

Research Paper

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The Critical Transition: China's Priorities for 2021



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1. Introduction

In 2017 Xi Jinping will complete his first full five-year term as China's leader. Towards the end of the year, in autumn, the country is due to hold its 19th Party Congress. This major meeting usually marks the moment when the Communist Party of China (CPC) assesses its performance over the previous five years, sets out political goals for the coming five-year period and makes new appointments.

Xi Jinping's leadership has been characterized by a number of significant domestic and international policy strategies. China's economic growth rate is slowing, and the country's economy is undergoing major restructuring. Export-led manufacturing growth and capital investment in fixed assets are now being replaced by consumer-led and service-dominated expansion. Meanwhile, the role of the CPC has been rearticulated with a major anti-corruption struggle since 2013 that has sought to clear away a raft of different networks and senior officials and connected business people. Xi has proved a more communicative, more populist and more nationalistic leader than his predecessors. He is also crafting an image of himself as a more visionary leader.

Internationally, China is striving for a relevance and role that it has never had before. Its reach is felt in international organizations, regionally, and through its economic and resource needs. It has a role in global affairs that embraces places once considered on its periphery, such as Latin America, the Arctic and Antarctic Circles, and the Middle East. Its impact in Asia is particularly striking, marked by activity in the South China Sea, and a new kind of relationship with Russia, India and the US. The major Belt and Road Initiative, in particular, has started to outline a new expansiveness in China's relations with the outside world, despite the largely abstract nature of its overall shape and form at the moment.

The themes and viewpoints in this collection of essays are particularly geared towards those with an interest in policy engagement with China. While setting out the core issues for the Xi leadership, it also focuses on what these might mean for the UK, particularly in the post-Brexit world and with the election of Donald Trump as US president. As the UK seeks a new kind of relationship with a rapidly changing China, this group of expert opinions maps out the key markers in the run up to 2021, when China is due to celebrate achieving the first of its centennial goals: the delivery of middle-income status and a moderately prosperous society.

Kerry Brown, Associate Fellow, Asia Programme

2. China's Leadership and Domestic Politics

Rod Wye, Associate Fellow

Summary

- China is moving from consensus-driven elite politics towards rule by a single leader, supported by a more centralized, reinvigorated Communist Party.
- The domestic policy background is challenging for the leadership as the economy enters a period of slower growth and other social and environmental problems, such as pollution, proliferate.
- The party remains determined to preserve its monopoly on power supported by an ideology – strongly tinged by nationalism – that focuses on strengthening and rejuvenating China and its institutions. As such, dissent will continue to be repressed.
- **For the UK:** despite a continuing strong push for deeper economic engagement with China, especially in the post-Brexit environment, the relationship will be subject to political challenges. China's leaders will be more difficult to engage at the most senior level and will show less tolerance over values issues. Particularly problematic for the UK will be political developments in Hong Kong, and how the UK reacts to them.

Breakdown of consensus

The current Chinese leadership, centring on Xi Jinping, came into being after a comparatively long period during which consensus politics was the norm. The way the 'harmonious society' concept was embodied by the previous leader, Hu Jintao, and his associates was very much a bureaucrat's dream: a smooth-running machine guided by a group of equals each responsible for their part of the overall picture and reaching major decisions through discussion and consensus. Norms appeared to have been established through agreed practice, if not through formal prescription: setting age limits for senior positions and limiting terms of office. The process of leadership transition was formalized, and new leaders were identified five years in advance and given a thorough period of apprenticeship. But it all rather lacked bite and a sense of wider purpose. In contrast, Xi Jinping's behaviour and the promotion of his 'China Dream' of a strong nation, along with his vision for the governance of China, have been far more aspirational.

Xi has proven adept at using the traditional means of Chinese Communist Party politics to consolidate and strengthen his power. Opponents have been ruthlessly purged, their networks of once powerful officials broken up and their influence undermined. Senior appointments are being made throughout the system of individuals who, if they are not largely Xi's supporters, at least owe their promotion and position to him. He has established a whole series of new instruments of bureaucratic power to bypass the standard institutions of the government and party; in particular

he has set up or taken over the chairmanship of a series of key, high-level party groups at the heart of power. Unlike his immediate predecessor, Xi's instincts are political rather than technocratic, and his priority is to construct a party that shares his vision, and is more effective in carrying out its duties. Nonetheless, Xi is still a considerable way from being an all-powerful authoritarian leader. Despite the deliberate encouragement of echoes of a Maoist past, Xi does not appear to be positioning himself as a leader in that mould, playing down the cult of personality. Furthermore, a leader cannot function alone. He needs a network of loyal functionaries to carry out his policies and an array of advisers to come up with creative ideas to meet the future challenges that China faces.

As a result, despite occasional rumours that Premier Li Keqiang is being bypassed or even removed, he remains a key figure in the administration; similarly Xi owes a huge debt to Wang Qishan, who has shown formidable bureaucratic and political skill in pushing through the anti-corruption campaign. Xi clearly feels that there is still much to be done. He has been quoted as saying that 'some officials have been forming cabals and cliques to covertly defy the Communist Party of China (CPC) Central Committee's decisions and policies' and that they 'risk compromising the political security of the Party and the country.'¹ These officials may partly be acting in self-defence against the expected arrival of investigators from the Central Commission for Discipline Inspection (CCDI), but Xi's words do point to there being, at least in his mind, those who are not reconciled to the current direction of politics or policy. He has made political enemies in the course of the anti-corruption campaign and his break-up of the power cliques of former opponents. Therefore, should he falter in his ambitions, it is likely there would be no shortage of potential critics.

Coming developments in elite politics: the 19th Party Congress

Chinese politics remains very much an elite affair, with power and ambition centred on the capital, Beijing. Most provincial-level senior leaders do not stay long enough in any one place to build up much of a local power base and the big institutions, such as the People's Liberation Army, have been reshaped with some regularity to prevent the establishment of 'independent kingdoms'. Xi has wielded the ultimate power of patronage for over three years now and the shape of many of China's major institutions has changed significantly. The elite political landscape is likely to be further reworked in his favour, particularly at the upcoming 19th Party Congress, when he will have the opportunity to appoint his allies to the Central Committee and to the key posts of the all-important Politburo and its Standing Committee. But the arrangements that emerge from the congress could also reveal more starkly the extent of his need to compromise with other groups.

Under the current arrangements, two relatively younger candidates would be selected from among their peers to become members of the Politburo Standing Committee and effectively the heirs-in-waiting to Xi Jinping and Li Keqiang. But Xi may have other ideas. A key indicator will be whether his ally Wang Qishan stays in post, despite having passed the informal age limit for those in office. If that part of the consensus is broken, other elements of the succession arrangements, such as term limits, may become more flexible. Xi would face considerable opposition to changing the rules of

¹ *China Daily* (2016), 'Xi warns of Party "cabals and cliques"', 3 May 2016, http://www.chinadaily.com.cn/china/2016-05/03/content_25036979.htm (accessed on 21 Nov. 2016).

the game in this way, but he has not been afraid in the past of ignoring apparently well-established conventions of Chinese politics. Either way some new clarity is expected at this congress.

Reconstructing the party

Outside the opaque realms of elite politics, the anti-corruption campaign has been used effectively as a means of ensuring the loyalty of bureaucrats to the current government orthodoxy. It has long since ceased to be solely a matter of rooting out corruption, though corrupt figures, both high and low ('tigers' and 'flies'), continue to be regularly identified and disgraced. As part of the party reconstruction drive, work teams are now being despatched from the CCDI to all major institutions and departments of the party and state. Their role is to ensure political and ideological conformity, as well as to improve apparent lax work practices in institutions (i.e. those that do not effectively serve the ends of the regime). Xi's vision is one of a highly effective, well-policed and disciplined vanguard party ready and capable of dealing with the new challenges that China faces. Xi emphasized this in a speech in 2015, 'Political discipline and rules exist to enable CPC cadres to defend the authority of the CPC Central Committee and cadres must follow those rules, aligning themselves with the Committee in deed and thought, at all times and in any situation.'² Dissident voices, particularly from the legal profession, have been ruthlessly silenced as a consequence of this position and the propaganda machine has been strengthened and streamlined to ensure greater conformity of view throughout China.

