

# CHINA US Focus Digest

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## PRINCIPLES FOR THE NEW GREAT POWER GAME

CHINA-US RELATIONS • PERIPHERY DIPLOMACY • ECONOMY

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# EDITOR'S NOTE

ZHANG PING

Over the past two months, the China-US relationship has encountered problems and disputes. Quarrels have erupted over cyber security, the South China Sea, peace and security in Asia, as well as in business and trade. The urgent task facing the two countries is to build up a mechanism to control their strategic differences in order to maintain a healthy and stable relationship.

In this issue's Cover Story, China-US Focus contributor Su Xiaohui stresses that equality, mutual respect and the elimination of "zero-sum" thinking are the principles for the new "great power game." The author also asks what level of comfort countries should seek in their foreign relations, and suggests that "relative" comfort is more stable and sustainable than "absolute" comfort for either side.

Mel Gurtov, Editor-in-Chief of "Asian Perspective", analyzes Obama's speech at West Point and its implications for U.S. foreign policy, as well as its limits on American exceptionalism.

To address anti-terrorism in China, we published an article entitled "Sino-US Anti-Terror Cooperation Difficult Yet Possible," written by Fu Xiaoqiang, director of the Center of Counterterrorism Studies at CICIR. Fu claims that China has found itself in a deep-water zone, where the fight against terrorism is a constant task, which necessitates the strengthening of anti-terror cooperation between China and the US.

Turning to the recent CICA Summit in Shanghai, Wu Zurong suggests that the US must heed the desires and grievances of Asian countries if it wishes to continue to play a defining role in the Asia-Pacific.

Wang Hongyi from CIIS calls for China-US cooperation in Africa, saying that it would be conducive not only to the stability of Africa, but also to the development of Sino-US relations.

On the cyber security issue, Franz-Stefan Gady from the East West Institute posits that the indictment of Chinese military personnel for alleged cyber-espionage has undoubtedly affected bilateral relations between the two nations. The author believes that reactions are bound to spiral in the area of cyber security.

Lastly, Stephen Harner, a former US State Department official, warns that recent US actions towards China set a dangerous tone for the Obama administration's strategy in the Asia-Pacific, and that these actions threaten the stability of Sino-US relations.

On the issue of China's relations with its neighboring countries, we have featured an article by John Ciorciari and Jessica Chen Weiss on the conflict between China and Vietnam in the South China Sea.

Commenting on China and Russia's massive \$400 billion gas deal, Michael Meidan urges the U.S. not to overestimate the China-Russia Gas Deal. The article analyzes the geopolitical implications of the deal, and shows how it could affect global energy markets and the US presence in Asia over the next few years.

Finally, the issue features an article by He Weiren, titled "China Remains No. 2 and PPP Remains in Laboratory." The author states that, despite some predictions that the Chinese economy will overtake the US in 2014, China's economy will remain the world's No. 2 for years to come.

We hope this issue will allow you to review the key issues facing China and the US today, and also offer insights on ways to improve the relationship between the two countries.

Thank you.

# PRINCIPLES FOR THE NEW GREAT POWER GAME



**Su Xiaohui**

*Deputy Director of International & Strategic Studies at the China Institute of International Studies*

The world's major countries are undergoing change, and the aim of these countries should not be to seek "absolute" comfort. The great powers should pay attention to the comfort of the others and will probably discover that "relative" comfort is a more stable and sustainable option, writes Su Xiaohui.

Recently, the United States announced the indictment of five Chinese military officers on allegations of cyber theft. Along with China-Russia exchanges during the 4th Conference on Interaction and Confidence-Building Measures in Asia (CICA) Summit, tension in the South

China Sea and the Ukraine crisis, cyber security has once again raised the question of how great powers, especially the US, China and Russia should get along with each other.

All of the three countries are important players

in the world. The ideal situation is that they can shrug off disputes and work sincerely with each other. In this case, world peace and prosperity will be secured.

However, the ironic reality is that the US has been pressuring both Russia and China, which has forced the latter two countries to strengthen their collaboration.

Concerning Ukraine, the US threatened to expand sanctions on Russia, and moreover, encouraged European countries to find alternative energy supplies in order to reduce the dependency on Russian energy. China has been criticized by the US for being assertive and irresponsible in the East China Sea and South China Sea disputes. Most recently, cyber security was brought up again as an accusation against China.

In this context, China and Russia have drawn closer to each other.

Russian President Vladimir Putin paid a state visit to China and attended the CICA summit. China and Russia issued a “substantial” joint statement. As both sides usually do, they reaffirmed mutual support for each other’s core interests, including sovereignty, territorial integrity and national security. China and Russia also presented coordinated positions on a number of issues in the statement. What is prominent was that both countries elaborated on some new hot topics such as the Ukraine situation and information security. Since Russia was excluded from the Group of Eight, China and Russia spoke highly of the multilateral frameworks for communication and cooperation, including the Group of Twenty (G20), BRICS, Shanghai Co-

operation Organization and the China-Russia-India regime. China and Russia attached great importance to the G20 and viewed it as a key forum for international economic cooperation. In the same period of CICA, the two countries conducted joint navy drills.

It seems that the confrontation of interests of the major powers has escalated and the great power game once again dominated the international arena. Some media hyped that the “China-US new type of relationship is in danger”, a “China-Russia alliance against the US” or a “mounting risk of a new Cold War”.

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***The ideal situation is that they can shrug off disputes and work sincerely with each other. In this case, world peace and prosperity will be secured.***

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However, the three great powers are aware that once world peace and stability is undermined, none of them will win. With the latest developments, it is time for the big countries to think about the principles that guide the relationship, instead of suffering from suspicion and concern.

The first and maybe most important principle for great powers to get along with each other is mutual respect. Selfishness is not helpful. All countries should avoid serving their own interests at the expense of the others’. Unfortunately, the US has gone too far. The country is anxious to protect its own interests, especially its military presence in the South China Sea. Under this goal, the US from time to time took biased positions concerning territorial disputes in waters, and used excuses such as “freedom of navigation” and “international rules” to interrupt China’s legal actions and protect sovereignty.

The spirit of the idea of the new type of relationship between major powers is equality and mutual benefit. China proposed this idea and the

US has agreed to work with China. It is groundless for the US to demand that China unilaterally show more support or make more contribution to US interests. It is unlikely for China to back up US decisions concerning the Ukraine issue or to sacrifice sovereignty in the South China Sea, in exchange of favorable feedback from the US.

Concerning cyber security, China admits that the US has an obvious technological advantage that cannot be matched by other countries. However, China does not approve US attempts to divide espionage from commercial theft, and utilized the latter to pressure China.

The second principle for a great power relationship is inclusiveness. “Zero-sum” thinking is outdated. The world or the Pacific is big enough to accommodate all countries. China does not aim at regional leadership or an exclusive presence. At the same time, the US should not overreact to China’s cooperation with neighboring countries. It also sounds harsh to China and Russia that the US-Japan alliance is “playing a leading role in ensuring a peaceful and prosperous Asia-Pacific.” On the other hand, the major powers should deal with disputes with a positive approach. Confrontation or sanctions will easily escalate the tension and put all the related parties at risk, not only in Ukraine but also in the South China Sea.

Last but not least, cooperation is also needed for great powers relations. It is true that the big countries are more capable. However, in the context of globalization, it is impossible for any country in the world to achieve economic development or maintain security all on its own. To strengthen cooperation is an inevitable necessity for major powers. As for China and US, besides economic cooperation, the two can talk about cooperation in relation to many issues, including issues such as disaster warning and relief, anti-piracy and environmental protection.

The world’s major countries are undergoing change, and the aim of these countries should not be to seek “absolute” comfort. The great powers should pay attention to the comfort of the others and will probably discover that “relative” comfort is a more stable and sustainable option.



# OBAMA AT WEST POINT: THE LIMITS OF AMERICAN EXCEPTIONALISM



**Mel Gurtov**

*Editor-in-Chief of Asian  
Perspective*

In light of President Obama's address at West Point, Mel Gurtov discusses various aspects of the speech and analyzes its implications on U.S. foreign policy.

“The United States is, and remains, the one indispensable nation.” From that starting point, the President launched a defense of his foreign policy at West Point on May 28. U.S. global leadership is not in doubt, he said: “The question we face, the question each of you will face, is not whether America will lead but how we will lead, not just to secure our peace and prosperity but also extend peace and prosperity around the globe.” The President highlighted the crux of his point when he stated, “Bottom line: America must always lead on the world stage. If we don’t, no one else will.” Anyone who might have thought the speech would represent a departure from the standard “we are number one” rhetoric must be sorely disappointed.

