing's bold display of military prowess. The latest war games have demonstrated poor coordination among the Communist Party, government and military departments. For example, it was not until November 21 that the Chinese Ministry of Foreign Affairs delivered its snub to the Kitty Hawk (suggesting the delay may be the result of policy discrepancy); however, the ministry reversed itself a day later by saying that the Chinese had now granted permission to the port call for "humanitarian reasons." This was in apparent reference to the hundreds of the crew's family members who had flown into Hong Kong in anticipation of Thanksgiving festivities. The battle group, however, was well on its way back to its Japan home base, and there was no question of it turning back to Hong Kong. The Kitty Hawk affair has cast doubt on China's ability or sincerity to play the role of a responsible member of the international community.

Most notably, there is the issue of military transparency, which was raised by Secretary Gates during his visit to China. The military drills were not reported by any official Chinese media. There are also indications that the PLA did not alert relevant Chinese government departments, let alone countries in the Asia-Pacific region, of the maneuvers. These developments may also cast a shadow over the Chinese Navy's first-ever port call on Japan this week. The Shenzhen missile destroyer will be in Japan for four days in what the two countries hope will be a symbolic confirmation of the thaw in bilateral ties (Xinhua News Agency, November 26). The increasing assertiveness of President Hu and his generals, however, could potentially stoke the "China threat" theory, which seems to be gaining credence in countries including Japan, the United States, and ASEAN members that still have territorial disputes

with the PRC.

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## China Flexes Its Muscle on Wall Street Redux

By Wenran Jiang

While China and the United States are increasingly deepening their economic, trade and financial interdependence, Beijing's experiment on the global stage is being closely monitored by Washington for its national security implications. Such is the case concerning China's newly established sovereign wealth funds (SWFs) under the government-controlled China Investment Corporation (CIC) back in September 2007. Ever since China, in haste, paid \$3 billion to buy a 10 percent stake in the U.S. private equity firm Blackstone Group LP, setting off alarm bells that have been ringing from Wall Street to Capitol Hill and raising the specter of China's ambiguous intentions behind its muscle-flexing in the world finance market (China Brief, November 14). The Group of Seven (G-7) finance ministers meeting in Washington, D.C. in October expressed serious concern over the nature of expanding SWFs' profile around the world—pointing to its growing significance in the global political economy.

### CHINA RIDING IN THE NEW WAVE OF SOVEREIGN WEALTH FUNDS

Sovereign Wealth Funds, large amounts of foreign reserves accumulated from commodity—exporting countries and high-saving states, are not a totally new phenomenon. As early as 1953, Sheikh Abdullah Al-Salem Al-Sabah, then ruler of Kuwait, established the Kuwait Investment Authority to diversify surplus capital from oil revenue for returns that could be used for building Kuwait's infrastructure. The largest SWF to date, the United Arab Emirates' Abu Dhabi Investment Authority (AIDA), was set up in 1976. In recent years, however, a new wave of SWFs has emerged on the global financial scene due to the concentration of foreign trade surplus in economies such as China, South Korea, Singapore and Taiwan. At the same time, petro-dollars have flown into the wallets of the Middle Eastern oil-producing states, as well as Russia and

Norway thanks to high oil prices in recent years.

As a result of these developments, six of world's largest SWFs are—not surprisingly—located in the following economies: Abu Dhabi (\$625 billion), Singapore (\$325 billion), Norway (\$322 billion), Kuwait (\$213 billion), China (\$200 billion) and Russia (\$148 billion) (Zhongguo Jingji Wan, November 19; New York Times, November 24) [1]. SWFs now control more than \$2 trillion in assets in the world. Although still a very small portion of the net global financial assets, SWFs are expected to triple in the next four years to \$7.9 trillion, and grow to \$13.5 trillion in assets in 10 years, rapidly becoming a heavyweight player in world finance with significant political implications. Although China is a late-comer to the SWF frontier, its share of SWF pie is projected to increase from the current \$200 billion to \$600 billion in two years (Reuters, November 6; Reuters, November 14).

Western powers initially poured massive commodities and capital into poor countries around the world back since the 18<sup>th</sup> to most of the 20<sup>th</sup> centuries. The British owned much of Asia's assets in the colonial era—but with the onset of globalization, the terrain has significantly changed. The rapid rise of oil-rich countries and newly industrialized nations in Asia in the past few decades have created opulent wealth that is often concentrated in the hands of the governments. The world has seen advanced industrialized countries and some powerful rising economies “trading places” when it comes to financial investment: reversing the historical pattern of the former investing in the latter. In this process, there are legitimate questions addressing whether the rules governing current world finance will be changed, either to confront or to accommodate the rise of new sovereign wealth funds.