Rule by law has been an insistent theme of the new leadership, allied to a strengthening of the legal system. But it remains the case that the party is itself ultimately not subject to outside constraints. From the party's perspective, it is acceptable that courts can be used to pursue certain administrative remedies against the actions of state bodies but they cannot be used to challenge its rulings or decisions. Constitutionalism has been an occasional subject for debate within Chinese intellectual circles but for the party it really only means the establishment of a set of rules and regulations to guide the conduct of others. It is not a means of supervising the work of the party, as that is a right that the party claims solely for itself. There has been no sign of any long-term concession on this point.

Problems on the periphery

The regime has been particularly unsuccessful in dealing with the periphery of China, where some of the more problematic differences lie. Despite the power of the Chinese state and the might of the Chinese economy, both of which have been brought to bear on these issues, significant sections of the populations in both Xinjiang and Tibet remain unreconciled to the version of Chinese rule offered by the current regime. This undermines the legitimacy of the Chinese position that economics is a source of social progress as well as peace and security. Hong Kong has in the past been something of a touchstone of the limits of tolerance and clearly things are changing there. Under the old consensus regime, a certain amount of leeway seemed to have been afforded to

² *China Daily* (2015), 'Xi stresses Party discipline, rules', 13 January 2015, http://www.chinadaily.com.cn/china/2015-01/13/content_19310668.htm (accessed 21 Nov. 2016).

political activity in Hong Kong. However, Beijing has shown its readiness to dictate the course of events in Hong Kong and sections of the Hong Kong population are increasingly uneasy by the growth in Chinese influence. Most recently, Beijing has reacted strongly and directly to the election of outspoken young activists to the Legislative Council to prevent them taking up their seats.³

The party and the maintenance of power

Whatever the outcome of the political machinations at the centre, the CPC maintains an absolute and unrelenting grip on the levers of power throughout the country. Its overarching priority remains to ensure that this monopoly is sustainable through the major economic and social changes that continue to affect China. The party has continued to display a remarkable ability to adapt itself to new conditions and to co-opt or coerce newly emerging groups to accept its unquestioned leadership. Until recently the party has been able to rely on growth and the promise of increasing prosperity as a base for its legitimacy. But the Chinese economy is not going to be as helpful to the leadership as it has been in the recent past. The period of high growth rates is over, and the management of the economy and escaping from the so-called 'middle-income trap' are becoming increasingly challenging. Problems caused by the rapid development of the last 20 years are also becoming more acute, notably environmental pollution. Inequality is increasing, and there are rising expectations among many sectors of the population. China faces a long-term demographic challenge of an aging population and the need to provide for it. The leadership continues to be concerned about the maintenance of social stability. Demonstrations occur quite regularly throughout China on a wide variety of individual issues, such as the siting of new chemical works or land requisitions. While none of this has reached an acute crisis level, the leadership will need to be more sensitive and responsive to such issues. Even in the face of such challenges, there is no sign of any sustained political challenge from outside the party. China's so-called new middle class has not shown any real inclination to involve itself in the political life of China, and has been happy to go along with the leadership of the CPC. Xi Jinping's 'China Dream' with its strong focus on restoring China to its rightful place in the world, with its nationalistic overtones, continues to have real resonance. This, it is hoped, will provide a new basis of legitimacy for the party at a time when the previous social contract, based on the party's ability to deliver regular economic growth, is wearing thin. It remains to be seen how successful this switch will be.

China's leadership is still focussed principally on its internal concerns. China's development has been an outstanding success story over the last 30 years, but future progress is ever more problematic. Externally the leadership is showing a new confidence in asserting and promoting what it sees as its proper rights and dues, while being increasingly sensitive to, and intolerant of, perceived slights. Internally it remains fully in control of the system, but is still very concerned about any manifestation of dissent or difference and can react in an extremely heavy-handed fashion. Looking to the longer term, the party sees the two centennials of 2021 (the foundation of the party) and 2049 (the establishment of the PRC) as key dates for the delivery of its vision of the restoration of China to its place as a great modern country, central to the world. In its own narrative it is only under party rule that this can be achieved.

³ See Tim Summers' analysis of developments in Hong Kong on page 11.

3. China's Foreign Policy

Kerry Brown, Associate Fellow

Summary

- The period up to 2021 will be crucial for the delivery of a stronger, more confident, higher status China, with a dominant role in Asia.
- Achieving this is crucial to Xi Jinping's leadership, as president in an era promising national renaissance and regeneration, rather than rapid economic growth.
- Interests in the South and East China seas, the status of Taiwan and the expansion of economic, intellectual and material resources will be China's main international priorities up to 2021. The sustainable balancing and management of these issues will be central to achieving the Chinese renaissance.
- The Belt and Road Initiative is one of the key indicators of China's aspiration to have a more central regional role, operating largely in the economic realm, but making political and diplomatic gains throughout.
- The election of Donald Trump as US president is both an opportunity and a threat to China. It engenders great uncertainty due to the lack of clarity about Trump's foreign policy views. But it also threatens to create a US that is distracted by domestic issues and division, which will be less willing to assert itself in Asia. This is a vacuum that China would be willing to fill.
- **For the UK:** leaving the European Union will create new opportunities to work with China – but will exacerbate the already extant dilemma of balancing strong security alliances with the US and others, against acceding to China's request for greater political loyalty and compliance in return for deeper economic links.

Chinese foreign policy over the next five years will be guided by two major imperatives – one rational, the other emotional. For the first, the challenges currently facing the Chinese economy mean that, with lowering growth and the transition from a manufacturing, export-based model to a service-oriented, higher consuming one, China's requirements from the outside world have changed. It is no longer looking for markets to which it can export manufactured goods; instead, in order to innovate rapidly and to focus on its domestic finance and service sectors (where 45 per cent of GDP activity is already focused), China needs to develop high quality technological and intellectual partnerships. The Chinese government's 2006–20 innovation plan has not produced the golden era of creativity that was expected and Chinese companies still remain poor at process and product innovation.⁴ China is aware that it must forge strong links with foreign partners, by

⁴ In 2012, China had a deficit of royalties and licence fees from patents of US\$17 billion. The US had a surplus of US\$82 billion, see Lam, W. W. L. (2015), *Chinese Politics in the Era of Xi Jinping: Renaissance, Reform or Retrogression*, New York and London: Routledge, p. 169.

allowing them controlled, tactical access to its internal market in return for intellectual property rights (IPR), where a fast emerging middle class will offer opportunities for growth. But the Xi leadership is also aware that this has to be managed on China's own terms. Since 2014, this has resulted in an effort to create clearer, but often harsh, rules for how to operate in China for foreign enterprises and non-government organizations. In some cases, this has even resulted in foreigners working for multi-national enterprises being incarcerated or expelled from the country.

This rational set of needs runs alongside a more emotional one. Xi Jinping has reversed the political understanding under his predecessor Hu Jintao that economic development should be prioritized. In the era after China's entry to the World Trade Organization (WTO) in 2001, political matters were largely left to stagnate in the belief that the country could address these issues after it became rich. China maintained a low profile, and often seemed to be embarrassed by its newfound economic prominence. Under Xi there has been a far harder-edged understanding of the kinds of influence that economic power has given China. Xi has appealed much more to nationalistic sentiment, through his talk of the 'China Dream', and his grand narratives in which China is placed on parity with the US and European Union. The acme of these is the vast Belt and Road Initiative, which, for all its vagueness, clearly stands as a statement of ambition and relevance to 64 countries ranged around China. The one clear characteristic of the Belt and Road Initiative is that it seeks to push China towards a more central role in its region, creating economic links that also forge greater political certainty for China as its partners let their material self-interest gain traction over political and diplomatic loyalties. Through Rodrigo Duterte, the populist leader of the Philippines, the region has already seen a leader question the country's overall loyalty to the US by asserting greater closeness to China. While this may be rhetoric, it risks becoming a pattern across the rest of the region.

Xi developed the idea of a 'historic mission' under Hu, speaking of two centennial goals, the first of which, in 2021, marks the hundredth anniversary of the founding of the Communist Party of China (CPC). This should mark the moment when the Chinese renaissance is complete – a China that has clear strategic space around it, which will never again be victimized as it was during the colonial era, and is able to deal with the world on its own terms. This creates new opportunities as China becomes more willing to get involved in issues like the Iran nuclear freeze in the Middle East, the global fight against Islamic extremism and climate change. The more negative side is the resultant strong domestic urge to replace legitimacy through economic performance with that of diplomatic prowess and recognition, fired by the manipulation of Chinese nationalistic sentiment. As a result, China has hardened its position on Japan, Taiwan and the South China Sea.