Obama characterized his foreign-policy approach as neither interventionist nor isolationist. While he agreed that many external events seemingly outside the scope of U.S. national security interests demand a U.S. response nevertheless—such as the civil war in Syria or the kidnapping of schoolgirls in Nigeria—that response should not be a military one. Citing Dwight Eisenhower, Obama said: “Since World War II, some of our most costly mistakes came not from our restraint but from our willingness to rush into military adventures without thinking through the consequences, without building international support and legitimacy for our action, without leveling with the American people about the sacrifices required.” Obama then went on to make a distinction that many presidents have made, between crises that seriously threaten national security and therefore require direct, even unilateral, involvement, and other situations that might “stir our conscience” but should not stir the military into action.

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***The US “pivot” to Asia  
is not going to stop,  
and neither is greater  
Chinese assertive-  
ness concerning their  
regional interests.***

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These latter situations were Obama’s main concern in his speech—specifically, terrorism and the necessity to mobilize allies and a variety of tools to bring terrorists to heel. He asked Congress to authorize \$5 billion for a new “counterterrorism partnerships fund” which “will allow us to train, build capacity and facilitate partner countries on the front lines.” He mentioned Yemen, Somalia, and Mali as countries where those partnerships could be effective. Contrary to his theme of avoiding US military involvement in places of remote interest, Obama cited drone strikes as one acceptable tool of counterterrorism when there is “actionable intelligence” and “near certainty of no

civilian casualties.” Here, Obama acknowledged an ongoing problem: Being square with the American people about such operations. The President also stated, “I also believe we must be more transparent about both the basis of our counterterrorism actions and the manner in which they are carried out. We have to be able to explain them publicly, whether it

is drone strikes or training partners.” Thus far, his administration has been anything but transparent about the use of drones and very careless about avoiding civilian casualties.

“I believe in American exceptionalism with every fiber of my being,” Obama said. “But what makes us exceptional is not our ability to flout international norms and the rule of law; it is our willingness to affirm them through our actions.” Indeed—and Obama rightly mentioned resistance to a new global climate change treaty, support of Egypt’s dictators, and failure to ratify the UN Convention on the Law of the Sea as examples of US exemptionalism. But he omitted plenty of other examples, such as the

National Security Agency's eavesdropping on international leaders, drone attacks in Pakistan and elsewhere, and failure to sign and ratify the Rome Treaty that established the International Criminal Court.

Given this, Obama's speech turned out to be surprisingly narrow in scope. Dealing with terrorist acts is important, of course; but devoting only a few words to relations with China and Russia is odd, for at least two reasons. One is the increasingly dangerous contest for sovereignty in the South China Sea. Obama made an oblique reference to that area as an instance of "regional aggression," and offered the hope that a code of conduct might be agreed upon to resolve differences. As mentioned, he urged U.S. Senate ratification of UNCLOS. Secretary of Defense Chuck Hagel, however, sounded an entirely different note when, in a speech in Singapore, he sharply criticized China for "destabilizing unilateral actions" and "intimidation and coercion" in the South China Sea. Naturally, this drew an equally sharp retort from Chinese representatives at the same event.

Obama's limited discussion of China is also odd because President Xi Jinping less than two weeks earlier had outlined "a new regional security architecture" for Asia that explicitly aimed to counter the U.S. alliance system. Though some points in Xi's speech echoed longstanding themes in China's foreign policy, such as breaking with Cold War-era thinking, adhering to the principle of noninterference, and practicing

peaceful coexistence, on this occasion Xi proposed an "Asia for Asians" security system. He said: "In the final analysis, it is for the people of Asia to run the affairs of Asia, solve the problems of Asia and uphold the security of Asia." While not a proposal to establish a formal alliance, Xi's idea was to upgrade the Conference on Interaction and Confidence Building in Asia by creating a multilateral "defense consultation mechanism" in the spirit of common security.

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***For the Obama administration, this means making sure that security reassurances to allies such as Japan and friends such as Vietnam do not drag Washington into a confrontation with China, which would benefit no one.***

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Exactly what Xi has in mind remains to be defined. Was he, for instance, proposing to replace or offset ASEAN's dialogue mechanisms? How would such a mechanism handle territorial disputes? What is beyond question is that the idea of an Asia-only membership dovetails with China's insistence that the United States stay out of the South China and East China Seas disputes, which would cede effective regional leadership to Beijing. President Obama has made clear that the

United States is not going to ignore these disputes. But in his West Point address, he chose not to respond to Xi's argument.

Given Obama's declaration early in his first term that the U.S.-China relationship is the most important one in the world, one would hope the escalating war of words on maritime issues will cease and be replaced by serious diplomacy. There is no logical reason why competing territorial claims cannot be peaceably resolved through multilateral dialogue if not through international arbitration. Nor is there any reason why the US alliance system cannot coexist with

a more robust Chinese economic and political role in East Asia. The U.S. “pivot” to Asia is not going to stop, and neither is greater Chinese assertiveness concerning their regional interests. There does need to be room for both, both the U.S. and China, however, must first adjust their policies. For the Obama administration, this means making sure that security reassurances to allies such as Japan and friends such as Vietnam do not drag Washington into a confrontation with China, which would benefit no one. And for China, this means reconsidering its refusal to allow an international legal body, such as the International Court of Justice or the dispute resolution system under UNCLOS, to judge the merits of competing claims in the South China and East China Seas.



# SINO-US ANTI-TERROR COOPERATION DIFFICULT YET POSSIBLE



*Fu Xiaoqiang*

*Director, Center for Counter-  
terrorism Studies at the China  
Institute of Contemporary  
International Relations*

Fu Xiaoqiang explains that terrorist groups in China now pose a more acute risk to the country due to the expansion of their network and capacity. Rather than inadvertently encouraging separatist and extremist groups in China, and being swayed by power politics, the United States should leverage common security goals and collaborate with China in fighting global terrorism.

With the threat of terrorism escalating at home, China has found itself in a deep-water zone, where the fight against terrorism is a constant task. Terrorism has become an outstanding stumbling block for China's development. From the central leadership to the man on the street, a consensus is emerging that terrorism is a threat to national security and that the fight against it will be complex.

From the Tiananmen attack in Beijing on October 28, 2013 to the one at the Kunming railway station in March 2014, Xinjiang-related terrorist activities have been escalating and spilling over into other areas. In a bid to amplify their effects, terrorists have spread their activities from Xinjiang to other parts of the country, from "hard targets" such as military, police and government facilities, to densely populated "soft targets", which are more sensational. The attacks in Beijing and Kunming were hallmarks of a new phase in the terrorist threat in China. Chinese citizens face a new reality: terrorist activities will be in long-term existence, terrorist sabotage has become a new normal, and anti-terrorism departments will face greater challenges than ever.

The increased risk of terrorist attacks in China has occurred against the backdrop of changes in the global security environment. To accurately evaluate the current conditions of counter-terrorism in China, one needs to understand China's current international standing.

International terrorism can be viewed in periods, with the world witnessing peaks of terrorist activities in the 1930s, the 1940s, and the late 1980s and early 1990s when the Soviet Union withdrew troops from Afghanistan. Activities of the "Eastern Turkistan Islamic Movement" (ETIM) terrorist movement in Xinjiang correlated with the other terrorist activities during these periods. In particular, in the early 1990s, the hazards of terrorism brewed in Afghanistan

as the Soviet troops withdrew, and the subsequent chaos spread to Xinjiang, leading to a series of terrorist incidents. Currently, with the United States accelerating its military withdrawal from Afghanistan, international terrorist forces in South Asia have shown unusual activity, and the threat of spillover is increasing. With the unrest in the Middle East and North Africa, a new wave of cross-border terrorist activity is emerging. Syria has been a training ground for terrorists from multiple countries, including elements from the ETIM in China's Xinjiang. The terrorist threat in China has risen to a level comparable to that of the early 1990s.

The new round of terrorist threats from the ETIM is inseparable from the activities of national separatism and religious extremism. The ETIM (or "Turkistan Islamic Party") are an armed separatist group that operates under the banner of religion. On the one hand, the ETIM has been in South Asia for a long time, has colluded closely with al-Qaeda, and has long been in league with local extremist religious forces and evil underground elements. On the other hand, terrorists in China have more recently been exposed to the remote control and influence of overseas ETIM forces. ETIM forces abroad have permeated the country. Some terrorists have received training abroad. Terrorists inside and outside the country have come into contact via the Internet. Some terrorists have escaped from the country to participate in terrorist activities abroad. Terrorists at home have learnt from videos promoting extremism and terrorist tactics issued by their peers overseas and have applied them to their own attacks, presenting an increasingly severe security threat. In fact, many Xinjiang-born ETIM terrorist organizations have already moved their core establishments abroad and are launching terrorist attacks in China through personnel permeation and remote command. The terrorist attack on April 30 is a case in point.