#### MIXED REACTIONS FROM AROUND THE WORLD

While the underlying economic logic for Beijing to set up SWFs may be similar to other economies that have large endowments for SWFs, China's entry into the SWF arena has attracted quite a high level of attention. The Chinese government argues that the CIC was launched to mitigate the risks in China's huge foreign exchange reserve. There remain, however, intense speculations about Chinese motives and strategic intentions—much due to the Chinese propensity for secrecy. Just like the Chinese Ministry of Education's attempt to set up Confucius Institutes around the world, which are modeled after Germany's Goethe Institute and the Japan Foundation, was subjected to suspicion of Beijing's political purposes. China's new CIC may not be perceived the same as Singapore's Temasek Holdings or Norway's Norges Bank Investment Management whose model it tries to adopt. While there is

little problem for education institutions around the world to receive funding from Germany and Japan as both are democracies, China's Confucius Institute initiative was met with some resistance in its earlier stages. Both SWFs out of Singapore and Norway are seen not so much threatening because Singapore is perceived to be a city-state that will not have geopolitical or geostrategic ambitions, while Norway's SWFs, despite their large size, are seen as primarily at generating returns to sustain the country's welfare system. In contrast, China's coming to the SWF sector will likely be met with extra caution because of a perceived incompatibility in regulatory frameworks and Beijing's potential use of SWFs for political leverage

As in the highly politicized bid efforts by China National Offshore Oil Corp. (CNOOC) to buy U.S. energy firm Unocal in 2005, U.S. policy makers are now again at high alert. The U.S. Stock and Exchange Commission Chairman Christopher Cox expressed concern that trillions of dollars in the hands of authoritarian governments may have strategic implications, which calls “into question the adequacy of our enforcement and regulatory regime” (Associate Press, October 24; BusinessWeek, November 12). U.S. Treasury Secretary Henry Paulson urged for setting up a code of governance for the SWFs at the IMF-World Bank meeting in October (Australian Financial Review, November 8).

India expressed concerns about the capital inflow of SWFs, especially from China. The Indian government is looking into setting up a special investment framework to regulate the SWFs, partly prompted by the establishment of CIC (The Economic Times, November 23).

Britain, however, appears to welcome Chinese investment in the forms of sovereign wealth funds. UK Trade Minister Digby Jones assured that Chinese SWFs would not face barriers to invest in UK companies as long as they abide by the country's standard regulations. Facing calls to curb Chinese investments in Europe, Jones said Britain would resist any attempts in the European Union level to restrict SWF investment. Responding to questions of foreign investment in UK's potentially strategic industries, Jones stated that “I don't believe I know where the limit on (sovereign wealth fund investment) is, because for us there isn't one” (Dow Jones International News, November 20).

#### POOR INVESTMENT RESULTS

Even if Chinese SWFs face no restrictions around the world, moving from relatively safe investment in U.S. government bonds with guaranteed returns to a range of private sector investment portfolios with potentially higher but uncertain

profits is not a simple drive. In a matter of months, the CIC lost a quarter of its \$3 billion investment in Blackstone since it went public in June, triggering a major debate in China on how the public money has been handled and the high risk model it adopted.

While some have complained about Western prejudice in singling Chinese SWFs out for scrutiny, others have questioned why the decision-making process for China to put \$3 billion into Blackstone only took two weeks before the CIC was even officially launched (Reuters, November 23).

There is a widespread perception that CIC is simply another arm of the PRC government, with top officials at the National Development and Reform Commission of the Ministry of Finance calling the shots. The Blackstone investment debacle also demonstrates that the Chinese bureaucrats are no master calculators with Sun Tzu-style strategic vision when it comes to maneuvering in the complex global financial market place. Rather than depending on highly trained professionals, the CIC is staffed with government officials who have little international financial investment expertise. Despite its massive capital accumulation, China has much to learn in this area and will remain a new player in the foreseeable future. It will take time to establish a professional management team; it will take time to gain a handle on the complex global finance; it will take time to measure where the good returns may come from; and it takes time to persuade others that China is indeed a new financial player that will play by the rules.

