

## **EXECUTIVE SUMMARY**

### **The U.S.-China Trade and Economic Relationship**

China is now the second-largest economy in the world and the world's largest manufacturer. Its market exceeds that of the United States in industries such as automobiles, mobile handsets, and personal computers. Although Chinese leaders acknowledge the need to balance their economy by increasing domestic consumption, China continues to maintain an export-driven economy with policies that subsidize Chinese companies and undervalue the renminbi (RMB). While the RMB rose by roughly 6 percent in nominal terms over the last year, it is still widely believed to be substantially undervalued. For the first eight months of 2011, the U.S. trade deficit with China increased 9 percent over the same period in 2010. The U.S. trade deficit with China is now more than half of the total U.S. trade deficit with the world. In the year to date ending August 2011, the United States exported about \$13.4 billion in advanced technology products to China, but imported over \$81.1 billion in advanced technology products from China, for a deficit of about \$67.7 billion. This is a 17 percent increase in the advanced technology products deficit for the same period over the previous year, ending in August 2010.

The Chinese government's special treatment of state-owned enterprises (SOEs) is of particular concern to U.S. businesses, as it can overcome comparative advantages of competitors, thereby harming American economic interests. China's SOEs are also an issue of contention in government procurement, as China seeks to wall off a large portion of its economy from foreign competition.

In 2010, the amount of foreign direct investment (FDI) flowing into China jumped to \$105.7 billion, up from \$90 billion in 2009. Foreign-invested enterprises were responsible for 55 percent of China's exports and 68 percent of its trade surplus in 2010. While some Chinese sectors are now open to foreign sales, huge swathes of the economy are reserved for Chinese firms. Despite Chinese claims that U.S. inward investment policies are protectionist, for the past two years there has been a more than 100 percent year-on-year growth of Chinese investment in the United States. Chinese investments have focused on manufacturing and technology, with an emphasis on brand acquisition. Some critics of China's foreign direct investment in the United States contend that Beijing's efforts are focused on acquiring and transferring technology to Chinese firms.

In March 2011, China ratified its 12th Five-Year Plan (2011–2015), a government-directed industrial policy that focuses on the development and expansion of seven “strategic emerging industries.” The central and local governments will likely continue to combine targeted investment with preferential tax and procure-

ment policies to ensure that Chinese firms emerge as global leaders, or “national champions,” in these industries within the next five years.

China’s indigenous innovation plans that limit government procurement to Chinese companies and China’s continuing lack of enforcement of intellectual property rights are both problematic. In addition, China maintains policies of forced technology transfer in violation of international trade agreements and requires the creation of joint venture companies as a condition of obtaining access to the Chinese market. While the publication of national indigenous innovation product catalogues that favor procurement of Chinese goods over foreign competitors appears to have slowed, local-level catalogues are still in circulation. China continues to be one of the largest sources of counterfeit and pirated goods in the world. The Chinese government itself estimates that counterfeits constitute between 15 and 20 percent of all products made in China and are equivalent to about 8 percent of China’s gross domestic product (GDP). Chinese goods accounted for 53 percent of seizures of counterfeits at U.S. ports of entry in 2010, and the U.S. International Trade Commission estimates that employment in the United States would increase by up to 2.1 million jobs if China were to adopt an intellectual property system equivalent to that of the United States.

The Chinese Communist Party (CCP) relies on economic growth and strict authoritarian rule to maintain control over a factious and geographically vast nation. Socioeconomic issues have been a large driver of protests in China. The party is particularly concerned about inflation, including a 10 percent increase in food prices over the past year, as well as such catalysts of protests as corruption, pollution, and income inequality. In order to maintain control more effectively, the party has created an extensive police and surveillance network to monitor its citizens and react to any potential threat to stability. In 2010, China invested \$83.5 billion in domestic security, which surpassed China’s published military budget of \$81.2 billion for the same year. In early 2011, the central government responded forcefully to the possibility that the unrest in the Middle East might lead to unrest in China. The Chinese government expanded restrictions on online information and access to communication services, reported government propaganda in domestic news outlets, restricted the freedom of foreign journalists, and arrested dissidents with little or no cause.