The management of the South China Sea problem is a particular worry, but at its heart sits the issue of Taiwan's status. For Xi and his leadership, the construction of a sustainable, long-term framework where reunification might be glimpsed has become more of a reality. Xi alluded to this during a meeting with a Taiwanese leader in 2014 where he stated that political issues could not be put off forever.⁵ This was also behind the real risk he took in meeting the then Taiwanese president Ma Ying-jeou in Singapore in November 2015, marking the first meeting of the leaders of China and

⁵ Hung, F. (2014), 'China official on key Taiwan trip says comes with sincerity', Reuters, 26 June 2014, <http://in.reuters.com/article/china-taiwan-idINL4NoP6oGo20140625> (accessed 21 Nov. 2016).

Taiwan in six decades. The election of the Democratic Progressive Party's Tsai Ing-wen in Taiwan in early 2016 has complicated this strategy, because of her party's stronger antipathy to any talk of closer links with the mainland. In 2016, there were also signs that Xi's China, aware of its stronghold over the Taiwanese economy, might use this to apply increasing pressure to enable at least some discussion of reunification. The potential obstacles to this idea are immense, but so, too, are the rewards if Xi is able to step closer towards his goal. More aggressive attempts to place reunification on the table, even to the point of doing deals with the US and other contesting nations in the South China Sea, should not be excluded. The outcome of this will partially be dependent on what priority the defence of Taiwan is given in the global community.

While China has exerted much effort on concerns relating to Taiwan and regional maritime issues, in the run-up to 2021, it will seek to develop stable and straightforward relations with its other major neighbours, particularly India and Russia. On the North Korean front, Beijing has largely accepted a Pyongyang with limited nuclear capability – but while it will toy with any ability to put decisive pressure on the Kim regime through the withholding of aid and energy, in the end its priority will be to maintain the status quo as it focuses on other issues. It does not want a collapsed regime as an ally, which becomes a source of constant trouble and demands political effort, nor does it want North Korea to fall into the arms of South Korea, and thereby its chief ally, the US. Maintaining the status quo will be China's priority.

Management of the relationship with the US will remain key to 2021. The election of Donald Trump was as much a surprise to the Chinese government as the rest of the world and Trump's inconsistency offers a mix of risk and benefit to China. On economic issues, if Trump carries through some of his pre-election threats, he will push for a harder deal with China, trying to repatriate jobs he believes have been taken from the US, albeit it is hard to see how easy this will be to achieve. He will also seek to place pressure on China's currency value, but again, this has been a steady theme throughout the last decade or so. There is little sign that Trump or the people around him truly know quite how to take forward their hawkish stance on these issues.

On matters related to international relations and diplomacy, Trump will ironically offer China more influence and space. He has threatened a looser arrangement with regional allies, asking them to contribute more financially to their own security. Should they choose not to do so, China will be in a position to exploit the divisions that this causes. It will seek a stronger regional role, particularly regarding maritime issues. On Taiwan in particular, because of the maverick approach that Trump has shown before 20 December 2016, such as speaking directly over the telephone with President Tsai Ing-wen and openly questioning the One China policy, Beijing will watch the new administration closely, to see if it continues this new, riskier approach. As with the seizing of a US water drone, too, in late December, China might be tempted to express its unease through more aggressive actions in the region. Things could very easily escalate between Beijing and Washington through a misreading and misunderstanding of each other's position. But the Trump era is also likely to force China into a leadership position on issues like nuclear proliferation and climate change, on which the new president has expressed scepticism. The vacuum that Trump's lack of experience and interest in foreign affairs creates, while providing some new opportunities for China, also offers a lack of predictability that Beijing will not welcome; China is likely to feel unprepared for the new, more exposed and more prominent role expected of it.

For the UK, its policy towards China and China's role in British diplomatic life has changed since 23 June 2016, the date of the UK referendum on EU membership. The decision to leave the EU has created a British position that is radically altered, and where there is now significant uncertainty. Ironically, in the space of a few months, two of the most predictable and stable international actors – the US and UK – have become sources of instability.

As the UK negotiates to leave the EU, jeopardizing its access to the single market, it will be in a position where it will have to simultaneously achieve two contradictory goals. Firstly, it will need to seek new potential markets, to arrange free trade agreements and other deals, for its services and manufacturing sectors. China is important to this end, and has already proved a source of investment and partnership. But this will now have to accelerate very quickly. To achieve a new, better quality economic relationship with China, the UK will need to radically alter its capacity to deal culturally, politically and commercially with the country. It will need to preserve the role of London as a global finance centre and a hub for renminbi internationalization. Failure to do this risks reducing the UK's attractiveness in other areas. The UK's almost complete focus on managing its relations with Europe will mean that political attention on Hong Kong will become a very low priority – something that has become increasingly clear as Hong Kong has experienced its own challenges over the last year.⁶ China will see the UK as a weakened and reduced diplomatic partner and, even if the signing of a trade deal were to happen, it would almost inevitably largely be in China's favour. The most sustainable and coherent position the UK can support for a post-Brexit future with China is to maintain strong free trade credentials, attempt to engage with China as part of a rules-based and predictable international trade and finance system, and create better value technology and intellectual exchange partnerships. These are largely areas in which, both inside and outside of the EU, the UK and China speak a common language.

Secondly, at the same time, the UK will have to ensure that it does not antagonize the US, an even more significant security partner in a post-Brexit UK. US displeasure at the UK unilaterally joining the Asian Infrastructure Investment Bank (AIIB) in 2015 is a foretaste of things to come, although under Trump it is unclear if these values issues will figure as much as they have in the past. It is more likely that the UK will be pulled into taking a position on some of the trade issues outlined earlier that Trump spoke about during his campaign. The UK is likely to create a more transactional, economic-focused relationship with China, one that emphasizes the rule of law and its support in the commercial or economic realm, rather than rights and values. As China enters a more contentious phase with a stalling economy, higher nationalism, greater conflict in society and the possibility of a perpetual Xi presidency, the UK will constantly have to balance its desire to criticize and benefit.

As a member of the EU, the UK had at least some protection as there were shared strategies for dealing with China; facing China alone, is a very different proposition. Brexit has significantly weakened the UK as an international actor although, ironically, the Trump presidency might help to alleviate this by offering a US–UK relationship that is much more traditional and closer than that under Obama. Ultimately, this means that the UK will be exposed to the ups and downs of the US–China relationship and its fate in the next five years as never before.

⁶ See Tim Summers' section on Hong Kong on page 11.

4. Hong Kong: Is the Handover Deal Unravelling?

Tim Summers, Senior Consulting Fellow

Summary

- Almost 20 years after the handover from British to Chinese sovereignty, Hong Kong faces a range of political, economic and governance challenges. The spillover from the rise of China and the impact of rapidly growing flows of people and capital into Hong Kong have created new pressures for Hong Kong society, which has become more polarized and fragmented.
- The centre of political gravity in Hong Kong is shifting away from the mainland at the same time as the two economies are increasingly intertwined. Beijing is frustrated by developments in Hong Kong, but its ability to influence the city's increasingly fragmented society and politics is limited.
- The 'Hong Kong Indigenous' movement and support for independence reflect growing insecurities and identity politics, but also challenge the constitutional settlement on which the 1997 handover was based. Moderate voices have been marginalized.
- **For the UK:** Hong Kong will remain important for policymakers in London, who need to balance a number of conflicting interests. Continued investment in expertise will be needed to properly deal with Hong Kong. The additional pressures resulting from Brexit will shift the UK's China priorities, with implications for UK–Hong Kong relations.

A crucial period for Hong Kong

Hong Kong has entered a crucial period in its history almost 20 years after the handover from British to Chinese sovereignty, on 1 July 1997. In the short term, the selection in March 2017 of Hong Kong's next chief executive could act as a further lightning rod for a wide range of concerns that have fuelled several years of rising political and social tensions in the city. Beyond March, the key political question will be whether the 'one country, two systems' principle – set out in the 1984 Sino–British Joint Declaration and 1990 Basic Law (the Chinese law that acts as Hong Kong's mini constitution) – can continue to provide an effective framework.