*The bloody scene at the open market area in Urumqi, Xinjiang Uyguru Autonomous Region after the terrorist suicide bombing occurred on the morning of May 23, 2014, when the market was crowded with morning shoppers. The terrorist attack killed more than 30 people and injured 90.*

Taking into account complicated geopolitical factors and the U.S.' and West's double standard in the fight against terror, it will become more obvious that China has entered a deep-water zone in its anti-terror endeavors. With the expansion of China's overseas interests, which are usually concentrated in high-risk and turbulent areas, and with the growth of its national might, China has to be more vigilant this time around. Although some terrorists carried out attacks using knives and sticks, their impact is no less than that of the 9/11 attacks. They have caused equally serious panic within society and have increased the cost of security precautions. They too are society's common enemies.

China and the U.S. once had close counter-terrorism collaboration in the aftermath of the 9/11 attacks, which promoted progress of Sino-U.S. relations and deepened mutual trust. However,

as the Obama administration proceeds with "rebalancing" his Asia-Pacific strategy, the two parties are seriously diverging with regard to combatting terrorist activities in China, which impedes the fortification of the major-country relationship they committed to.

In Chinese eyes, the ETIM's terrorist activities are inseparable from the separatist attempts in Xinjiang. The less violent separatist organizations like the World Uygur Congress, which has long been active seeking overseas support, and the violent forces like the ETIM, which have rampantly conducted terrorist activities and extremist religious undertakings, both share the common ultimate goal of splitting Xinjiang from the motherland. National unity and integrity of national sovereignty and territory are China's core interests. Both separatist activities and their behind-the-scenes supporters are challenging

the country's core interests. The domestic terrorist forces are challenging these core interests even more. However, they will surely be handled with iron fists.

The U.S. and some other countries have, in governmental or non-governmental manners, hosted and supported ETIM forces, and offered them continuous support using excuses of "racial issues" or "human rights issues". To China, these are offensive and they open challenges to its core interests. Though such deeds do not equal direct support to ETIM terrorist activities, they have provided ETIM terrorist forces with indirect encouragement. In some instances, they have connived with ETIM forces and have acquiesced in their terrorist attacks in China. In addition, the U.S. and some other countries were shilly-shally after the terrorist attacks in China. They doubted the terrorist nature of those incidents, worrying that the Chinese government would suppress human rights in the name of fighting terrorism.

China and the U.S. have conspicuous disagreements over ETIM terrorist activities. In the past, the U.S. never transferred Chinese terrorist suspects held at Guantanamo to the Chinese government. Instead, they were displaced to other countries on various pretexts. The U.S.'s legal definition of the ETIM and their crackdown on the ETIM have been far less severe than those of other terrorist organizations that constitute a direct threat to the U.S., such as al-Qaeda. Such factors have influenced Chinese judgments about American strategic considerations, making the latter believe that the U.S. intervention

and support for separatist forces in Xinjiang have indirectly instigated terrorist activities. In the context of the "pivot" to the Asia-Pacific, this means the U.S. is again playing the "Xinjiang card", taking advantage of troubles in Xinjiang to contain China, even offering support for ETIM terrorist activities from behind the scenes to distract China. This is also the prevalent Chinese interpretation of the U.S.'s ambiguous attitude.

Sino-U.S. anti-terror collaboration calls for a global perspective. The two parties should candidly exchange ideas, and try to look at problems from the other side's angle. As major countries with special responsibilities for the international community, they should strengthen anti-terror cooperation, and find maximum common interests in the fight against terrorism via full communication. The U.S. is resolutely against terrorism. But there are Americans in terrorist organizations in Syria. Some ETIM terrorists are also in Syria participating in the Jihad. China and the U.S. could discuss countermeasures for the potential threats from foreign terrorists in Syria in collaboration with other countries.

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***Sino-U.S. anti-terror collaboration calls for a global perspective. The two parties should candidly exchange ideas, and try to look at problems from the other side's angle.***

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The U.S. should be aware that conniving with ETIM terrorist activities will eventually hurt itself. The ETIM are in close league with international terrorist forces. They all accept and support al-Qaeda's terrorist theories and ideologies, and from a long-term perspective, they will not refuse to take the U.S. and the West as their major targets. What they oppose and want to sabotage is world peace. Therefore, China and the U.S. share common interests in cracking down on international terrorism, eradicating extremism, and preventing the rise of new sources of international terrorism.



# WHAT THE US CAN LEARN FROM THE UPCOMING CICA SUMMIT



**Wu Zurong**

*Researcher at China Foundation for International Studies*

In order for the United States to continue to play a role in the Asia-Pacific, it must listen to the desires and grievances of other Asian nations. This can be achieved by actively listening at the upcoming CICA Summit, as well as by adjusting US policies according to the desires of Asian nations.

The fourth Conference on Interaction and Confidence Building Measures in Asia (CICA) Summit is to be held in Shanghai from May 20 to 21, 2014 under the theme of increasing dialogue, mutual trust and collaboration to build a new Asia that is peaceful, stable and cooperative. Delegations from nearly 40 countries and international organizations will attend the Conference Summit, with 14 heads of state and heads of government, and 8 chiefs of international organizations that have confirmed their presence. It is the largest multilateral security forum in Asia and voices will be heard comprehensively from Asian countries with different social systems, religions, cultures and economic development stages. If the United States, as an observer country, could carefully listen to the views expressed at the Conference Summit, and go along with the tide of development and common aspiration of people in Asia, it could receive a lot of help and draw valuable inspiration from them so as to re-adjust its strategy of rebalancing to Asia, and to truly play a constructive role. If the US would pay attention to what the Conference Summit participants say on the following vital issues, it would possibly help the US avoid making disastrous blunders in its relations with Asia.

Firstly, whether the vast majority of Asian countries welcome the US military alliance strategy, and whether it promotes peace and stability in the region. The US is a Pacific or Asia-Pacific country, but definitely not an Asian country. However, due to historical reasons, it still has bilateral military alliance treaties with a few Asian countries, such as Japan, the Philippines, the Republic of Korea (ROC) and Thailand. During US President Obama's trip to Asia last month, arrangements had been made to especially strengthen the US-Japan and US-Philippines military alliances despite the fact that they do not have a formidable enemy in Asia, and that such old alliances cannot solve, but rather will create new problems. In his public statements

on those military alliances, Obama particularly stressed that the US has no intention to contain China, but what he actually did during the visit contradicted his rhetoric. It is high time that the US listen to what Asian people say on those US military alliances in Asia, and what role such alliances should play. The US can no longer ignore the fact that most Asian countries don't like to see US establish its military bases, or station its troops permanently in their countries. It is clear that they don't think those military alliances promote peace and stability in Asia, nor do they believe in the so-called "China threat" fabricated by Japan, the Philippines and the US. When the US realizes that its true intention is to make trouble in Asia by bolstering those military alliances and can no longer deceive anyone, it would probably have to think about the serious consequences of its obstinate implementation of the military alliance strategy in Asia.

Secondly, whether the US has come to understand that the promotion of sustained, healthy economic development is the strongest common aspiration of all Asian peoples, and it should take this into full consideration when working out its policy on Asia. Except Japan or probably the ROC, all countries in Asia are developing countries. It is their prime task to promote economic development in a peaceful and stable environment through increased exchanges and collaboration. People in Asia want to see more US imports from Asia; more US investment; more economic and humanitarian assistance to Asia; as well as more cooperative programs in cultural and educational areas. Regrettably, statistics show that there has been no significant increase since the US started to implement its strategy of rebalancing to Asia three or four years ago. If the US truly wishes to work together with Asian countries for the common prosperity, it should do more to meet the needs for economic and social development in Asia instead of focusing on rewriting trade rules through negotiating economic and trade trea-

ties, on selling weapons and military equipment, as well as advantageous agricultural products to Asia.