### **Conclusions**

#### *The U.S.-China Trade and Economic Relationship’s Current Status and Significant Changes During 2011*

- The U.S.-China trade deficit in 2010 set a record high of \$273 billion. The U.S.-China trade deficit now accounts for more than 50 percent of the total U.S. trade deficit with the world.
- Over the last 12 months, the RMB has appreciated by 6 percent. Economists estimate, however, that it remains substantially undervalued. There is increasing grassroots pressure in China to widen the trading band of the RMB and increase the pace of appreciation.

- The Chinese economy, generally, and Chinese exports, in particular, are moving up the value chain. On a monthly basis, the United States now imports roughly 560 percent more advanced technology products from China than it exports to China. Exports of low-cost, labor-intensive manufactured goods as a share of China's total exports decreased from 37 percent in 2000 to 14 percent in 2010.
- China's foreign currency reserves are skyrocketing. A major contributor to this phenomenon is China's continued policy of maintaining closed capital accounts. China's foreign currency reserves currently exceed \$3 trillion, three times higher than the next largest holder of foreign currency reserves, Japan.
- Commensurate with growth in foreign currency reserves, China's domestic money supply is ballooning out of control. Between 2000 and 2010, China's money supply grew by 434 percent. China's money supply is now ten times greater than the U.S. money supply, despite the fact that China's GDP is only one-third as large.
- Such rapid growth in China's domestic money has created strong inflationary pressure. This has helped create a real estate bubble, which resulted in price increases of more than 100 percent in some cities within a handful of years. In September, China's consumer price index topped 6.1 percent across the board and higher in rural areas.
- China has grown more assertive and creative in using WTO procedures to alleviate, eliminate, and avoid certain restrictions in the Accession Protocol. At the same time, the WTO has ruled that China's existing system of state monopoly over imports of cultural products is inconsistent with WTO obligations. China has not yet complied fully with the WTO ruling, and the United States has the right to initiate further proceedings to compel China to do so.

*Chinese State-owned Enterprises and U.S.-China Bilateral Investment*

- China's privatization reforms during the past two decades appear in some cases to have been reversed, with a renewed use of industrial policies aimed at creating SOEs that dominate important portions of the economy, especially in the industrial sectors, reserved for the state's control.
- The Chinese government promotes the state-owned sector with a variety of industrial policy tools, including a wide range of direct and indirect subsidies, preferential access to capital, forced technology transfer from foreign firms, and domestic procurement requirements, all intended to favor SOEs over foreign competitors.
- The value and scope of U.S.-China bilateral investment flows have expanded significantly in the past ten years. However, U.S. direct investment in China is more than 12 times greater than Chinese direct investment in the United States. Official U.S. statistics show that U.S. cumulative FDI in China was

\$60.5 billion in 2010. The Chinese Ministry of Commerce estimated that in 2010, cumulative Chinese FDI in the United States was \$4.9 billion.

- The Chinese government guides FDI into those sectors it wishes to see grow and develop with the help of foreign technology and capital. Foreign investors are frequently forced into joint ventures or other technology-sharing arrangements, such as setting up research and development facilities, in exchange for access to China's market. Meanwhile, large swathes of the Chinese economy are closed to foreign investors. China's investment policies are part of the government's plan to promote the development of key industries in China through access to foreign technology and capital.
- Chinese FDI in the United States is a relatively recent phenomenon and remains very small compared to the U.S. investment in China, but there is great potential for growth. China has stated a desire to diversify its holdings of foreign exchange, estimated at \$3.2 trillion in mid-2011, the majority of which is invested in dollar-denominated debt securities. As with other statistics, there are discrepancies between official U.S. and Chinese statistics on bilateral investment.
- Due to the considerable government ownership of the Chinese economy, provision by Chinese companies of critical infrastructure to U.S. government or acquisition by Chinese companies of U.S. firms with sensitive technology or intellectual property could be harmful to U.S. national interests. The Committee on Foreign Investment in the United States investigates the national security implications of mergers and acquisitions by foreign investors of U.S. assets.
- In areas where there are no national security considerations, Chinese FDI has the potential to create jobs and economic growth.
- China has recently introduced a national security investment review mechanism similar to the Committee on Foreign Investment in the United States, although there are concerns among foreign companies that the Chinese government may use the mechanism to derail investment by foreigners in those companies and sectors it wants to remain under government control.