Along with the principles of a 'high degree of autonomy' (except in foreign affairs and defence) and 'Hong Kong people running Hong Kong', the 'one country, two systems' principle was central to the handover deal between the UK and China. Since 1997, this deal has generally worked well. Hong Kong has continued to operate its own legal, judicial, economic and political systems, has its own currency and financial system, is a separate immigration and customs territory, and follows its own path in social policy, including education. However, whether its 'high degree of autonomy' has been fully respected is passionately debated, like most issues in Hong Kong today, as a range of political,

economic and governance challenges face the city. Added to the mix is the emergence, since autumn 2014, of a small but vocal movement that rejects the constitutional settlement in the name of self-determination or independence for Hong Kong.

The question is therefore no longer just evaluating whether promises made prior to 1997 have been kept, but what the future holds for Hong Kong, and even whether the handover deal itself can survive the current challenges.

The answers are relevant not just for Hong Kong and the rest of China, but also for international actors with interests in Hong Kong. As the former colonial power, the UK remains at the forefront of international attention when Hong Kong issues hit the headlines, though locally it is only a marginal actor. Perhaps unexpectedly, 20 years after the handover, dealing with Hong Kong and Britain's colonial legacy remain challenges for policymakers in London.

Hong Kong and the rise of China

Developments in Hong Kong have not unfolded in isolation, and as a relatively small and open economy and society, Hong Kong is more exposed than most places to events beyond its boundaries. More than anywhere else, Hong Kong has been transformed by the impact of the economic rise of China since the early 1990s, and especially over the last decade. While the Basic Law sets out measures to keep Hong Kong's system separate from that in mainland China, their economies have become increasingly connected, through the ongoing development of infrastructure linkages, the impact of the Chinese economy on major Hong Kong business sectors, such as financial services and logistics, and the impact of rapidly growing flows of people and capital into Hong Kong from the rest of China. Subsequently, Hong Kong's economic future has become substantially dependent on that of China, particularly its hinterland in the Pearl River Delta.

But earlier predictions that the growth of Shanghai or other Chinese cities would render Hong Kong irrelevant have not come to pass, and while evaluating the respective strengths of these cities requires nuanced analysis, Hong Kong's open capital markets, rule of law, free flows of information and general openness (still rare across Asia) clearly give it an enduring advantage for global business and create opportunities from the rise of China. This can be seen in the city's role in the ongoing internationalization of the Chinese currency, and China has taken advantage of Hong Kong to reduce risks and mitigate concerns over its 'go global' strategy.

At the same time, the spillover impact of the economic rise of mainland China and the dislocating pace of change have created new pressures for Hong Kong society, and prompted resistance to economic integration or anything that might look like 'mainlandization', especially given Hong Kong's size and population density. Growing income and wealth disparities, consequences of capitalist globalization that are not unique to Hong Kong, have increased the politicization and polarization of Hong Kong society, and given rise to populist and nativist movements. Despite its outward sheen of wealth, wages are stagnant for many in Hong Kong, while housing and living costs remain high. As in other societies, many feel that the government is out of touch, exacerbated in Hong Kong by perceptions (not always justified) that the city's leaders look to Beijing first in devising policy. Demands for more democracy are not just about the Hong Kong population 'taking control' of politics, but also offer the hope of overcoming inequality.

Politicization and polarization of Hong Kong society

The last few years have been particularly politically charged. The 79-day 'occupy' movement in autumn 2014 – evidence not of reduced freedoms but of their exercise in a way unimagined in 1997 – presaged the rejection in June 2015 by Hong Kong's legislature of a package that would have seen candidates for chief executive (the special administrative region's top official) being subject to a popular vote. The grounds for rejection were that the nomination process was too restrictive. Since then, riots marked Chinese New Year in 2016, while the apparent abduction at the end of 2015 by mainland security agents of Lee Po, a publisher of gossipy books about elite politics in China, raised concerns across Hong Kong and internationally, which lasted through the first half of 2016 (Lee is both a British passport holder and Hong Kong Chinese).

Political tensions rose further following Legislative Council elections in September 2016, when half a dozen supporters of self-determination won seats. The subsequent controversy over the aborted oath-taking by two legislators-elect, who had used the ceremony as a platform for the rejection of Hong Kong's status as part of China,⁷ led the National People's Congress Standing Committee in Beijing to interpret the relevant provision of the Basic Law in November. A court judgment in response to a case brought by the Hong Kong government barred the two legislators-elect from taking their seats. This episode has only served to heighten the 'insecurity dilemma' between parts of Hong Kong society and the central government.

Worries that Hong Kong's freedoms are being eroded, even as local political debate remains vibrant, have bolstered support for anti-government and anti-Beijing sentiment among the Hong Kong population. The result is a society that is increasingly politicized, polarized and fragmented. This diffusion of power cannot only be seen in the continued difficulty that opposition politicians have in developing strong political parties and platforms, but in tensions within the establishment camp, brought on partly by antagonism between many traditional business elites and the current chief executive, C. Y. Leung, who announced in December 2016 that he would not seek a second term.

This combination of local politics, the social and economic challenges brought by China's economic rise and long-standing suspicion of the Communist Party of China's (CPC) motives means that political tensions in Hong Kong are likely to continue in the medium term. 2017 will be particularly challenging. In late March, the next chief executive (whose term will begin on 1 July) will be selected by the existing method of a committee of 1,200, following the failure of the 2014–15 constitutional reform package to deliver consensus on a more democratic way forward. While Hong Kong citizens may reluctantly have accepted this small-circle election in the past, hoping for more democratization in the future, the febrile political mood in the city means that protests are likely.

⁷ The oath requires allegiance to the 'Hong Kong Special Administrative Region of the People's Republic of China' (not to the PRC separately or on its own).

Limits to Beijing's influence

Against this background, the common narrative that Hong Kong's problems are due to the central authorities ('Beijing') increasing their control needs revisiting. Developments in Hong Kong have clearly led to growing frustration in the capital, and a desire to influence events in the city more. But the story over recent years has actually been one of relatively limited influence. Beijing has exerted a certain amount of indirect influence over the business community and pro-establishment politicians since before 1997, but it has had more difficulty in shaping outcomes. The failure to get its own constitutional reform package through Hong Kong's legislature in 2015 followed the shelving of earlier plans to reform national and moral education (2012) and national security legislation (2003), as well as the unpredictable chief executive race in 2012.

This limited influence results partly from the constitutional arrangements under which the central government's only formal role in Hong Kong's governance (other than areas outside its autonomy such as foreign affairs or constitutional reform) is through the selection of the chief executive, but also from deep-seated views across much of Hong Kong society, the exercise of freedom of expression, and a robust judicial and legal system. When mainland officials have sought to intervene outside these frameworks – as in the apparent abduction of Lee Po, which is incidentally the only time the British government has called a breach of the Sino–British Joint Declaration – the backlash in Hong Kong has led to a weakening of Beijing's ability to influence Hong Kong society. The longer-term consequences of the November 2016 interpretation of the Basic Law may well be along similar lines.

What the November legislative elections showed was a growing diffusion of power and influence across society. Rather than a tighter grip from Beijing, or Hong Kong becoming gradually more like the rest of China, the centre of political gravity in Hong Kong is shifting away from the mainland at the same time as their economies are increasingly intertwined. The contradictions this brings will unsettle Hong Kong society further, and anti-Beijing sentiment in Hong Kong is likely to grow.

Challenging the constitutional settlement?

Many of these issues have come to a head in a new and unexpected trend in Hong Kong politics since the 'occupy' period of 2014, the rise of the 'Hong Kong Indigenous' movement. This partly echoes developments in Taiwanese politics from the 1980s and reflects some deep-rooted identity issues among Hong Kong citizens, who have long seen themselves as having a different political and social culture from the rest of China (notwithstanding the historical centrality of migration from mainland China in forming Hong Kong society).

The indigenous movement comes in various shades, from open advocates of independence for Hong Kong (and even a few who call for a return to British sovereignty), to those who demand self-determination, either immediately or in 2047,⁸ and a slightly softer demand for 'total autonomy' for

⁸ The Sino–British Joint Declaration makes explicit guarantees for the 50 years from 1997 to 2047. However, contrary to common assumptions, there is no time limit or expiry date in the Basic Law, and therefore no reason to assume that 2047 marks the end of China's commitment to 'one country, two systems'.