Thirdly, whether the US is playing hegemony and power politics at the expense of the interests of Asian countries is to be tested. Asia is a region with diversity and dynamism, and is full of development opportunities and potential. It may be natural or understandable in a certain sense that the US, as the sole superpower in the present world, wants very much to draw as many benefits as possible from this fertile region. Asian countries appreciate very much US constructive role in Asia, but they have a very strong desire to be treated as equals. It must be pointed out that what the US did in collusion with Japan and the Philippines during Obama's trip to Asia last month concerning the territorial disputes in the East China Sea and South China Sea means imposing US will on China and other countries, which is seriously disrupting peace and stability in the region. It has constituted a serious violation of China's sovereignty and territorial integrity. The continued wanton support by the US for Japan's efforts to speed up military expansion will prove to be very dangerous. It tells people in Asia that the US is trying by every possible means to dominate Asian affairs, or to "shape the future of the Asia-Pacific and beyond" by projecting military power through its military alliance strategy. Asian affairs are not to be dictated by the US, but to be managed by all Asian countries in cooperation with the US and other countries on an equal footing.

The US has gone further on the wrong track through its misguided military alliance strategy in Asia. In order to avert further damage to peace and stability in Asia, or potential calamity for the whole world, it has become an urgent mission for the US to listen to what participants of the CICA summit say so as to draw helpful inspiration and change its course. The US will find it in its own interests to respond positively to the

CICA's call for a new outlook on Asia security by giving up Cold War mentality and zero-sum game logic. After all, the CICA Summit seeks cooperation, not confrontation, with the US.



*Chinese President Xi Jinping speaks during the fourth summit of the Conference on Interaction and Confidence Building Measures in Asia (CICA), in Shanghai, East China, May 21, 2014.*

# COMMON GROUNDS

## FOR CHINA-U.S. COOPERATION IN AFRICA



**Wang Hongyi**

*Associate research fellow at  
the China Institute of Inter-  
national Studies*

**Wang Hongyi asserts that there is an urgent need for China and the United States to coordinate on African affairs, and that trilateral cooperation has become a core issue of rapidly accelerating interactions with Africa.**

Given that trilateral cooperation between China, the United States and Africa is still at a low level, China and the U.S. are in urgent need for coordination on African affairs so as to avoid misunderstanding and frictions with regard to African affairs. This will be conducive not only to the stability in Africa, but also to the development of Sino-U.S. relations.

The low-level cooperation is evidenced by the following: trilateral cooperation is still limited mainly to coordination under multilateral frameworks; Cooperation is confined to the fields of medical services and training, and cooperation in peace and security is lacking; and cooperation projects are mainly joint training programs, or the U.S. provides funds or technical support for China-African projects.

But a series of high-profile events indicate that changes are indeed happening. Leaders from China and the U.S. recently paid visits to the continent. The U.S. is to host a U.S.-Africa summit meeting in August and China will host the sixth ministerial conference of the Forum

on China-Africa Cooperation next year. Their respective interaction with Africa shows the continent's rising strategic value to China and the U.S. Under such a scenario, China and the U.S. need to strengthen coordination on African affairs.

As China and the U.S. speed up interaction with Africa, making rules for trilateral cooperation has become a core issue, and China should seek a major role in making such rules. China has always highlighted bilateral cooperation in its diplomacy and economic cooperation, and does not have much experience in multilateral cooperation. The U.S., however, is well-versed in multilateral cooperation and is the leading player in making international rules. On the core issue of setting the rules, China should try to seek a major role, and if this fails, China should then adopt loose and provisional agreements so that its freedom and the room for cooperation with Africa will not be squeezed.

In setting the rules, China should try to propose cooperation subjects that are beneficial to all

sides, and the focus for trilateral cooperation should include infrastructure, inter-regional projects, security and peace.

But during this rule-setting, Africa must be respected and their interests must be safeguarded. As the disadvantaged party in the multilateral framework, African countries have their concerns. China should abide by the principle of giving a big role to African countries, and trilateral cooperation must be recognized by African countries which should be guaranteed of a full participation in the process.

As trilateral cooperation is still at the infancy, China and the U.S. should restart the consultation mechanism on the African affairs.

China and the U.S. already had five rounds of consultations before 2012, and the strategic consultations had achieved some practical results, but the three parties had not yet decided on specific cooperation fields or projects. The official consultation mechanism has been virtually paused since 2013. To open a new chapter for trilateral cooperation, China and the U.S. need to restart the mechanism as early as possible so as to make decisions on specific projects for trilateral cooperation.

Trilateral cooperation ought to start with the non-competitive sectors such as training and technology cooperation. Both China and the U.S. have organized various training activities in Africa, and have accumulated rich experience in agriculture and medical services. China has constructed 33 anti-malaria centers and more than 30 hospitals there and have trained more

than 3,000 doctors for Africa. The U.S. devised a plan in 2011 to train 140,000 doctors for African countries. For African countries, medical and health services are not a sensitive issue, and China and the U.S. have big room for cooperation in this sector. They could use those anti-malaria centers and hospitals as the venues for medical training programs.

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***“Trilateral cooperation ought to start with the non-competitive sectors such as training and technology cooperation.”***

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There are also favorable conditions for Sino-U.S. cooperation in the agro-training field. China has constructed 24 agricultural demonstration centers in Africa and the number will soon rise to 40. The demonstration centers, fully equipped, are suitable for organizing training and planting

demonstration activities. Because China pays for operation costs for only three years, these centers will have a funding shortage afterwards. The United States Agency for International Development set up a fund for African agricultural development in 2011, and President Obama also promised in 2012 to increase agricultural investment in Africa. China and the U.S. can make use of the demonstration centers to jointly train agro-technicians for Africa.

From a long-term perspective, however, trilateral cooperation projects could be executed and managed by the Forum on China-Africa Cooperation, which is a high-level, long-term decision-making mechanism for China-Africa cooperation. The forum has accepted the African Union and other African organizations as members and could play its multilateral functions.

First, the forum could help promote China-U.S. cooperation on peace and security issues. China and the U.S. have been maintaining coordination on African peace and security under the bi-

lateral and United Nations framework, but such a level of cooperation could hardly meet the actual needs. The two countries could discuss and share African security information under the Forum on China-Africa Cooperation so as to protect the safety of Chinese and American nationals in Africa, to jointly fight against pirates and promote military exchanges in Africa.

Second, the forum could help improve the African market and investment environment. The U.S., the biggest investor in Africa, has been attempting to improve the African market and investment environment, to promote the judi-

cial, customs, taxation and financial integration among the African Union, and China is also trying to avoid institutional, judicial, policy and financial risks for its investment in Africa. The two countries have common grounds and could strengthen cooperation in the sectors.

And third, the committees of the forum could serve as platforms for China-U.S. cooperation on Africa affairs. When trilateral cooperation and exchanges gain speed, the committees could become permanent institutions to undertake daily liaison work among the three parties.



*On the afternoon of May 5, 2014, Chinese Premier Li Keqiang, accompanied by Prime Minister Hailemariam Desalegn of Ethiopia, visited the light railway project in Addis Ababa.*



# CHINESE CYBER-ATTACKS: WILL THE US STEP UP ITS ACTIVE CYBER DEFENSE POSTURE?



*Franz-Stefan Gady*  
Senior Fellow at the East-  
West Institute

Despite recent steps by the Pentagon to build trust between the Chinese and U.S. militaries, the indictment of Chinese military personnel for alleged cyber-espionage has undoubtedly affected bilateral relations between the two nations. Without an entirely accurate view of Sino-U.S. cyber competition, escalatory reactions like the suspension of the China-U.S. Working Group are bound to continue.

The indictment of five Chinese military hackers by a grand jury in the Western District of Pennsylvania illustrates the increasing importance of cyberspace in the great power relationship between the United States and China. It also shows that four years of talking about cyber-espionage, including at the presidential level, have led to nowhere. All five of the alleged offenders are purported to be members of the secretive Unit 61398 of the People's Liberation Army in Shanghai. They are accused of computer hacking, economic espionage and other offenses targeting the U.S. private sector. According to U.S. Attorney General Eric Holder: "This is a case alleging economic espionage by members of the Chinese military and represents the first ever charges against a state actor for this type of hacking."

Any serious analysis on cyber-espionage has to be caveated with the fact that we have to evaluate evidence based on primarily open source intelligence, which does not provide us with an entirely accurate picture of the China-US cyber competition – much of it is happening in the shadows and outside the public's view. However, it is evident that the Department of Justice indictment was partially announced to assuage the U.S. private sector and to demonstrate that the United States government is boosting its efforts to stop Chinese cyber attacks. Likewise, we can make a few additional deductions based on the history of China-US cyber relations.