#### *Indigenous Innovation and Intellectual Property Rights*

- China's indigenous innovation policy is an outgrowth of the government's broad industrial policy and has been openly developed and documented through public plans and pronouncements, particularly the *National Medium- and Long-Term Plan for the Development of Science and Technology (2006–2020)*. The indigenous innovation policy seeks to nurture certain high-wage, high value-added industries designated by the government. Chinese firms are to be favored over foreign firms or China-based foreign affiliates in government procurement contracts. State-owned enterprises and municipal and provincial governments are also to show favoritism to Chinese domestic industries and businesses.

- Chinese officials, including President Hu, have pledged to modify China's indigenous innovation policy in response to protests from U.S. business leaders and top officials. Those promises have not been implemented at the local and provincial levels, however. China has a history of making promises and delivering little, particularly when doing as little as possible benefits the Chinese economy, as has been the case with China's promises to bring its intellectual property protections up to international standards and to cease requiring technology transfers from foreign firms.
- Foreign-invested enterprises seeking to be considered for government procurement contracts or public works projects are expected to file for patents and copyrights within China in order to qualify for preferential treatment in government contracting. Foreign affiliates risk the unintended transfer of their technology to Chinese firms if they do so, because of the nature of the Chinese intellectual property system and the lax enforcement of intellectual property laws and regulations in China.
- Although China agreed in 2001 to stop explicitly requiring foreign companies to surrender their technology to China in return for market access and investment opportunities, the government in Beijing still employs several tactics to coerce foreign firms to share trade secrets with Chinese competitors. China's industrial policy in general and its indigenous innovation policy in particular seek to circumvent accepted intellectual property protections and to extort technology from U.S. companies.
- In addition, the long effort by the central government to foster indigenous innovation is a message that will likely outlive any product catalogues. Restricting market access to domestic firms and requiring technology transfer as a cost for foreigners attempting to do business in China demonstrated the government's view that Chinese companies and governments are better off substituting domestic goods for imports.

*China's 12th Five-Year Plan and Technology Development and Transfers to China*

- One of the main objectives of the 12th Five-Year Plan is to redirect China's economy to one more focused on domestic consumption and less on exports and investment. The plan assumes that China's growth would therefore be more balanced and sustainable. The plan also emphasizes higher value-added production and increased government support for domestic high-tech industries.
- There is cause for skepticism about China's prospects for carrying out the rebalancing goals of the 12th Five-Year Plan. The Chinese government had similar goals in previous plans, but their implementation was sidelined in favor of pursuing higher export and investment growth.

- Increasing household consumption, a major goal of the 12th Five-Year Plan, and the subsequent emergence of a more assertive consumer class, may be in direct contradiction to the Chinese government's policy of keeping economic power firmly in the hands of the state and may compromise lending to many vested interests, including SOEs and the export sector.
- The 12th Five-Year Plan also advocates a move up the manufacturing value chain with the explicit mention of seven strategic emerging industries: New-generation information technology, high-end equipment manufacturing, advanced materials, alternative-fuel cars, energy conservation and environmental protection, alternative energy, and biotechnology. These industries, which will receive targeted government support, have the potential to be a source of economic growth and advanced innovation.
- Analysts and foreign business leaders fear that the emphasis on industrial upgrading will lead to the introduction of new government subsidies, which in turn will disadvantage foreign competitors.
- As part of its indigenous innovation policy, China incentivizes foreign companies to transfer technology in exchange for market access.
- Chinese government requirements that foreign corporations transfer technology to Chinese joint venture partners in exchange for market access violate written WTO prohibitions on forced technology transfers. The new requirements for technology transfer from foreign partners are often made in implicit rather than explicit terms, which may make challenging them in the WTO dispute procedure more difficult.