#### MIXED PROSPECTS

Despite Chinese SWFs' uncertain status and risky performance, a common criticism is that Beijing has manipulated the market to keep its currency low in value. Yet, many outside of the political circles both inside and outside China have not taken such an argument as the major cause of China's massive foreign reserve buildup. Ironically, it was the United States and other Western companies that have moved much of their production base to China in the past two decades, which has enabled the latter to accumulate even more trade surplus dollars. Most of that money has in fact flown back to the U.S. economy via Beijing's purchase of U.S. treasury bonds but now are also ending up in sovereign funds to mitigate the risks of a potential recession in the United States. That trend is likely to continue with more trade deficit with China from the United States and Europe.

At the same time, the Renminbi's (RMB) appreciation to a higher value under increased pressure from the outside will likely drive China to accelerate diversifying its investment

away from U.S. treasury bonds in order to seek higher and quicker returns. If Washington is comfortable having Beijing buy up \$400 billion of its treasury bonds to subsidize President Bush's deficit spending economic policy, it needs to answer the question of why it should be so alarmed about Chinese investments in the form of SWFs—both are in nature to seek interest returns for the money.

There are also strong incentives around the world for capital infusion from large investors such as China. When Nikkei prematurely reported that CIC was about to buy Japanese assets with its \$200 billion treasure chest, both the Japanese yen and stock market went up (Reuters, November 27). If managed well, SWFs may inject new blood into the world economy and maintain global finance equilibrium; otherwise, SWFs may trigger a new wave of protectionism and do harm to world financial instability.

Back in the 1980s when Japanese companies were seen by U.S. lawmakers as “buy[ing] up America” —even though it never really happened, there was much resentment against Japan. Maybe it's more appropriate this time around for the United States to be more judicious in assessing the actual potential of a “Chinese financial threat.” Beijing, on the other hand, has much to gain if it proceeds to assure the rest of the world how it intends to use its newly gained and expanding foreign reserve to diminish suspicion and enhance mutual trust with other economies, to reform its financial institutions with much-needed transparency, and to make its global investment more wisely and less aggressively. In that regard, it is a bit insuring when China's Vice Minister of Finance Li Yong stated that “[t]he CIC will make things more transparent, and learn best practices from other sovereign wealth funds” (Xinhua, November 8).

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#### NOTES

1. Other experts estimate the numbers of SWF allocation slightly differently. See Florence Chong, “Risks and rewards in sovereign funds,” *The Australian*, October 30, 2007.

## Beijing Keeps a Wary Eye on the Korean Peace Process

By Jing-dong Yuan

### INTRODUCTION

Earlier in October, the Six-Party Talks—a multilateral process established in 2003 to defuse and resolve the North Korean nuclear issue that contains the United States, the two Koreas, Japan, Russia and host country China—reached an agreement seen as a major step toward the dismantlement of North Korea’s nuclear weapons program. The “Second-Phase Actions for the Implementation of the Joint Statement” commits North Korea to “disabling” the three main facilities at its Yongbyon nuclear complex, declaring all its nuclear activities by the end of the year, and reaffirming its pledge not to engage in nuclear transfers of any kind—materials, technology, or know-how.

Meanwhile, another major event, the second inter-Korea summit between North Korean leader Kim Jong-Il and South Korean President Roh Moo-hyun, closely following the Six-Party Talks also took a small—albeit important—step in the long and at times tortuous road toward peninsular peace and reconciliation. The two leaders signed the “Declaration on the Advancement of South-North Relations, Peace and Prosperity,” which pledges to expand and promote inter-Korean economic cooperation, hold frequent meetings between “their highest authorities,” and enhance military confidence-building measures. What is most interesting to note, though, is the nuance with significant policy implications in the Roh-Kim joint declaration’s call for having the “leaders of the three-four parties directly concerned” negotiate an end to the current armistice and build a permanent peace regime on the Peninsula.

### BEIJING BUYS IN ON “ANY” PEACE PROCESS

China views the outcomes of both the latest round of the Six-Party Talks and the inter-Korea summit with guarded praise. On the former, it reinforces Beijing’s persistent emphasis that “patience, sincerity, and pragmatism” are keys to moving the negotiation process forward. On the summit, greater economic interactions between the North and the South are compatible with Beijing’s peninsular interests, as a less fragile and paranoid North Korea lifts some burden from China as well as ensures an atmosphere conducive to bilateral and multilateral discussions on the North Korean nuclear issue and the future of peninsular peace and stability.