Hong Kong while retaining (symbolic) Chinese sovereignty. As noted above, the 2016 legislative elections returned a handful of candidates who advocate such positions.

Any shift towards independence or self-determination is anathema to Beijing, given the centrality of national sovereignty in the party's own discourse, and the way that Hong Kong's return to Chinese sovereignty was trumpeted as a national achievement, even without considering potential implications for Taiwan. But the Hong Kong Indigenous movement, for the first time since the Sino-British negotiations in the 1980s, openly challenges the constitutional settlement that was the outcome of those negotiations. The vast majority of Hong Kong people probably still support that settlement and would like to see 'one country, two systems' continue, but politics is increasingly being dominated by marginal views and a sharp rise in identity politics, leading to growing defensiveness by both central and Hong Kong governments.

A policy challenge for the UK

In the second half of 2014, Hong Kong briefly rose near to the top of the UK's foreign policy agenda, as the 'occupy' movement coincided with an enquiry by the House of Commons Foreign Affairs Committee and several parliamentary debates on Hong Kong. UK policymakers found themselves trying to balance domestic pressure to support a popular movement with the UK's historical legacy and commitments that set out a more gradual approach to democratic development, and wider considerations such as an increasingly important relationship with China, both politically and commercially. The additional pressures resulting from Brexit will likely shift the UK's China priorities, making good economic relations with China – and in particular with Hong Kong – more important.

The UK's challenge is not just about political positioning. Hong Kong remains an open and liberal outpost in a region and world in which globalization appears to be in retreat. Even with the rise of China, Hong Kong is an important trade and investment partner to the UK in its own right, and financial sector links between London and Hong Kong have been growing. Hong Kong's burgeoning creative industries and service economy, and proximity to the rest of China, give the UK an interest in its continued success. The principles of 'one country, two systems', negotiated prior to 1997, remain the best compromise available, and their maintenance would serve the UK's wider interests in Hong Kong.

These policy demands bring with them a requirement for the UK to invest in Hong Kong expertise, and to retain a deep understanding of the historical background and British legacies, as well as the current political, social and economic dynamics in Hong Kong. Given the extensive challenges facing British foreign policy, from Europe to East Asia, this will not be easy to achieve.

5. Taiwan and Cross-Strait Relations

Steve Tsang, Associate Fellow

Summary

- Cross-strait relations will remain tense even though Taiwan's President Tsai Ing-wen is likely to refrain from taking a confrontational approach to Beijing.
- Taiwanese domestic politics will limit Tsai's ability to proactively engage with the Chinese government.
- Complementary economic ties will continue between the mainland and Taiwan but on a gentler trajectory than the previous eight years.
- While Beijing will put pressure on Taipei, it is unlikely to instigate a confrontation unless it needs to distract attention from a major domestic crisis or sees an opportunity to do a deal over Taiwan with President Trump.
- The Tsai administration in Taipei will continue to exercise restraint and avoid taking actions to 'provoke' Beijing, particularly given the unpredictability of a Trump presidency.

Mismatch in expectation

Relations between the People's Republic of China (PRC) and Taiwan changed significantly when the leader of the Democratic Progressive Party (DPP) Tsai Ing-wen took over as president from the Kuomintang's Ma Ying-jeou in May 2016. However, focusing on Tsai as the cause for this change is misguided. In the foreseeable future she will not pursue a policy to assert *de jure* independence in Taiwan or proactively pick quarrels with Beijing. Her immediate priority is confronting formidable domestic challenges – from the rise of populism against the establishment, to implementing social and transitional justice reforms, to the need to deliver perceptible improvement in living standards and opportunities for citizens through growth and higher wages. Her administration will prosper or flounder over these issues. She also knows that as president she needs to keep cross-Strait relations on an even keel. Tsai will try to maintain a good but balanced relationship with the PRC – not bending over backwards in order to improve ties with Beijing, but not deliberately crossing or stepping on any of Beijing's redlines either.

Despite Tsai's policy to maintain a good working relationship with Beijing, she will continue to be deemed unfriendly and unreliable by Chinese leaders and officials. The fact that she is a leader of the 'independence-minded' DPP and was a key adviser on mainland policy to former president Lee Teng-hui during the introduction of the 'special state-to-state relationship' policy will make her,

from Beijing's perspective, an untrustworthy leader of Taiwan. The fact that she has not openly embraced the 1992 Consensus⁹ as defined by Beijing, means that it will continue to be suspicious of her intentions. This is notwithstanding the fact that, since assuming office as president, Tsai has openly acknowledged the existence of an arrangement made in 1992 for the two sides to reach an understanding that there is 'one China', without agreeing to what exactly this means. While the difference between the two may seem like splitting hairs, from the perspective of the PRC government, public acceptance by Tsai of the 1992 Consensus is a basic requirement to enable the two sides of the Taiwan Strait to maintain good relations.¹⁰ However, in order to maintain support from the full spectrum of the DPP political base, Tsai cannot acquiesce to this. This mismatch will remain for the rest of Tsai's presidency until 2020.

Tsai's hands are tied

Beijing's inherent suspicion of Tsai leaves her much less room to manoeuvre than her predecessor Ma Ying-jeou. This has been exacerbated in light of Xi's rising self-confidence and a desire to see one China recognized more widely. In practice this means that even when Tsai implements a policy that is calculated to show her government's commitment to not distancing Taiwan any further from the mainland, her actions will not gain much credit in Beijing.

This applies, for instance, to Taipei's position in response to the Permanent Court of Arbitration ruling over the South China Sea maritime disputes brought by the Philippines and issued in July 2016.¹¹ Tsai largely adhered to the general position of her Kuomintang predecessor, in effect supporting the Chinese 'historic' claims in the South China Sea based on the 'nine-dash line' even though they were dismissed by the court ruling. Significantly, such an approach goes against Taiwan's efforts to reach out to the wider world and to project itself as a rule-abiding, responsible member of the international community. Taiwan could have stayed out of the controversy and simply announced that, as a matter of principle, it could not accept the Permanent Court of Arbitration ruling that Taiping/Itu Aba is not an island as it was not allowed to be properly involved and represented in the process leading to the ruling. Taiping/Itu Aba is of no strategic significance to Taiwan but it would be of considerable value in securing fishing rights if it were accepted as an island entitled to territorial waters and an exclusive economic zone. The position of the Tsai administration, which affirmed its claims in line with the 'nine-dash line' would have been seen as a significantly more friendly move had it been made by Tsai's Kuomintang predecessor. As a result, it was approved of but not met with appreciation by Beijing. Although Tsai is likely to persist with the current policy on the South China Sea, there is little she can do about Beijing's mistrust of her without taking dramatic action of the sort that is guaranteed to lose her credibility and support from her own party. The prospect that Tsai will commit domestic political suicide in order to gain the trust of Beijing is negligible.

9 In 1992, Taipei and Beijing reached an understanding by which both governments would publicly say there was only one China while each retained the right to define 'one China'. In Taiwan this meant 'one China, different interpretations' whereas in the PRC it implied that the 'one China principle' would be respected by both sides. The '1992 consensus' was a term made popular by Su Chi, a senior Taiwanese minister of the Kuomintang, but has since been taken by Beijing to imply Taipei agreed to its interpretation.

10 As happened under Ma Ying-jeou's presidency (2008–16).

11 See Bill Hayton's section on China and the South China Sea on page 20.

While Beijing's policy is to wait and see how Tsai will approach cross-Strait relations, it also includes putting carefully calibrated pressure on her administration. It has already applied economic pressure by reducing the number of Chinese tourists to Taiwan. Beijing is, however, unlikely to push to the extent that cross-Strait economic ties and cooperation become seriously strained. The two economies remain complementary and highly integrated and policies to punish Taiwan economically usually also come at some cost to the mainland economy.

The slowdown in Chinese growth should restrain Beijing from applying too much economic pressure on Taiwan, particularly since the Tsai administration will avoid being 'provocative' towards Beijing. The Tsai administration, for its part, has tried and will continue to reduce Taiwan's economic dependence on the mainland by pursuing a policy of encouraging Taiwanese business to go south, reaching out to Southeast Asia and beyond for investment, manufacturing and trading opportunities. But Taiwanese businesses in mainland China will continue to make their investment and manufacturing decisions independently, based on a business case. Unless China's business environment deteriorates significantly for Taiwanese investors, such businesses as a group may become more cautious but will not disinvest from the mainland.