#### *China's Internal Dilemmas*

- The primary objective of the CCP is to remain in power. All other goals are intended to serve that end. As a consequence, the party has dedicated enormous resources to repress dissent before it becomes a destabilizing element and threatens the party's control.
- Despite the efforts of the party and the government to minimize dissent, citizen protest has been on the rise. Protests are sometimes brutally suppressed. The government will arrest and detain as a precautionary measure those it considers a threat to its control. The party and the government employ the news media to propagandize and mislead the public.
- The party is well aware of the dangers to its continuing authority posed by public rejection of a government that is unresponsive to the people. The party therefore reacts to citizen ire by attempting appeasement. This may take the form of authorizing the news media to highlight official abuses, particularly those committed by local officials. Still, corruption in all levels of government remains a problem for Beijing.

- Inflation has historically caused problems for the government in China. The rural poor and migrant workers are particularly disadvantaged by higher prices because they are so often reflected disproportionately in food and energy, which consume a larger portion of family expenses in rural areas. The government has responded to rising inflation with price controls and some curbs on bank lending. These tools are inadequate in the long run. China's policy of keeping the RMB undervalued in order to gain an export advantage removes a powerful anti-inflation tool from the central bank.
- Income and wealth inequality is a growing problem in China. One cause is the *hukou* system of residential registration, which was intended to limit the migration of the rural poor to the cities. This has created a large migrant population in China, moving from city to city to seek work in factories but unable to access healthcare and education services without the proper *hukou* designation for that area. This situation perpetuates poverty among the disadvantaged. Local officials favor it, because it limits their responsibility toward the migrant workers. A smaller group, known as the "ant tribe," consists of college graduates from second-tier schools in rural areas who also lack the *hukou* to live in urban areas but who nevertheless seek but are unable to find the jobs that they have trained for. This restive and disappointed population is a potential source of unrest.
- China's middle class has been considered by some to be a potential force for political reform. But the opposite is likely. As long as the party can deliver strong economic growth, particularly in urban areas, the middle class is likely to remain a force for stability.
- China's central government has reacted strongly to perceived challenges to its authority. It detains and imprisons dissidents. It censors the news and punishes journalists for infractions of its unwritten and arbitrary rules. China also attempts to control and censor the Internet and has had more success than most other authoritarian regimes in suppressing the flow of information among the public.

### **China's Activities Directly Affecting U.S. Security Interests**

China continues to demonstrate progress in its military modernization efforts. Of note, the People's Liberation Army (PLA) is acquiring specific means to counter U.S. military capabilities and exploit U.S. weaknesses. Since January 2011, China has conducted a flight test of its next-generation fighter aircraft, continued development of its antiship ballistic missile, and conducted a sea trial of its first aircraft carrier. These developments, when operational, will allow China to better project force throughout the region, including the far reaches of the South China Sea.

The PLA's military strategy is designed to provide the army with the means to defeat a technologically superior opponent, such as the U.S. military. As such, it focuses on controlling China's periphery, especially the western Pacific Ocean, degrading an opponent's technological advantages, and striking first in order to gain sur-

prise over an enemy in the event of a conflict. The Commission prefers to use the term “area control” for China’s regional strategy, because the terms “antiaccess” or “area denial” foster a U.S.-centric view that downplays the PLA’s ability to easily conduct operations against regional states. While U.S. bases in East Asia are vulnerable to PLA air and missile attacks, Japanese, Philippine, and Vietnamese bases are just as vulnerable, if not more so.

Tensions continued in 2011 between China and other claimants in the South China Sea territorial disputes as well as with Japan over territory in the East China Sea. Despite intermittent statements of cooperation, Chinese assertiveness in the South China Sea indicates that China is unlikely to concede its sovereignty claims. An implication of China’s growing assertiveness, especially its harassment and intimidation of foreign vessels, is the growing risk of escalation due to miscommunication and miscalculation. As chances of confrontation grow, so could the consequences for the United States, especially with regard to the Philippines, with which the United States holds a mutual defense treaty.