Beijing, however, reacted to the joint declaration’s somewhat puzzling reference to the peace regime negotiation in forceful and unambiguous terms. While praising and endorsing the two Koreas’ efforts in reconciliation and toward establishing a peace regime, a Foreign Ministry spokesman also emphasized that as a signatory state to the 1953 Armistice Agreement and an important and influential country in Northeast Asia, China expects to be included in any negotiation leading to a peace regime on the Korean Peninsula (Ministry of Foreign Affairs, October 9). Chinese Premier Wen Jiabao in a recent meeting with President Roh in Singapore for the ASEAN +3 Summit likewise stated that “China will support negotiation on a Korean Peninsula peace regime. As a signatory to the cease-fire of the (1950-53) Korean War, China will actively participate in negotiations on a Korean Peninsula peace regime” (Yonhap News, November 20). Chinese analysts, not surprisingly, echo the official position and emphasize that China made great sacrifices during the Korean War and should not be excluded from any negotiation leading to a peace regime on the Peninsula. Whether peace and stability can be achieved and in what form will have direct bearing on China’s security interests (Xinwen Chenbao, October 10; People’s Daily, October 10).

Interestingly, China even alludes to the condition under which a peninsular peace regime is conceivable. Ning Fukui, Chinese ambassador to South Korea, stated that a formal inter-Korean peace treaty cannot be signed as long as the North keeps nuclear weapons (Lianhe Zaobao, October 18). Beijing’s quick reactions to the peninsular peace process reflect its keen interest and growing stakes in balancing the following four policy objectives. First, a denuclearized Korean Peninsula to avert a possible nuclear domino effect in Northeast Asia, with the possibility that Japan, South Korea, and even Taiwan might follow suit. Second, a stable and working PRC-DPRK relationship. Third, the growing ties between Beijing and Seoul and China’s views of the longer term prospects of a unified Korea and the consequences for China’s economic security and strategic interests. Fourth, the complexity of Sino-U.S. relations with its regional and global implications, and their differences in assessments, priorities, and the end game regarding both the North Korean nuclear issue and the future of peninsular developments [1].

### CHINA’S STRATEGIC INTERESTS IN PENINSULAR AFFAIRS

China’s long-term interests in peninsular affairs must be understood in geo-strategic and economic terms. Beijing has pursued a three-pronged policy toward the Korean Peninsula. First, China opposes the nuclearization of the Peninsula due to its deep concerns over the potential chain reaction—the domino effect that leads to further nuclear

proliferation in the region. This explains why Beijing since 2003 has adopted a more proactive, and at times interventionist diplomacy to manage, deescalate, reverse and, hopefully, resolve the North Korean nuclear dispute. Second, since the establishment of diplomatic relations between Beijing and Seoul in 1992, China has adopted and maintained a balanced two-Korea policy under the new political and security environment. While offering support to the two Koreas' desire for peace and unification, Beijing also is keen on seeing a neutral unified Korea and certainly would be strongly opposed to one under U.S. influence [2].

Third, China's continued interests in peninsular stability have been driven in part by its long-standing appreciation of the importance of North Korea as a strategic buffer. Historically, the peninsula acted as the fulcrum for China to exercise its influence in Northeast Asia and it doubles as a passageway for foreign invasion, Japan in particular. Beijing is therefore highly sensitive to any power establishing dominance on the peninsula. This line of thinking partially explains China's entry into the Korean War and its continued involvement in peninsular affairs [3]. Some Chinese analysts even consider the Korean Peninsula as a major asset in countering U.S. hegemonic ambitions in Northeast Asia and call for the formation of a quasi-military alignment between China, North Korea, and Russia [4]. Yet North Korea's strategic importance to China also provides Pyongyang with a trump card in its dealing with Beijing—China is averse to seeing the North's deteriorating situation since this would in turn affect Chinese interests, hence giving it a source of asymmetrical power [5].

Indeed, some Chinese analysts concede that since Pyongyang has drawn the logical conclusion that its very existence has contributed to China's security by drawing down significant numbers of U.S. and South Korean troops and therefore relieving the pressure on China, Beijing would find it hard to adopt sanctions against North Korea and indeed even had to accept the reality of its nuclear test. The fact that China, however, joined other nations in imposing UN sanctions on North Korea in reaction to its nuclear test also suggested that China's own security interests were seriously compromised because of Pyongyang's defiance of international warning, including those from China [6]. That is why while Beijing's active engagement has prevented the crisis from escalating, it has not been able to reverse the course of developments or bring it to a closure. In that context, China's role has remained largely procedural in maintaining the process open and at most restraining deterioration of the situation [7].