Chinese pressure on Taiwan will persist

The Chinese government will continue to put political pressure on Taipei, for example, by suspending cross-Strait exchanges and by encouraging other countries to inconvenience Taiwanese citizens, in an attempt to turn them and their families against Tsai. There have, for example, been a number of cases where Beijing has persuaded countries such as Kenya, Malaysia, Thailand and Cambodia to deport Taiwanese citizens arrested for minor offences to the PRC, instead of back to Taiwan. Beijing has also ended the 'diplomatic truce' in place during the Ma Ying-jeou presidency (2008–16). This process started after Beijing established diplomatic relations with Gambia in March 2016, having declined to respond to overtures from Gambia since it broke off relations with Taipei in 2013. The implication is that Beijing is likely to court Taiwan's 21 remaining diplomatic allies, entice them to abandon Taiwan and establish diplomatic relations with itself – the first of them being São Tomé and Príncipe. Beijing will almost certainly not try to entice all of them to abandon Taiwan at the same time; instead it is likely to do so through a process of erosion designed to generate the maximum sustained political heat for the Tsai administration. While such pressure will be deeply irritating and embarrassing for Tsai, it will be insufficient to force her to bend to Beijing's will.

Under Xi Jinping the Chinese government will not hesitate to take a robust position vis-à-vis Tsai but, to date, Taiwan has not been high on Xi's political agenda. Instead, Xi has focused on consolidating his and the Communist Party's control in China, and making his 'China dream' a reality, which involves economic rebalancing on the one hand and gaining international recognition on the other. Xi's reaffirmation of his anti-corruption drive, as part of a party-reconstruction effort, suggests that he will be fully preoccupied with these priorities in the foreseeable future, particularly in the run up to the 19th Communist Party National Congress in the late autumn of 2017. What cannot, however, be dismissed is that should Xi get into serious difficulties regarding his top priorities – and should a major economic slowdown divide the leadership of the Communist Party of China (CPC) and thus potentially put his and the party's political dominance in question – he

would seek a political distraction. In such a scenario, significantly increasing tension over Taiwan in order to galvanize both party and country to rally around him will be a tempting option. There is general consensus within the CPC and the general public that keeping Taiwan within the fold of China is a historic mission that all Chinese have a patriotic duty to support.

Will Tsai take a hard line towards Beijing?

It is an open question whether Tsai will follow in the footsteps of her DPP predecessor Chen Shui-bian in toughening her stance towards the PRC. When Chen became Taiwan's president in 2000 he also made a point of avoiding confrontation with the PRC. However, Beijing's refusal to respond to Chen's initial self-restraint later led to Chen pursuing a policy of small but incremental steps in asserting Taiwan's independent existence, just short of asserting full *de jure* independence. Tsai has demonstrated a greater commitment than Chen to avoid grandstanding gestures. She has, for example, instructed Taiwan's diplomatic corps not to lobby for membership at the United Nations, a course of action Chen chose and that irritated Beijing. But whether she will continue to hold the line if Beijing takes a more strident approach towards her and her administration in the next three years remains to be seen.

The election of Donald Trump as US president has heightened the possibility that Beijing may take a risk over Taiwan. Trump has no policy regarding Taiwan and his election has raised uncertainty over whether the long-standing commitment of US support under the Taiwan Relations Act might be changed. Taking a call from Tsai before his inauguration as US president did not imply a commitment to support Taiwan to assert *de jure* independence; it was a signal to Beijing that Trump intended to deal with China on his own terms. The prospect that some of his potential advisers on Asia, such as Randy Forbes, Richard Armitage and Randy Schriver, are pro-Taiwan needs to be balanced against his indifference to Taiwan's value as a democracy, as well as his tendency to speak without following the script prepared by his advisers. If Xi believes that Trump could be persuaded to do a deal over Taiwan, this could present a rare opportunity for Beijing to make the Taiwan Relations Act irrelevant and allow China to incorporate Taiwan without triggering a US intervention. It remains to be seen if this will come to pass. But the reality that Taiwan will have to live with the unpredictability of a Trump administration should reduce the chance of Tsai taking undue risks in cross-Strait relations.

6. China and the South China Sea

Bill Hayton, Associate Fellow

Summary

- China possesses a deep sense of entitlement to the South China Sea and ultimately seeks to occupy every land feature and dominate resource extraction within its U-shaped 'nine-dash line' claim.
- Chinese officials are attempting to fit this sense of entitlement within the structures of international law but face both practical problems and internal disagreements about the best way to do so.
- Other states – rival claimants to the South China Sea and others with strategic interests there – will seek to obstruct China's advances, creating ongoing tension in the region.

China's interests in the South China Sea

Although China's claim to the rocks and reefs of the South China Sea only emerged in the early twentieth century, the claim has been 'backdated' and officials routinely assert that the islets have been a part of China since 'ancient times'. As the claim developed in parallel with China's struggles against foreign powers it has been imbued with nationalistic feelings: 'restoring' the features to Chinese control has become part of the narrative of ending the 'national humiliation' inflicted upon China by the imperialists. This mission has been given new emphasis since Xi Jinping came to power in 2012.

The South China Sea has also come to be seen by Chinese strategists as a vital 'strategic space'. The 2015 iteration of China's published military strategy states 'the PLA Navy (PLAN) will gradually shift its focus from "offshore waters defense" to the combination of "offshore waters defense" with "open seas protection"'.¹² China's national prosperity depends upon the output of its coastal megacities and the trillions of dollars' worth of trade that crosses the sea. Preventing those cities and trade routes from being threatened by a potential adversary have become core missions of the Chinese navy, the PLAN. Control of the sea, or at least the denial of access to it, would also be a vital part of any operation to invade Taiwan. The deployment of China's ballistic missile submarine fleet at the Yulin naval base on the southern coast of the island province of Hainan, combined with the development of major facilities in the Paracel and Spratly islands since 2013, suggests that the PLAN is developing a 'bastion' for its nuclear deterrent. The purpose is to develop a secure manoeuvring space within the South China Sea, in which its nuclear submarines could be protected from the US Navy or any other potential adversary.

¹² The State Council Information Office of the People's Republic of China (2015), *China's Military Strategy*, <https://news.usni.org/2015/05/26/document-chinas-military-strategy> (accessed 22 Nov. 2016).

At the same time, a series of practical considerations have given various domestic lobbies within the Chinese political system reason to bolster the claim. Whether for reasons of state budget, bureaucratic prestige or commercial profit, the military, fishing interests, oil companies and coastal provinces all see benefits in maximizing and defending the claim. For many years Chinese fishing fleets have operated unsustainable practices in the South China Sea. Inshore waters have been overfished, forcing boats to sail further into disputed waters. Fishermen from the port of Tanmen (on Hainan) in particular have become notorious for over-exploiting the giant clams found on the reefs in the Paracel and Spratly archipelagos. These efforts have been encouraged and subsidized by provincial and central governments and protected by state agencies. There is no sign of this changing.

All of these factors – nationalism, the search for political legitimacy, security considerations and bureaucratic interests – motivate China's actions in the South China Sea. As they are unlikely to fade away, the political and strategic logic is for China to continue to push ahead with physical assertions of its territorial ambitions through deployments of mass fishing flotillas, stronger coastguard and naval patrols, and the continued construction of artificial islands.

Fitting a sense of entitlement with international law

In July 2016, an international arbitral tribunal fired a shot across the bows of China's ambitions in the South China Sea.¹³ The case, which was brought by the Philippine government, deliberately avoided questions of sovereignty. It did not attempt to resolve which country is the rightful owner of each rock and reef. Instead, it focused on maritime *entitlements*: what rights in the sea could be claimed from each feature.

The tribunal made two particularly significant rulings – firstly that none of the features in the southern part of the South China Sea are full islands in the legal sense and secondly that the 'U-shaped line', first published on an official Chinese map in 1948, could not be considered a valid claim to marine resources. The net effect was to rule that China's maritime claims could not legally extend beyond a series of circles of 12-nautical-mile radius, drawn around features above water at high tide.