First, the indictment clearly signals that the United States is switching from a more conciliatory stance in the last few months to a more confrontational posture. As I have written in the past, the Pentagon particularly has tried to build trust between the Chinese and U.S. militaries with its unprecedented briefing for senior Chinese military leaders on the U.S. military doctrine for defending against cyber attacks. The Obama White House quickly followed suit with the announcement that it will share more openly intelligence on zero-day vulnerabilities - a sym-

bolic gesture of unilateral cyber disarmament. Both cases were meant to signal China that the United States – aware of its technological superiority in cyberspace – is willing to accommodate Chinese fears and more actively engage in dialogue. To the dismay of the U.S. administration, China has not reciprocated their efforts and according to the 2014 Mandiant Report has even expanded the scope of its cyber operations.

Second, the indictment also signals that the United States government is ready to progress up the escalation ladder from vicariously "naming and shaming" Chinese state-sponsored hackers via the U.S. private sector and media (e.g., the 2013 Mandiant Report), to a more direct approach. According to one expert this indictment was the Department of Justice's contribution to a White House initiated strategy to contain Chinese cyber attacks. This new more blatant method of "naming and shaming" fits into the escalatory framework of a national cyber deterrence strategy. If the Chinese will continue cyber operations at the current level, step up their cyber-espionage activities, or "name and shame" U.S. hackers and intelligence operatives, the United States will have no choice but to intensify coercive measures vis-à-vis Beijing.

Third, in case the indictment fails to have an impact, the United States government may also step up its active cyber defense posture. According to one scholar: "Active Cyber Defense is direct defensive action taken to destroy, nullify, or reduce the effectiveness of cyber threats against friendly forces and assets." Any sort of cyber defense contains next active defense components, such as honeypots, intrusion prevention systems (IPSS), and anti-malware systems. Yet, it also includes politically and strategically sensitive counter-attacks on critical information infrastructure of the intruder. Despite the danger of serious political repercussions, various experts have repeatedly advocated such measures in the past; one expert testifying in front of the United

States Senate referred to this escalatory step as a strategy “relying on attribution and retribution.” As an additional escalatory factor, active cyber defense can set a precedent for an increase in private sector “cyber vigilantism”, i.e. companies unilaterally engaging in destructive counter-attacks (“hack back”) outside their networks once they have identified the perpetrators, which, in many cases will presumably be on Chinese territory or aimed at Chinese owned critical information infrastructure.

To avoid these escalatory steps, the United States and China have to find ways to have an open and fair dialogue on cyber-espionage and other cybersecurity related issues. This essentially implies an almost schizophrenic, two-layered approach of simultaneously cooperating with each other on one level of cybersecurity, while dissuading one another from excessively engaging in malicious cyber activities at another level. This strategic doublethink dichotomy holds true for both China and the United States. Yet, while there is no indication that the nascent cooperation on the technical level has been suspended between both countries, on the macro level political confrontation appears to be the most likely modus operandi in the near-term future.



## HOW THE OBAMA ADMINISTRATION IS LOSING TRUST IN ASIA



**Stephen Harner**  
Former US State Department  
official

Two recent foreign policy actions by the Obama administration set a dangerous tone for its strategy in the Asia-Pacific and threaten the stability of Sino-U.S. relations, warns Stephen Harner.

We don't want to talk to China about "core interests," we want to talk about "common interests," is how Evan Medeiros, senior advisor on Asian policy in Obama's National Security Council (NSC), in a May 22 interview on Phoenix TV, described the Obama administration's approach

to a "new type of great power relations."

What the Obama administration is seeking in a "new type of relationship" are areas of common interests where the two can cooperate, like climate change, the rule of law, and cyber security.

Listening to the articulate Medeiros, what he says seems at first reasonable and constructive. We can believe that this approach is fully endorsed and considered optimal by the State Department and the all-powerful Department of Defense (DoD).

After a moment's reflection, however, we begin having doubts.

What if the "common interests" defined by the U.S. are not really "common" to or are defined differently by China?

What, particularly, American ideas of "common interests" would – according to the U.S. "cooperative" agenda – conflict with China's clearly defined "core interests"?

For evidence that both these situations exist – which means the NSC's policy approach is, at best, conceptually flawed – we cite two recent situations: The United States' May 19 accusations and Department of Justice indictments against alleged Chinese PLA cyber-espionage; and U.S. Secretary of State John Kerry's May 12 charge that China's movement of an oil rig into the South China Sea was a provocation and "aggressive act."

Because the U.S.-China cyber-security issue has been so prejudicially and one-sidedly presented by most U.S. media, some background information is required for a fair discussion of it. Two data points are particularly relevant.

The first is the revelation, from secret documents leaked by Edward Snowden and reported

in The Washington Post on August 31, 2013, that the U.S. National Security Agency (NSA), had, since at least 2011, been conducting "offensive cyber-operations" – codenamed "GENIE" – against China (along with North Korea, Russia, and Iran). The Post reported that "the \$652 million project has placed 'covert implants,' sophisticated malware transmitted from far away, in computers, routers and firewalls on tens of thousands of [targeted country--i.e. Chinese] machines every year, with plans to expand those numbers into the millions."

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***While the U.S. refuses to discuss "core national interests," can China at least trust the United States to pursue its own national interests? If not, there can be no trust, and no constructive and sustainable bilateral relationship.***

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The second point would be the Obama White House's insistence during the June 2013 Obama-Xi Jinping "Sunnyland's Summit" that on issues of "cyber-security," only commercial espionage – the U.S. charge of China's "theft" of American intellectual property – would be discussed, and that "military/defense related cyber-security" – i.e., the type of "GENIE" program actually conducted against China – was taken "off the table."

In the White House's view of "common interests," then, we find the U.S. taking a strong stand against "theft" of intellectual property, and presuming to enlist China on a "common" resolution of the issue. But we also see an obstinate U.S. refusal to acknowledge, much less to address, the surely greater damage and loss caused to China's "core national interests" by covert U.S. sabotage of China's real national security system infrastructure from the GENIE program.

In short, the Obama White House's high-sound-

ing rhetoric about “common interests” – rather than a practical and constructive approach to relations with China – seems like more of a camouflage and diversion from aggressive and, objectively, hostile U.S. policies and actions that threaten China’s core interests.

Since at least 2010, the Obama administration has chosen to insert itself into territorial issues in the South China Sea, when Hillary Clinton, claiming to support the “rule of law,” made statements clearly biased in favor of Vietnam and the Philippines and against China. Unsurprisingly, Secretary of State John Kerry’s statements have followed the same line.

It was fortunate that on May 15, three days after Kerry called Chinese drilling operations “provocative” and an “aggressive act,” People’s Liberation Army Chief of the General Staff General Fang Fenghui was in Washington, D.C. on a reciprocal visit, and able to reply directly to U.S. press questions about the matter. Quoting the Department of Defense’s transcript of the press conference, General Fang said:

“China is conducting the exploitation activity in – within 12 nautical miles of the Zhongjian Islands which is part of the Paracel Islands. And this is an activity conducted within our territorial water.

And secondly, the related countries in the South China Sea region have drilled actually many oil wells in the South China Sea, but China has never drilled even one. From this single fact, we can see how much restraint China has exercised. And the purpose of this restraint is to keep – to maintain the stability of the South China Sea region.

“We have an enduring position of putting aside disputes and achieve common exploitation. But while China is holding this position, other nations are drilling oil wells in this region. So

that’s – that is the status quo. And I have to underscore it is only under this background that we are conducting that exploitation activity within the Zhongjian island.”

In short, China is conducting a vital economic activity within its own territory – a “core national interest.” For the U.S. Secretary of State to call this “provocative” or an “aggressive act” is actually a provocative and hostile anti-Chinese policy stance on the part of the United States.

Again, we see U.S. rhetoric about pursuing “common interests” disguising utterly contradictory policies and actions that are obstacles to and can only harm prospects for a constructive U.S.-China “new type of great power relationship.”

The U.S. Justice Department’s inexplicable indictments of PLA officers caused China to suspend the U.S.-China “cyber-security” working group and cancel planned military-to-military exchanges with the Pentagon. The Chinese Ministry of Foreign Affairs has responded resolutely to John Kerry’s outlandish statements that have again put the U.S. squarely in the middle of issues that do not and should not matter to U.S. interests, and in no way present “common interests” with China.

The question is inevitable and must be answered: While the U.S. refuses to discuss “core national interests,” can China at least trust the United States to pursue its own national interests? If not, there can be no trust, and no constructive and sustainable bi-lateral relationship. Without a fundamental change in the Obama administration’s approach, the near term U.S.-China relationship is in trouble.