Retaining that influence remains crucial for China. There are already concerns among Chinese analysts that improvement on the North Korean nuclear issue could dilute the importance of China as a mediator or chair of the Six-Party Talks since one of Pyongyang's key objectives has always been to talk directly to Washington and, to the extent possible, reduce its dependence on Beijing. The reference to "three parties" in a possible international summit, implying exclusion of China, must be understood within this context (Lianhe Zaobao, October 12). To sustain China's critical role on peninsular developments, Beijing is likely to advocate and support the expansion and extension of the current Six-Party Talks into a regional crisis management and confidence-building mechanism, leading eventually to a security institution for Northeast Asia [8].

Geo-strategic interest aside, Beijing is also keen on turning North Korea from a basket case into economic opportunities. As a consequence of years of economic difficulties and continued international isolation, China now effectively shoulders a large portion of economic aid to North Korea in terms of food and energy supplies, in addition to exports of critical materials at below market prices, just to keep it afloat and prevent massive exodus of economic refugees from roaming into China. For instance, Beijing reportedly allocates between 25 percent to one-third of its total annual foreign assistance budget to North Korea in recent years. From the mid-1990s to 2001, Chinese financial assistance to North Korea was estimated at U.S. \$210 million, about 10 percent of the total provided by the international community during the same period. It provides between 70 to 90 percent of North Korea's energy supplies, with Chinese fuel supplies estimated at over U.S. \$100 million a year. China has now become North Korea's largest trading partner by default, with bilateral trade in 2003 amounting to U.S. \$1 billion, about 33 percent of North Korea's total foreign trade. This amount grew to U.S. \$1.4 billion (2004), U.S. \$1.5 billion (2005), and U.S. \$1.7 billion (2006), with China accounting for close to 50 percent of the DPRK foreign trade (Asia Times Online, October 6; Congressional Research Service, May 26, 2005; International Crisis Group, February 1, 2006; Nautilus Institute Policy Forum Online, January 6, 2006).

In recent years, China has sought to move the bilateral economic relationship from one of largely financial assistance to economic cooperation with mutual benefits. Over 100 Chinese companies are investing in North Korea, with activities concentrated in mining and resource-related manufacturing to take advantage of the complementary nature of the two economies. Three areas have received particular attention: mining, iron and the steel industry, and port development (International Crisis Group, February 1,



2006). In December 2005, the two governments also signed an agreement on joint exploration of oil in the Yellow Sea during DPRK Vice Premier Ro Tu Chol's visit to Beijing. Yet, given the significant energy shortage and the poor state of infrastructure and lack of legal framework for contractual sanctity, Chinese investments remain small in scale and have yet to generate meaningful returns [9].

#### CONCLUSION

China has important geo-strategic and—over the longer term—economic interests in peninsular affairs. While endorsing the North-South process toward negotiating a permanent peace regime, Beijing will likely insist on retaining its lead role in the process to ensure that its interests are protected and advanced based on—at the least—three principles and policy objectives. First, China would support inter-Korea reconciliation and peace based on denuclearization and peninsular stability, and toward a unified but friendly neighbor. Second, Beijing seeks to retain its role in the Six-Party Talks to expand it into a regional security institution. Third, China is working toward promoting its economic interests in North Korea, especially as the latter's importance as sources of raw materials and future markets grows. In this context, Chinese officials will remain highly vigilant even as the premium of the North Korean nuclear threat decreases as the peace process proceeds. The peace process is expected to run into several electoral hurdles as both Roh and Bush are eager to leave their legacy before the end of their terms, and China, as ever, waits patiently to see the inter-Korean peace process evolve.