In 2011, as in previous years, the U.S. government, foreign governments, defense contractors, commercial entities, and various nongovernmental organizations experienced a substantial volume of actual and attempted network intrusions that appear to originate in China. Of concern to U.S. military operations, China has identified the U.S. military’s reliance on information systems as a significant vulnerability and seeks to use Chinese cyber capabilities to achieve strategic objectives and significantly degrade U.S. forces’ ability to operate.

The Commission’s *2011 Annual Report to Congress* investigates China’s advancing space program. China is now among the top few space powers in the world. China’s leadership views all space activities through the prism of comprehensive national power, using civil space activities to promote its legitimacy in the eyes of its people, to produce spin-off benefits for other industries, and for military-related activities. For example, China appears to be making great strides toward fielding regional reconnaissance-strike capabilities. China has also continued to develop its antisatellite capabilities, following up on its January 2007 demonstration that used a ballistic missile to destroy an obsolete Chinese weather satellite, creating thousands of pieces of space debris. As a result, in April 2011, astronauts evacuated the International Space Station out of concern of a possible collision with this debris. In addition, authoritative Chinese military writings advocate attacks on space-to-ground communications links and ground-based satellite control facilities in the event of a conflict. Such facilities may be vulnerable: in recent years, two U.S. government satellites have experienced interference apparently consistent with the cyber exploitation of their control facility.

## **Conclusions**

### *Military and Security Year in Review*

- Over the past year, China has demonstrated progress in modernizing the PLA. Recent developments confirm that the PLA seeks to improve its capacity to project force throughout the region.



- Continued improvements in China's civil aviation capabilities, as first noted in the Commission's 2010 Annual Report, enhance Chinese military aviation capabilities because of the close integration of China's commercial and military aviation sectors.
- In an effort to calm regional fears, China attempts to broadcast a benign image of its growing military capabilities. Official statements from Beijing over the past year describe China as a status quo power and downplay its military modernization efforts.
- In 2011, China continued a pattern of provocation in disputed areas of the South China Sea. China's policy in the region appears driven by a desire to intimidate rather than cooperate. Many of China's activities in the region may constitute violations of the *United Nations Convention on the Law of the Sea* and the *Declaration on the Conduct of Parties in the South China Sea*. While China sometimes demonstrates a willingness to cooperate with other claimants to disputed waters in the South China Sea, it is unlikely that China will concede any of its claims.
- China's government or military appeared to sponsor numerous computer network intrusions throughout 2011. Additional evidence also surfaced over the past year that the Chinese military engages in computer network attacks. These developments are consistent with the PLA's known missions and organizational features, as noted by the Commission's *2009 Annual Report to Congress* and contracted research study *Capability of the People's Republic of China to Conduct Cyber Warfare and Computer Network Exploitation*.
- China's military strategy envisions the use of computer network exploitation and attack against adversaries, including the United States. These efforts are likely to focus on operational systems, such as command, control, communications, computers, intelligence, surveillance, and reconnaissance assets. This could critically disrupt the U.S. military's ability to deploy and operate during a military contingency. Chinese cyber attacks against strategic targets, such as critical infrastructure, are also possible.

*China's "Area Control Military Strategy"*

- The PLA's military strategy is best described as an Area Control Strategy. At its core, this strategy seeks to provide guidance to the PLA on how to defeat a technologically superior opponent.
- In order to defeat a superior opponent, the Area Control Strategy emphasizes degrading an opponent's technological advantages; striking first in a conflict; and establishing military control over China's periphery, especially the maritime region off of China's eastern coast.

- Many of the PLA's force modernization efforts reflect China's Area Control Strategy. As a result, the PLA is acquiring capabilities that allow it to conduct surprise attacks aimed at degrading a superior military's advantages and preventing an opponent from effectively operating along China's periphery.
- Many of the PLA's evolving capabilities appear aimed at directly countering U.S. military capabilities or to exploit potential weaknesses in U.S. military operations. In addition, as the PLA expands its force projection capabilities, China's Area Control Strategy and supporting means will increasingly impact regional states. Finally, the heavy focus on offensive operations inherent in the PLA's Area Control Strategy could serve to undermine stability in the region.