# CHINA AND VIETNAM: RIOTS AND THE RISK OF ESCALATION IN THE SOUTH CHINA SEA



*John D. Ciorciari*

*An assistant professor at the University of Michigan*



*Jessica Chen Weiss*

*An assistant professor at Yale University*

**As John Ciorciari and Jessica Chen Weiss explain, relations between China and Vietnam have plummeted to their lowest point since the end of the Cold War following a quarrel over disputed territory in the South China Sea.**

Over the past month, Sino-Vietnamese relations have plunged to their lowest point since the two countries normalized relations at the end of the Cold War. The latest row erupted after China moved an oil rig into disputed waters and defended it by ramming and firing water cannons at Vietnamese patrol vessels dispatched to the area. Those events prompted the largest anti-China demonstrations in Vietnam to date, and for the first time, protests descended into violent riots, leaving at least three Chinese dead, damaging numerous foreign factories, and causing many Chinese to flee.

The riots have pushed the Chinese and Vietnamese governments into somewhat uncharted territory. Vietnamese Prime Minister Nguyen Tan Dung issued a text message encouraging citizens to show patriotism within the law but added: “Bad elements should not be allowed to instigate extremist actions that harm the interests and image of the country.” Local Vietnamese media blamed the violence on unspecified “agitators.” But Chinese foreign minister Wang



*On 2 May 2014, a Chinese company's HYSY 981 drilling rig started its drilling operation inside the contiguous zone of China's Xisha Islands (see Annex 1/5 for the locations of operation) for the purpose of oil and gas exploration.*

Yi has insisted that Vietnam bears “unshirkable responsibility” for the attacks, and Chinese state media questioned whether Hanoi had encouraged or acquiesced in “violent crimes” against Chinese nationals and property.

In recent years, as the Sino-Vietnamese territorial feud has intensified, Vietnamese leaders have become more willing to allow anti-China protests. The Vietnamese authorities quickly curtailed anti-China protests in 2007, permitted them for several weeks after a maritime clash in 2011, and allowed much larger demonstrations this month before the violence prompted a government crackdown. As we emphasize in a new working paper, a government dealing with nationalist protests has to weigh the dangers they pose to domestic stability and the risk of interstate conflict against the possible benefits of showing resolve and attracting international attention.

For Vietnam’s leaders, allowing anti-China protests is a way to signal resolve by effectively committing the government to a hardline position on the territorial dispute. Allowing demonstrations also broadcasts grievances and draws attention to the dispute. Vietnam’s official media has been unusually active in covering the latest wave of anti-China demonstrations, including a rare self-immolation by a 67-year-old woman in Ho Chih Minh City. Chinese foreign ministry official Ouyang Yujing accused Vietnam of seeking to “generate a media hype and ‘put up a show’ in front of the international audience.” International involvement is a

key part of Vietnam’s strategy to raise the costs of Beijing’s unilateral advances in the South China Sea.

Vietnamese leaders have long understood these hazards. In an authoritarian state, anti-foreign protests can serve as portals for the expression of broader social and political grievances. In July 2011, 20 prominent Vietnamese intellectuals seized the opening created by anti-China protests to issue an extraordinary petition criticizing

Hanoi’s economic and foreign policies. Public demonstrations also reduce the space for face-saving diplomatic compromises, especially if they descend into attacks on foreign persons and property.

Hanoi’s limited options help explain its rising tolerance for anti-China rallies. Nationalist protests are most credible as expressions of popular will and most effective at garnering attention and signaling resolve precisely when they threaten to

exceed the government’s control. As China has pushed inexorably forward, Vietnamese leaders have taken greater risks. Thus far, there is little evidence that allowing selected protests has helped Vietnam arrest Chinese advances or drive Beijing toward earnest multilateral talks, but the nationalist genie in Vietnam is now well out of the bottle, and the government may find it difficult to put back.

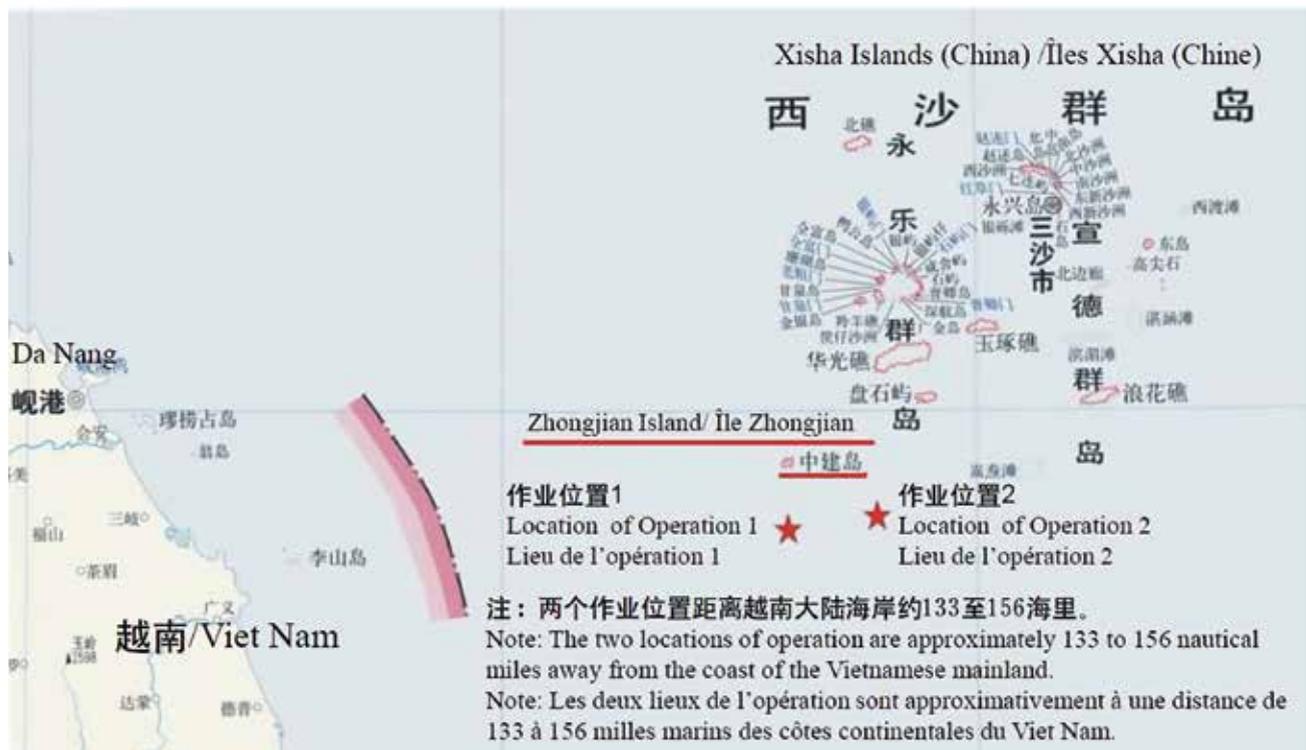
Beijing has incentives to talk tough but downplay the extent of popular nationalism on both sides. China controls the Paracels and has a

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***A government dealing with nationalist protests has to weigh the dangers they pose to domestic stability and the risk of interstate conflict against the possible benefits of showing resolve and attracting international attention.***

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中国企业作业位置图/Locations of the Chinese Enterprise' Operation/  
Localisation de l'opération de l'entreprise chinoise



commanding position in the area, with a growing lead in relevant naval capabilities and potent economic levers to pull against Vietnam. It does not need to signal resolve and has a strong disinterest in generating international attention, which is anathema to Beijing's salami tactics in the South China Sea. The PRC also stands little to gain from amplifying nationalist rhetoric and contributing to a crisis on the eve of the sensitive 25th anniversary of Tiananmen Square on June 4.

But the killing of Chinese nationals this month has tested the limits of China's willingness to restrain its own nationalists. Thus far, Chinese propaganda authorities have kept state-owned media relatively quiet, emphasizing Vietnamese efforts to arrest the "troublemakers" and char-

acterizing the violence as riots against foreign-invested firms. Even an op-ed by former senior military official Luo Yuan called for Chinese to be calm, trust the party to act wisely given the larger strategic picture, and consider Chinese compatriots in Vietnam. Some Chinese veterans were allowed to demonstrate in Shenzhen, protesting the US pivot and calling for the defense of the South China Sea, but authorities prevented an anti-Vietnamese protest from materializing in Kunming, according to an American expatriate there.

China's disinterest in fanning the flames of Vietnamese nationalism gives Hanoi an opportunity to make amends. If the Vietnamese government is able to dampen popular nationalism and satisfy China's demands for accountability,

it will avoid a more serious rupture and reduce the near-term risk of war. But in doing so, Hanoi will drift back into the quieter diplomatic game China seeks to play.