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## U.S.-China Military Hotline a Model for Cross-Strait CBM

By Cheng-yi Lin

After the EP-3 mid-air incident, the PRC learned an important lesson in crisis management and the Central Party School, the highest institution to train officials of the Communist Party of China (CPC) in Beijing, began to offer its first course on the subject in 2002. Meanwhile, the United States undertook a critical re-evaluation of its military exchange programs with the PRC. Since the departure of former Defense Secretary Donald Rumsfeld, the U.S.-PRC

military relationship has thawed significantly under a series of high-level visits. For example, before Defense Secretary Robert Gates's recent visit to China, former Chairman of the Joint Chiefs of Staff Peter Pace, U.S. Pacific Command Commander-in-Chief Admiral Timothy Keating, and the Navy's former Chief of Naval Operations Michael Mullen all called on Beijing separately, and Beijing's navy chief Vice Admiral Wu Shengli visited the United States in 2007 [1]. These exchanges culminated in the agreement to set up a military hotline in time for Defense Secretary Gates' early November visit.

Beijing claims that the military hotline with the United States is the first of its kind with a foreign country and may become an example for future Chinese bilateral arrangements with other military powers (Liaowang Xinhua News, November 12). Cautious observers do not overestimate the value of this first ever-military hotline between two of the world's most powerful militaries. Qian Lihua, deputy director of the Foreign Affairs Office of the Chinese Ministry of National Defense, revealed it was Peter Rodman, former assistant secretary of defense, who first officially raised the idea of establishing a military hotline during the Defense Consultative Talks in June 2006 (International Herald Tribune, June 11). Even though the proposal had been earlier communicated by Washington, Beijing only recently became responsive to the United States' clarion calls (China Brief, June 13). At the Shangri-La Defense dialogue in June 2007, Lieutenant-General Zhang Qinsheng, deputy chief of the general staff of the PLA, claimed publicly that Beijing's acceptance of the hotline is a demonstration of the PLA's sincere commitment to military transparency [2].

There remain, however, several technical hurdles for Beijing to follow through with establishing the hotline. These hurdles include determining the corresponding department to serve as the receptor of communication—if not the Ministry of Defense; the interval of contacts through this channel; the key focal point or receiver—if not the defense minister themselves; and the content of conversations: will it be purely military or will there be an political overcast? The PLA also has a new General Chief of Staff Chen Bingde, and Defense Minister Cao Gangchuan, who was Defense Secretary Gates's host in Beijing, is soon to step down around the National People's Congress in March 2008, and may be succeeded by the Politburo member Xu Caihou, deputy chairman of the Central Military Commission (CMC). Given the expected change in personnel, the first run for the military hotline will probably be a stage greeting rather than for testing conflict avoidance or crisis prevention. Yet the military hotline may relieve Ambassador Joseph Prueher, former commander-in-chief of Pacific Command and the U.S. ambassador to the PRC from 1999-2001,

who probably regretted not having a direct line to Chinese Defense Minister Chi Haotien during the Taiwan Strait crisis in 1996 (CRS, August 20).

The perception gap that exists between Beijing and Washington is over the function and purpose of military exchange between the two countries. For Beijing, the military hotline is a key catalyst for future military exchanges program with the United States. For the United States, military transparency, clarification of military intent, notification of dangerous military activities, avoidance of military incidents or even crisis communications in the Taiwan Strait are main functions of the hotline [3]. Peng Guanqian, a strategist at China's Academy of Military Science, pointed out that the major symbol of this military hotline is political rather than military (Ta Kung Pao, November 16). This implies that breakthrough with the military hotline is highly dependent on the progress of a constructive and cooperative relationship between Beijing and Washington, and avoiding potential pitfalls that may derail the process. The United States and the PRC had Military Maritime Consultation Talks but could not prevent the mid-air incident in Hainan island, and the Defense Consultative Talks were interrupted by the embassy bombing in 1999 and unprecedented U.S. arms sales to Taiwan in 2001.

On November 9, on his final stop in Asia at the Sophia University in Japan, Defense Secretary Gates categorized China as "a competitor in some respects and partner in others," but not a "strategic adversary" as branded by his predecessors. Gates sees the need for a military hotline to assist mutual understanding of strategic military intent, decision-making, and key capabilities of the PLA. The PRC agreed to jointly oppose a nuclear-armed Iran, but Beijing still owes Secretary Gates and Peter Pace, former chairman of the Joint Chiefs of Staff, an explanation for the Chinese anti-satellite test in January 2007 when the issue was raised in Beijing. Secrecy and lack of transparency is embedded in Chinese strategic culture and defense thinking and Beijing simply could not share what they have with a foreign competitor such as the United States.