*The Implications of China's Civil and Military Space Activities*

- China is one of the top space powers in the world today. The nation's capabilities, which are state of the art in some areas, follow from decades of substantial investment and high prioritization by China's top leaders. The prestige of space exploration and the national security benefits of space systems serve as primary motivators for Chinese decisionmakers.
- China views all space activities in the context of "comprehensive national power." This concept includes many dimensions, but military aspects are fundamental. The PLA's primacy in all of China's space programs, including nominally civil activities, illustrates this emphasis.
- China's civil space programs have made impressive achievements over the past several decades. If Chinese projections hold, these programs are poised for continued accomplishments over the next ten to 15 years, such as the development of a space laboratory and eventually a space station. As part of an active lunar exploration program, China may attempt to land a man on the moon by the mid-2020s.
- China seeks new opportunities to sell satellites as well as satellite and launch services in international commercial space markets. Chinese firms' prospects for greater success in this field remain uncertain over the near term. However, China's international space-related diplomatic initiatives and their firms' ability to offer flexible terms on sales to developing countries may provide additional opportunities.
- In the military sphere, China appears to seek "space supremacy." The PLA aims to implement this policy through two tracks. First, they increasingly utilize space for the purposes of force enhancement. The best example is China's integration of space-based sensors and guided weapons. Second, they seek the capabilities to deny an adversary the use of space in the event of a conflict. To this end, China has numerous, active, counterspace weapons programs with demonstrated capabilities. China's military space and counterspace activities are part of a larger strategy for area control.

### **China's Foreign Policy**

Despite Beijing's attempts to emphasize its peaceful rise, China continues to support countries that undermine international security. In particular, China's support for North Korea and Iran undermines international efforts to compel these countries to discontinue agendas and programs that destabilize their regions and undercut U.S. interests. As China's global interests expand in a complex international environment, Beijing has experienced a growing number of domestic actors, such as SOEs, interested in determining China's foreign policies. The plethora of new and emerging voices in China's foreign policy-making process makes it more challenging for foreign countries to interact effectively with China. In addition, the pluralization of China's foreign policy actors increases the chance of miscalculations when determining its foreign policies.

In a positive development, economic and diplomatic ties across the Taiwan Strait continue to improve; however, military relations between China and Taiwan lack progress. China maintains some 1,200 short-range ballistic missiles opposite Taiwan. U.S.-Taiwan relations were dominated this year by the question of whether the United States would approve Taiwan's separate requests for additional arms sales. Taiwan has requested three different sales: new F-16C/D fighter jets; upgrades for its current fleet of F-16A/B fighter jets; and diesel-electric submarines. In August 2011 the United States notified Congress of the sale of F-16A/B upgrades but not new F-16C/D fighter jets nor diesel-electric submarines. Reacting against the sale of any new military equipment, China has indicated that it may suspend some military-to-military engagements with the United States.

Some developments in Hong Kong over the past year suggest that Beijing's influence in the region's affairs is growing. During 2011, Beijing increased its focus on Hong Kong's economy, especially its role as a vehicle for the internationalization of China's currency. Mainland involvement in Hong Kong's political affairs was an issue of contention among Hong Kong policymakers and citizens throughout 2011. While Hong Kong citizens and press largely continue to enjoy freedom of expression and assembly, at times these rights were challenged by Hong Kong authorities, who were often perceived to be acting out of deference to Beijing.

### **Conclusions**

#### *An Overview of China's Relations with North Korea and Iran*

- China has continued over the past year to support North Korea despite North Korea's destabilizing actions. Diplomatically, China shields North Korea from pressure in international fora. China also continues to trade with and invest in North Korea, providing it with an economic lifeline in the face of growing international ostracism. Beijing's continued support for Pyongyang is primarily driven by its fear of a collapse of the North Korean regime and the consequences this would have for China's economic, social, and security interests, as well as the fear of the loss of a buffer state on its border.