# DON'T OVERESTIMATE THE CHINA-RUSSIA GAS DEAL



**Michal Meidan**  
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After the announcement that Russia and China finally signed a 30-year natural gas pipeline agreement valued at \$400 billion, Michal Meidan analyses the geopolitical implications of this deal and how it could affect global energy markets and the U.S. presence in Asia for the foreseeable future.

On Wednesday, May 21, 2013, China's state-owned CNPC and Russian Gazprom signed a landmark \$400 billion natural gas pipeline agreement. According to the 30-year deal, Russia will send 38 billion cubic meters (bcm) a year to northeast China, starting in 2018. Russian President Vladimir Putin called the agreement an "epochal event" for Russia, for whom the energy sector represents nearly a third of GDP. Beyond the financial impact, the agreement allows Mr Putin to demonstrate that Russia, in the face of Western sanctions over the annexation of Crimea, still has allies. But, although the deal has political and commercial significance for China, it is far from being the cornerstone of a renewed Sino-Russian alliance against the United States, and does not fundamentally alter the dynamics of Asia's gas market.

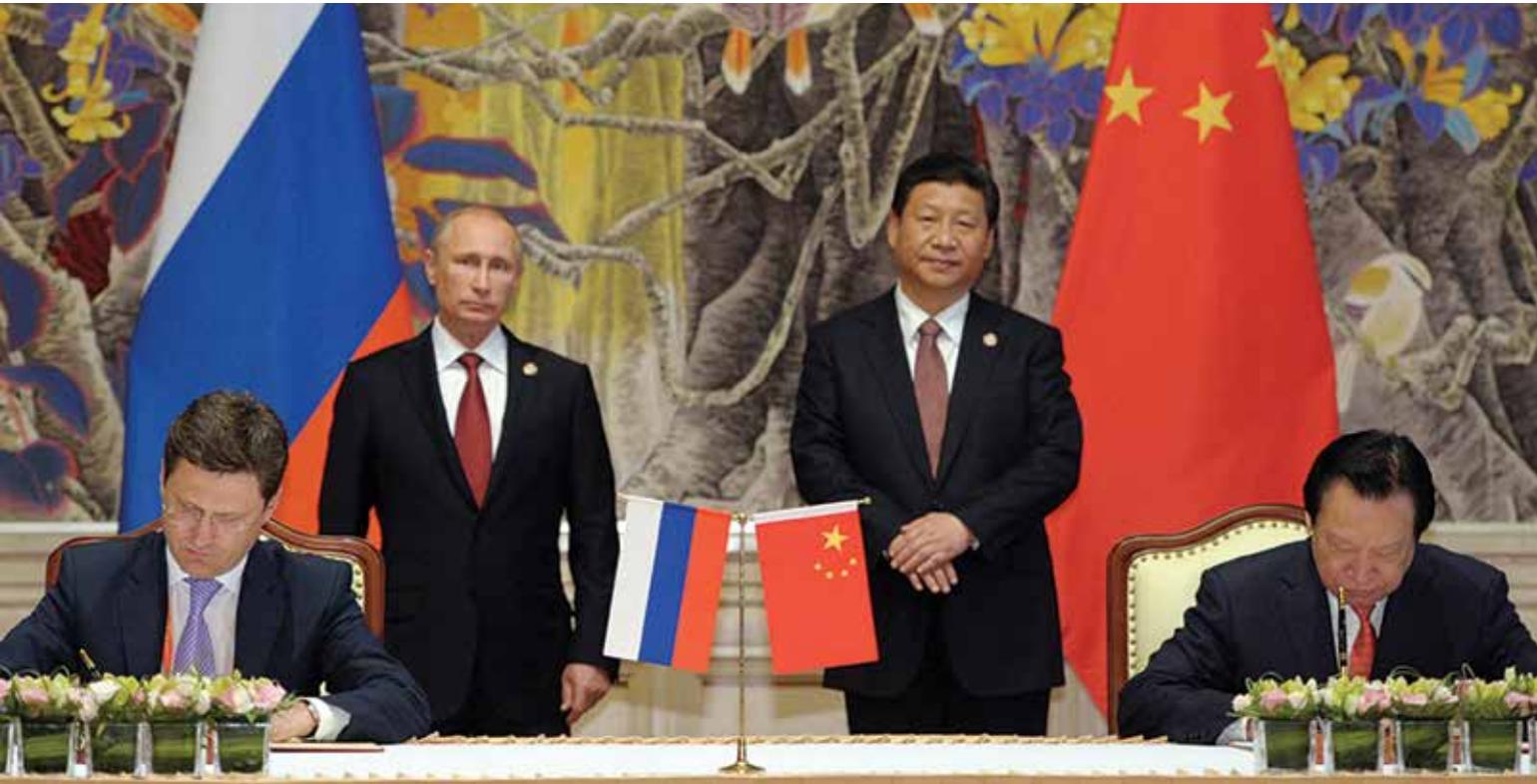
## Chronicle of a Political Deal Foretold

After more than a decade of negotiations and false starts, China and Russia finally clinched a long-awaited gas supply deal. The two countries' commercial interests have grown more closely aligned over the past two years, as an uncertain demand outlook from Europe prompted

Gazprom to look east for new markets. The arrival of competitive suppliers, including Australian and North American liquefied natural gas (LNG) in Asia as early as next year, also contributed to a sense that Russia's window of opportunity was closing rapidly.

At the same time, the Chinese government is aiming to more than double gas consumption by the end of the decade – from 165 billion cubic meters (bcm) in 2013, to 400-420 bcm in 2020 – on the back of an aggressive environmental agenda. Yet since the beginning of Sino-Russian negotiations over gas supplies well over a decade ago, China's leaders have been aggressively pursuing numerous supply options, all of which have afforded Beijing greater leverage in its pricing negotiations.

Haggling over the contractual terms thwarted the deal time and time again. But this time around, the looming sanctions on Russia over the annexation of Crimea and Putin's upcoming visit to Europe provided the political impetus to get the contract over the finish line.



*China signed with Russia a long-awaited, 30-year deal on May 21, 2014 to buy Russian natural gas worth some \$400 billion.*

## A Political Win for Russia, But Also for China

While the deal was a political lifeline for Putin, it was also a welcome boost for China's new leaders as they enter their second year in office. Simmering tensions in the East and South China Sea, irritants in China's relationship with the US over trade and cyber-security, and concerns over the country's economic trajectory have increased the need for a geopolitical win. Chinese President Xi Jinping can now claim success in locking in gas supplies to feed the government's ambitious fuel-switching agenda as it ramps up efforts to tackle its "airpocalypse". He has also managed to conclude a significant deal that his predecessor, President Hu Jintao, failed to accomplish. But while this deal has helped Putin and Xi score political points, the geopolitical and market implications of the deal should not be exaggerated.

## China and Russia: Still Number Two

The deal will catapult Russia to becoming China's second largest gas supplier after Turkmenistan by 2020. By the same token, gas shipments to China would also represent a nearly 25% increase in Russia's gas exports outside the former Soviet Union. But Gazprom's 38 bcm through the "Power of Siberia" pipeline will account for 9% of China's total gas consumption and will be a far second from Central Asia's 80 bcm, a situation that Beijing is likely happy to maintain. For all of the rhetoric around the deal, Russia's repeated willingness to use energy as a political tool has made Beijing wary of Moscow. Furthermore, not only is Sino-Russian bilateral trade roughly a third of Sino-American trade volumes, but Beijing still considers its ties with Washington as its most strategic bilateral relationship.

Meanwhile, a quarter of Russian exports, 167 bcm in 2013, are destined for Europe, a fact that is unlikely to change significantly given the web of pipelines that connect the two. Moreover, the “Power of Siberia” cannot displace those links. The two fields that will largely supply China, and would otherwise remain undeveloped, are also a great distance from the drilling rigs that feed Europe. In sum, Russia will not be diverting gas from Munich or Kiev to feed Beijing’s demand any time soon.

## Enter Shale Gas

The pipeline deal is not a game changer in terms of China’s supply dynamics. First, Russian piped gas has already been incorporated in Chinese supply assessments for the coming decade, so the agreement does not suggest a gas surplus. Second, even if Russian exports to China eventually reach 60 bcm, Beijing will still want to keep other supply options open as it seeks to mitigate the vulnerabilities associated with growing import dependency and meet the needs of different geographies and different importers.