In April 1993, Taiwan's Straits Exchanges Foundation (SEF), the semi-governmental organization in charge of cross-Strait affairs, first reached an agreement on a system for contacts and meetings between SEF and China's Association of Relations Across the Taiwan Straits (ARATS) in Singapore, and designated the deputy secretary level as the emergency contact person. Later on, the Taiwanese focal point found it difficult to reach his counterpart in ARATS during a time of emergency for clarification or information sharing. Ambassador Prueher once complained that the PRC's Ministry of Foreign Affairs

and the PLA did not respond to his inquiries immediately after the EP-3 incident for several hours (CRS, August 10). Similar complaints were also filed in Japan's experience during the intrusion of a Chinese Han-class nuclear-power submarine into Japanese territorial waters in the Okinawa islands chain in November 2004. In a conversation with an anonymous researcher in the National Defense Academy of Japan back in February 2005, the Self-Defense Agency communicated with the Chinese North Fleet but got no response immediately after the first call.

Compared to the 1995-1996 Taiwan Strait missile crisis, the PRC is now deploying weapons system such as J-10 indigenous fighter aircraft, Sovremenny-class destroyers, Kilo-class submarines, Type 022 missile fast attack craft, and about 1,000 surface-to-surface missiles targeting Taiwan. Through military modernization, Beijing is eager to let the United States and Japan know that Beijing is preparing to deter, delay and defeat foreign intervention (China Leadership Monitor, Summer 2005). In its 2007 Military Power of the People's Republic of China (PRC), the Pentagon reconfirmed that the "expanding military capabilities of China's armed forces are a major factor in changing East Asian military balances" (Office of the Secretary of Defense, February 2006).

Taiwan cannot compete with the PRC in military modernization and the island cannot defend itself without intervention from the United States and Japan. After the long stone-walling from the Kuomintang, the major opposition party, of the special defense budget in the Legislative Yuan, Taiwan has finally adopted a scaled-down defense acquisition package from the United States, including approval of 12 P-3C Orion maritime ASW aircraft (U.S. \$190 million), an upgraded PAC-II version rather than a PAC-III for the island's anti-missile defense (U.S. \$109 million), the assessment feasibility of diesel submarines (U.S. \$6.2million), and initial appropriation of additional F16 C/D (U.S. \$499 million) [4]. It may not be significant in scale but it is a breakthrough in appropriating budgets to acquire the major weapons as agreed by President Bush in April 2004. In the National Security Report 2006, President Chen Shui-bian stated a goal of reversing the declining trends and increasing the defense budget from 2.54% in 2006 to 3% of GDP by 2008 (NSC 2006 National Security Report, p. 88). Recently, President Chen publicly admitted that it might be difficult to meet the targeted benchmark; however, there are signs in the defense platform of the DPP and KMT's presidential candidate that indicate a commitment from both sides to raise the ratio of Taiwan's annual defense budget.

As early as 2004, President Chen pledged that Taiwan will not develop weapons of mass destruction such as nuclear,

biological and chemical weapons and urged the PRC to openly renounce the development and use of weapons of mass destruction. Chen also suggested military buffer zones be established to exclude military aircrafts and ships from entering. More importantly, Chen drew from the experience of the 1972 Incidents at Sea Agreements between the United States and the USSR, and the 1998 Military Maritime Consultative Agreement (MMCA) between the United States and the PRC and suggested that the "Code of Conduct across the Taiwan Strait" and more specifically a military hotline be considered in the Taiwan Strait for conflict prevention. In particular, Taipei suggests both sides conduct a joint effort to develop an "emergency procedure," to reduce uncertainty in case of contingency, and to handle accidental sea or air intrusion in keeping the situation from escalating beyond control (MND 2004 National Defense Report, p. 76).

A military hotline between the United States and the PRC is welcomed in Taiwan. Taipei sees the current upgraded military exchanges between China and the United States as operations of "security management" rather than a whole-hearted security cooperation. Without doubt, the U.S.-PRC military hotline could serve as a channel to defuse any tensions in the Taiwan Strait and it is not logical to exclude its applicability to Taiwan and China. Yet for many years, China has been intentionally lukewarm to Taipei's proposal of confidence-building measures (CBMs). From 1991-1995, directors of offices of Jiang Zemin and Lee Teng-hui had secretly met several times for building smooth cross-Strait relations leading to the Koo-Wang Talks in Singapore [5]. The creation of a secret channel indicated that there were precedents in the Taiwan Strait for a hotline that can foster a more predictable and less suspicious relationship to calm the cross-Strait tides.

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#### NOTES

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