- Despite U.S. efforts to sanction Iran for its support of international terrorism and pursuit of weapons of mass destruction, China remains a large investor in Iran's petroleum industry and a major provider of refined oil products. China may also be supplying Iran with advanced conventional weapons, such as cruise missiles. China's investments in Iran's petroleum industry, and its continued provision of gasoline and advanced conventional weapons, may be at odds with U.S. laws.
- Continued Chinese support for North Korea and Iran demonstrates China's willingness to place its national interests ahead of regional stability by providing economic and diplomatic support to countries that undermine international security.

#### *Actors in China's Foreign Policy*

- As China expands and diversifies its overseas activities, it encounters an increasingly complex environment requiring the input and advice from knowledgeable subject matter experts. As a result, China's foreign policy-making process is changing to accommodate input from actors who previously had little or no say.
- Actors with increasing influence on China's foreign policies include the PLA, large state-owned enterprises, and academics and think tanks. In addition, while still minor compared to other actors, public opinion, expressed primarily online, appears to have a modicum of influence on some Chinese foreign policies.
- The CCP remains firmly in control of China's foreign policies, especially for issues deemed critical, such as China's policies toward the United States, North Korea, and Taiwan. This is despite the increased difficulty Beijing may have in coordinating a coherent policy among a growing number of actors.
- The growing complexity of China's foreign policy-making process has mixed implications for the United States. On the one hand, Washington may find it more difficult to interact with priority counterparts in Beijing as the number of actors in the policy process expands. On the other hand, the plethora of Chinese actors may provide U.S. foreign policymakers with opportunities to understand or influence Beijing.

#### *Taiwan*

- In 2011, Taiwan and China have continued to strengthen their economic and diplomatic relations by focusing on implementing previous agreements rather than signing new agreements.
- A major factor leading to the slower pace of reduced tensions across the Taiwan Strait is Taiwan's upcoming presidential and legislative elections. Seeking to prevent improving cross-Strait ties from being used against the incumbent Kuomintang Party, both Taiwan and China have moved away from pressing for rapid negotiations and developments as in previous years.

- The cross-Strait military balance continues increasingly to favor China, making it less likely that a peaceful resolution to the Taiwan issue will occur. Despite attempts to improve its capacity to defend the island against a potential attack from the mainland, Taiwan continues publicly to call for additional U.S. arms sales to augment its defense needs.

#### *Hong Kong*

- Hong Kong plays a central role in China's policy goal of internationalizing its currency. In 2011, China introduced substantial new measures supporting Hong Kong's status as China's primary platform for RMB offshoring.
- Mainland involvement in Hong Kong's political affairs was evident in 2011, prompting citizen discontent and conflict within Hong Kong's democratic groups.
- Hong Kong continued to have a vibrant protest culture in 2011, with record amounts of participants in some annual protests. However, there were reports that police sometimes challenged Hong Kong citizens' rights during protests, especially when protests targeted mainland China.
- Hong Kong's mass media reported increased interference in their activities by Hong Kong authorities in 2011. Public perception of self-censorship in Hong Kong's press peaked in 2011, and public opinion of press credibility fell to its lowest level in eight years.

#### **China's Public Diplomacy Initiatives Regarding Foreign and National Security Policy**

The CCP treats the control of propaganda/public diplomacy messages to foreign audiences as a fundamental tool of statecraft. China is highly critical of what it calls the "western media's ideological assault on the rest of the world" and sees itself as engaged in a "global war for public opinion." In pursuit of a larger voice in international affairs, Chinese media officials have significantly increased resources for state-controlled foreign language news outlets. In addition, Chinese propaganda organs are actively engaged in influencing foreign officials and media. This is particularly concerning given the possibility that the People's Republic of China's official messages may not always reflect actual Chinese foreign policy goals.

#### ***Conclusions***

- The Chinese government places a high priority on the management of information as a tool of policy, to include the messages that it promotes to international audiences regarding its goals in foreign and national security policy. The central leadership of the Chinese Communist Party selects official foreign policy messages intended to support state policy goals. These messages are then disseminated through diplomatic channels, state-controlled media, advertising, and "track two" exchanges.