These rulings, in the eyes of the tribunal, removed the basis for China's claims to resources in the vast majority of the South China Sea. China's response was intriguing. Its state media and officials lambasted the tribunal and accused its judges of bias. At the same time, however, it sought to quieten nationalist protest at home and avoided provocative actions out at sea. It also started to suggest new legal arguments upon which China could continue to claim rights to maritime resources around the Spratlys. These arguments have been dismissed by most non-Chinese legal experts but they do, nonetheless, suggest that China is attempting to fit its sense of entitlement within legal norms rather than outside them.

¹³ See Steve Tsang's section on China and Taiwan on page 16.

What appears significant is that China did not attack the legitimacy of the UN Convention on the Law of the Sea (UNCLOS) but instead, in various speeches and articles, sought to offer new interpretations of the convention that might support the Chinese position. This seems to be the latest phase in a process of attempting to fit China's historical claim into the limits of commonly-understood international law. It has not been successful so far – and the latest interpretations appear to be at odds with the text of UNCLOS – but the effort does suggest that China wishes to be seen to be working within the rules-based system of international maritime order.

This seems to reinforce the idea that China is in the process of building up its capacity in international law and attempting to adapt to its strictures. While each incremental step may not appear particularly significant there does appear to be a general direction of travel towards international acceptability. Taken together, these developments suggest that China's rise will not necessarily entail a wholesale challenge to international law but efforts to stretch it in ways that might give its actions at least a veneer of compliance.

Ongoing regional instability

Nonetheless China's past behaviour suggests that it will continue to push ahead with physical challenges to the status quo. The arbitral tribunal ruling is legally binding but is not supported by specific enforcement powers. It gives the Philippines the right to protect the resources in its Exclusive Economic Zone (EEZ) but the country does not possess sufficient coastguard or naval vessels to deter Chinese encroachments. An important question, therefore, is whether the Manila government will acquiesce if China violates the ruling or whether it will call upon its treaty ally, the US, to defend its armed forces if they face threats.

Credible reports¹⁴ from Washington suggest that the US did intervene on behalf of the Philippines during the first half of 2016. China was on the verge of constructing a military base on the previously unoccupied Scarborough Shoal before it was dissuaded from doing so by US military deployments and strong messaging from American diplomats. During 2016, the US Navy had three warships on more-or-less permanent 'sentry duty' in the South China Sea.¹⁵ A second question is how long this enhanced naval presence in the region can endure.

In the absence of US counter-pressure, it is likely that China will continue with its policy of 'salami slicing': taking small steps towards consolidating dominance over the South China Sea. This situation is likely to endure for the next few years at least. China will continue to try to change the status quo in various ways and this will provoke reactions from the Southeast Asian claimants, the US and other countries with an interest in freedom of navigation in the sea, notably Japan. While all governments understand that overt conflict could be disastrous for the region they will need to appear ready to risk such conflict in order to defend their interests. As a result there are likely to be frequent episodes of brinkmanship in the foreseeable future.

14 Cooper, Z. and Douglas, J. (2016), 'Successful Signaling At Scarborough Shoal?', warontherocks.com, 2 May 2016, <http://warontherocks.com/2016/05/successful-signaling-at-scarborough-shoal/>

15 Larter, D. B. (2016), 'This strike group made China nervous — even without an aircraft carrier', *Navy Times*, 17 November 2016, <https://www.navytimes.com/articles/this-strike-group-made-china-nervous-even-without-an-aircraft-carrier>.

China will also try to pursue its South China Sea interests diplomatically: attempting to persuade countries around the world to back its position in the disputes and continuing its efforts to divide the Association of Southeast Asian Nations (ASEAN) over the issue. Certain governments, notably Cambodia, have been willing to block ASEAN moves to take united positions on the maritime disputes in exchange for development aid and other incentives from Beijing. At the same time other powers – Japan and the US – have been working in the opposite direction. This internal disunity and great power competition is likely to have ‘spillover’ effects into other areas of regional cooperation.

Two new presidents

The victories of Rodrigo Duterte in the Philippine presidential elections and Donald Trump in the US are likely to prompt a new phase in the security dynamics of the South China Sea. In October 2016, President Duterte visited Beijing and shortly afterwards Chinese coastguard ships allowed Philippine boats to resume fishing at Scarborough Shoal. This move brings China closer to compliance with the arbitral tribunal's ruling. There were also reports of Philippine coastguard vessels operating there. At around the same time the Philippine government announced that it would no longer be taking part in joint naval exercises or patrols with the US navy. It appears that the Philippine and Chinese governments have reached a new accommodation about maritime security.

The election of President Trump and early comments by his advisory team suggest that the new US administration intends to take a more muscular approach to naval security in the region. There has been discussion of both enlarging the navy and taking a more ‘hawkish’ approach to China. This raises the possibility that the US could be seen to be taking a more confrontational position in the South China Sea at the same time as Southeast Asian governments are seeking more conciliatory options. This disconnect could undermine the US's overall approach.

It is important to note that there has not been a major confrontation between Chinese forces and those of its Southeast Asian neighbours since the HS981 oilrig crisis of May–June 2014. There has been no attempt to drill for oil on the ‘wrong’ side of notional ‘halfway’ lines between the various claimants. Fishing boats, on the other hand have continued to operate in other states' claimed EEZs. Their activities are the most likely source of ongoing violations of the arbitral tribunal's ruling.

In the past decade, there have been confrontations in both the South and East China seas – but not at the same time. When tensions have increased in one theatre they have decreased in the other. During 2016, despite a few high profile events, there were far fewer incidents involving Chinese vessels in the South China Sea than there were in the East China Sea. This may change, however.

Belt and Road

To date, China has been particularly unsuccessful in promoting maritime cooperation with its Southeast Asian neighbours. The US\$500 million ‘China–ASEAN Maritime Cooperation Fund’ announced in 2011 is almost entirely unspent. The ‘2015/16 Year of China–ASEAN Maritime

Cooperation' was equally ineffective. While there are commercial joint ventures underway – notably between ports in Malaysia and Chinese companies – the idea of a 'Maritime Silk Road' seamlessly integrating ASEAN with China is still far away. Chinese investment in Southeast Asia is certainly growing, as is two-way trade. However, it's not clear that this is a result of the Belt and Road Initiative or simply greater efforts by Chinese companies to try and find profit opportunities away from their slowing domestic markets.

Conclusions

The South China Sea is likely to remain an arena of competition between China and Southeast Asia and between China and outside powers for some time. There will be ongoing episodes of instability and crisis but all sides will work to keep the tension within manageable limits.

There is an urgent need for a political solution, not least to preserve the region's fish stocks. If the South China Sea fisheries continue to decline at the current rate, it is likely that millions of people around its coasts will face hunger and the destruction of their economic livelihoods. The territorial disputes are preventing governments from reaching agreement on measures necessary to research the state of those stocks and control overfishing.

There is a reasonable solution to the disputes in plain sight: all the regional claimants should agree to a *de facto* recognition of the existing territorial occupations and to the applicability of UNCLOS to govern maritime disputes between them. These two steps may be politically painful but they will be equally difficult for all the claimants and may therefore represent the 'least painful' option.

The July 2016 tribunal ruling greatly clarified the legal situation in the South China Sea. It is critical for both the integrity of international law and for regional stability that all members of the international community understand, uphold and defend the importance of the ruling. The UK government recently suffered an unwelcome ruling from the Permanent Court of Arbitration (in a dispute with Mauritius over fishing entitlements near Diego Garcia) but has taken steps to comply with it. This 'good example' should be communicated to governments in the region to demonstrate that even powerful countries need to abide by the rule of law. This principle will become increasingly important to maintain as the world moves into the Trump era.

7. China and North Korea

Jim Hoare, Associate Fellow

Summary

- China's relationship with North Korea is long and complex. Chinese support is unlikely to be withdrawn but it may be tempered. The current generation of leaders in both countries do not share the personal relationships of the past but the ties go beyond individuals.
- The Chinese see the present problem as one created by the US and the decision to end the 1994 Agreed Framework, coupled with an unwillingness to engage on both sides. From China's perspective, it alone cannot solve this impasse. It has tried without success to bring the two sides together via the six-party talks, a format it would be willing to revive, but believes that the US must take the initiative.
- The election of Donald Trump and the uncertainties as to what his North Korean policy will be will have increased Chinese concerns about the long-term stability of the Korean peninsula.
- **For the UK:** this is not likely to be an issue on which the UK can bring much to bear. Other international concerns are likely to be more important. China will not see Britain as an independent actor and it will expect the UK to support the US position at the UN and more generally. In addition, despite British diplomatic links with the DPRK, China does not consider there to be any particularly special UK–DPRK links that would allow the UK to play a role. For its part, the US has shown little disposition to use British diplomatic links with North Korea to any great extent.