The “Power of Siberia” is uniquely placed to supply China’s northeastern provinces (Heilongjiang, Jilin and Liaoning), which have very few alternative sources of supply. New LNG imports are slated to reach China’s eastern provinces, the country’s largest and most affluent consumer hubs. What is more, investment and procurement choices, although highly political, are also informed by commercial calculus and internal dynamics: as CNPC invests in pipeline imports, its rival CNOOC is looking to secure and expand its share of the LNG market.

Finally, the Chinese government is counting on an extremely ambitious domestic shale production target of 60-100 bcm to supply the bulk of its demands, for which it still needs US technological knowhow. At the same time, failure to reach its shale production goals could lead

to greater demand for imported LNG. To be sure, the pricing structure of the deal highlights China’s growing leverage as a consumer and suggests greater pressure on new suppliers to match these lower prices, likely at around \$10 per one million British thermal units (Mmbtu). However, given that China’s current supplies come in at prices ranging from \$4/Mmbtu to \$18/Mmbtu, there is still scope for North American gas to be competitive in the Asian market.

# CHINA REMAINS NO.2

## AND PPP REMAINS IN LABORATORY



*He Weiwen*  
Co-director, China-US/EU  
Study Center, CAIT

Despite predictions that the Chinese economy will overtake that of the U.S. in 2014, China will still remain the world's No.2 power for years, writes He Weiwen.

The World Bank ICP report on April 30 found that China will overtake the US as the world largest economy in 2014, based on its Purchasing Power Parity (PPP). The report said that, by this approach, one dollar was equivalent to RMB 3.506. As a result, China's GDP should be \$13.5 trillion in 2011, or 86.9% of US GDP (\$15.53 trillion). The report also found that during 2011-2014, Chinese GDP would have grown by 26%, while the US GDP grew by 7.6%. Based on this calculation, China's GDP will be 0.12% larger than the US' in 2014, toppling the latter from world No. 1.

This finding has caused lots of glamour in the world's media. Some even regarded it as a milestone in world history, as the US will bid farewell to the No. 1 spot it has kept for 142 years since 1872. The official China National Statistics Bureau, and most Chinese experts, however, have shrugged off this finding and insisted that PPP data is only one of the approaches in research, instead of the official statistics.

This author regards the GDP data based on PPP as laboratory data, interesting for further study, but not the official statistics.

### Standard Purchasing Power Won't be Found in Real Life

The PPP approach assumes a basket of products and services, and calculates the cost to buy them in US dollars. Then it applies the same approach to other countries and calculates the cost in each of the countries in their own currencies. Suppose that \$100 is needed to buy it in the US, and RMB 350 is needed in China, it reaches parity of one dollar to 3.50 renminbi. Based on this parity, it calculates the Chinese GDP. The report found that the parity between the dollar and the yuan is 1:3.506. Hence, the Chinese GDP in 2011 was already \$ 13.5 trillion.

In real life, however, no one can work out the cost of products and services, even in the US. The reason is simple: there is no single, national price for any specific product or service. Take the big Mac for example. The author had a big Mac at a McDonald's in Leezburg, Virginia, on August 26, 2010 for \$ 6.39 (sales tax included), and had the same big Mac at a McDonald's in Queens, New York City, on October 29 for \$8.29 (sales tax included). What is the US price of a big Mac? None exists. When living in Manhattan 10 years ago, the author often filled up with gas in New Jersey, instead of Manhattan, be-



cause it was cheaper. And the gas price changed almost every week. So, what was the US national price for gas in 2011? None exists. Therefore, the purchasing power could only calculate a limited price for specific products at specific markets in specific cities. There is no standard cost of the “basket” at all. It is the same in China. There is no single national price for eggs, rice, apartments, or anything else.

### Dollar vs. RMB Parity Questionable

The ICP report conclusion of China’s GDP overtaking the US in 2014 was based on the dollar-yuan parity of 1:3.506, or 1 dollar equals 3.506 Yuan. It is questionable how this parity has been worked out. Let’s make a brief comparison of prices of selected products and services in the US and China. Again, there is no national price, only prices in specific cities at specific times.

#### Food:

Take Boston and Hangzhou in 2011 for example. Rice was RMB 4.33 yuan per 500g in Hangzhou and 0.93 dollar (converted to 500g) in Boston,

with the parity of 1 dollar to 4.65 Yuan. Whole fat milk was 11.50 yuan per litre in Hangzhou and 0.60 dollar (converted to the liter) in Boston, showing a parity of 1 :19.20. A Fuji apple was 5.99 per 500g in Hangzhou and 1.1 dollar (converted to per 500 g) in Boston, with a parity of 1:5.45.

#### Clothing and footwear:

Levi’s casual trousers were sold at 39.9 dollars per pair in Boston and 799 in Hangzhou, with a parity of 1: 20. A Tommy Hilfiger T shirt was sold at 29.99 dollars in Boston and 799 yuan in Chinese major cities, with a parity of 1: 26.6. Nike shoes range between \$ 39.99-129.99 in most US east coast outlets stores, and between 300-2000 yuan in Chinese major outlets and stores, with a parity of 1: 7.5-15.4.

#### Transportation:

The Toyota Corolla retail price is normally at around 14,000 dollars in San Francisco, and around 130,000-140,000 yuan in China’s major cities, with a parity of 1: 9.50-10.00. Petrol at gas stations was sold at around 1.05 dollars per liter (converted from the gallon) in New Jersey

last mid-December and at around 7.00 yuan in Beijing, with a parity of 1:6.67.

### **Housing:**

A 1100 sf apartment in Union City, NJ, 30 minutes by bus to Port Authority, Manhattan was sold at \$216,000 in 2009, converting to \$ 1368 per construction sm. An apartment of 63 sm between the North 4-5 ring roads, Beijing, an hour by bus to Xidan, was sold at RMB 1.86 million, or RMB 29,520 yuan, leaving a parity of 1:21.58. The stories are true because I know both of the buyers.

### **Services:**

The taxi rate in Manhattan is \$ 0.20 per 1/9 mile, or \$ 1.125 per km, and RMB 2.40 yuan per km in Shanghai, a parity of 1: 2.13. The express passenger train fare of Amtrak, US east coast, is \$ 78-112 for equivalent first class between Metropark, NJ to Washington, D.C., 210 miles. The high speed train between Shanghai and Nanjing, 305 km, takes RMB 224 yuan for first class, with a parity of 1: 2.0-2.87. The long haul bus fare from New Brunswick, NJ to Manhattan, 60 miles (96 km) was \$ 9.55, or \$ 0.10 per km; while that for Zhengzhou to Kaifeng, Henan Province is 18 yuan for 32 km, or RMB 0.56 per km, leaving a parity of 1: 5.6.

The above comparison shows that the dollar/yuan parity in selected services is lower than 3.506, but is considerably higher than 3.506 for products and housing. One can argue that the RMB parity of 3.506 to the dollar is well overvalued.

## **PPP Cannot Cover All GDP**

The basket for the PPP test covers only selected products and services, mostly in consumption. It cannot cover all the consumption of tens of thousands of varieties. More fundamentally, GDP means the total output of a national economy, including investment, construction, govern-

ment services and external trade. Therefore, the PPP approach only deals with a small part of the economy, not the national economy.

## **A Static PPP Means a Laboratory Test**

The finding of the report that China's GDP will be 0.12% larger than the US in 2014 was based on the calculation on a static 2011 figure, multiplied by the accumulated real growth from 2011-2014. Hence the self-contradiction: PPP compares the "basket cost" with the prices changing each year and inflation level hovers up and down. The report, however, neglected all the price and inflation factors over the past three years and based the 2014 figure on 2011 price level. It shows that the PPP approach is a laboratory test, which does not represent the real picture.

The current exchange rate approach is still the internationally accepted norm for measuring national GDP. On this basis, China's GDP could exceed RMB 60 trillion in 2014, or approximately \$ 10 trillion, as compared to the expected over \$ 17 trillion in the US. China will still remain world No.2 for years.

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Based in Hong Kong, the China-US Exchange Foundation was established in 2008 by individuals who believe a positive relationship between the strongest developed nation and the most populous, fast-developing nation is essential for global wellbeing. The Foundation is a non-government, non-profit entity and is privately funded.

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China-US Focus, published by the China-United States Exchange Foundation, is built on the principle that China and the United States hold the most important bilateral relationship of the 21st century.

China-US Focus is the only open-platform website where Chinese and American thought leaders can openly express their views on the myriad issues that face the two nations, thus promoting communication and understanding between the peoples of China and the United States.

China-US Focus also provides comprehensive resources on current and historical facts and information related to the bilateral relationship.

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