The past and the present

The Chinese–Korean relationship is a complex one of historical importance to the Chinese and both Koreas. It is also a relationship in which geography has played a major role. Compared with the vast expanse of China, the Korean peninsula is a small appendage hanging onto the end of the Eurasian landmass. This proximity led to fruitful exchanges. Korean culture, politics and society were heavily influenced by China, although the traffic was by no means one way. At the same time, the relationship has been a source of tension between the two. To protect China's interests, successive rulers tried to keep Korea within the Chinese world order. The Koreans usually acquiesced, but they would also periodically assert their independence. The resulting political paradox was that Korea, historically, was both independent of and subordinate to its larger neighbour. The issue seemed to be settled in 1894–95 when China's intervention in Korean affairs led to its defeat by Japan. Korea formally asserted its independence, which lasted a mere 10 years before the country became first a protectorate and then a colony of Japan.

The close links between China and Korea continued through the colonial period. Koreans fought on both sides of the Chinese civil war, and Koreans fought with the Chinese against Japan. The defeat

of Japan in 1945, the subsequent division of Korea, and the Communist Party of China (CPC) victory in 1949 complicated the Chinese–Korean relationship. South Korea was cut off from its traditional links but North Korea was not. New links developed and when North Korea's very existence was threatened in late 1950, China's new rulers intervened as their imperial predecessors had done, saving the country and its ruling regime. The North Koreans argue that this was done because Chinese interests were threatened as UN forces advanced towards the Chinese border, not out of real concern for North Korea, and that Chinese interests also prevailed at the 1954 Geneva Conference, which left Korea divided.

A vague understanding of this historical and geographical background has led many in the West to the assumption that the Chinese have power and influence over North Korea. It is a short leap of logic to argue that the Chinese should be willing to use that power to persuade or force North Korea to conform to 'international standards'. This position has become more prevalent since the emergence of the North Korean nuclear programme in the late 1980s. But while there is evidence that the Chinese will pressure North Korea if they believe Chinese interests are at stake, they also know that the North Koreans resent such interference and that it may prove counterproductive. The Chinese may not welcome the spread of nuclear weapons in East Asia, but they believe that what is needed to deal with the North Korean issue is US direct engagement.

Generational change

The first generation of communist Chinese leaders and their Korean counterparts had direct links. Mao Zedong's eldest son died fighting in the Korean War, while North Korea's founder, Kim Il Sung, spent much of his youth in China's northeast, then under Japanese control, and was a member of the CPC before he was a member of what became the Korean Workers' Party. Kim Il Sung's eldest son and successor, Kim Jong Il and his sister, were sent to China in the early stages of the Korean War. Personal links also existed among the military of the two countries. But such links have steadily grown weaker as generations changed. Perhaps the last time they really functioned was in the 1980s but even then the North Koreans were hostile to China's path to economic and political development. North Korean hopes were raised in 1989 by the suppression of the Tiananmen demonstrations but quickly fell as Deng Xiaoping asserted the primacy of economic reform. In addition, the Chinese decisions to end favourable economic terms for North Korea in 1991 and then establish diplomatic relations with South Korea were severe shocks for North Korea and damaged links with China. After 1994, Kim Jong Il's attitude waxed and waned but he was never as close to the Chinese as his father had been. As for the current leader, Kim Jong Un, he not only lacks the direct links of his father and grandfather but he appears suspicious of Chinese involvement. It has been suggested that one of the reasons for the dismissal and execution, in 2013, of his uncle by marriage, Jang Song Thaek, was his links with China.

Chinese caution

China can and sometimes will act to restrain its neighbour but usually only when it is in its own interests to do so. As a result, it has more recently allowed think-tanks and the media to engage in some discussion of possible options for dealing with North Korea, an area traditionally considered politically sensitive. Those who seize on such developments as a sign that China is ready to abandon

support for North Korea are likely to be disappointed. An antagonistic North Korea is something that China can do without. With a large Korean community on the Chinese side of the border with widespread links to North Korea, China has to be careful. There are also economic links between North Korea that may seem small by global standards but are important locally. The nuclear issue and related missile development do concern China but its leaders believe that it was the US that created the current crisis by abandoning the 1994 Agreed Framework and that it is only the US that can resolve the problem.¹⁶ The Chinese strongly believe that they have been helpful, particularly in convening the six-party talks in 2003 involving Russia, China, North Korea, South Korea, Japan and the US. While they have signed up to the latest sanctions, an overzealous implementation of them is unlikely. Exasperation with the current North Korean leadership led to an initial endorsement – but it may not last.

Then there is the wider question of Sino–US relations. Tensions over the South China Sea, Taiwan and other issues make China less willing to cooperate with the US on North Korea. This is unlikely to change under the Trump administration. Rather, new tensions over trade and investment seem highly likely.

Britain's role

Britain's role in the North Korean issue is minimal and will remain so. Neither China, the US nor North Korea have ever shown any interest in a British role. While traditionally close to the US, post-Brexit, the UK has come to look upon China as a potential greater economic partner in the future, and is therefore unlikely to want to antagonize it over North Korea. Like the other nuclear weapon states, Britain has been firmly against proliferation and has condemned the North Korean programme from the beginning. British politicians have occasionally justified the UK's continued possession of nuclear weapons by citing the nuclear threat that the North Korean programme might pose. This seems far-fetched. The North Korean preoccupation is with the US and with neighbouring countries, such as Japan and South Korea, not with Europe. Back in 2000–02 the North Koreans hoped that Britain might be a counterweight to the US, but that view has long since gone. Although Britain has diplomatic relations with North Korea and has a resident embassy in the country, trade and aid are both very small and are unlikely to develop in the current climate.

¹⁶ See Zhen, L. and Zhuang P (2016), 'We won't tolerate instability: Beijing's warning to Washington and Pyongyang', *South China Morning Post*, 8 March 2016, <http://www.scmp.com/news/china/diplomacy-defence/article/1922570/we-wont-tolerate-instability-beijings-warning> (accessed 13 Jan. 2017).

8. Sino–Japanese Relations

John Nilsson-Wright, Senior Research Fellow

Summary

- Despite a history of mutually beneficial bilateral ties since 1972, there has been a recent sharp deterioration in bilateral relations between China and Japan.
- These tensions are the result of five factors:
 1. Changing relative economic power and the legacy of two decades of stagnant economic development in Japan;
 2. Personality politics and the emergence of new, assertive leaders in both Japan and China;
 3. Geopolitical and geoeconomic rivalry and the challenges to regional and global order associated with ‘China’s rise’;
 4. China’s growing military assertiveness in the South and East China seas and the increased risk of bilateral conflict over competing territorial claims; and
 5. The growing salience of identity politics in both China and Japan and a perceived trend towards historical revisionism in Japan.

Relations between the People’s Republic of China (PRC) and Japan have, for much of the period since 1949, been characterized by pragmatic engagement and a cultural affinity that has often overcome potentially sharp ideological and strategic differences. In the context of the Cold War, it might have been expected that Japan’s alliance dependency on the US, as well as the bitter legacy of the Pacific War, would have kept the two countries estranged from one another. Privately, however, Japanese leaders, on both the left and right of the political spectrum, were eager to develop a working relationship with Beijing.

War guilt, admiration for China’s success as one of the first Asian countries to successfully throw off the yoke of Western colonialism, and strong cultural commonalities highlighted by the Japanese phrase ‘*dobun doshu*’ (‘same script, same race’) encouraged many in Japan to hope for a post-war rapprochement with the PRC. At the elite level, pragmatic economically focused politicians, such as Prime Minister Shigeru Yoshida in the early 1950s, looked to the future growth of the Chinese market as an opportunity for private sector trade and investment cooperation. Growing economic engagement throughout the 1970s, helped by limited liberalization in China under Deng Xiaoping, also ushered in stronger bilateral ties, including substantial levels of overseas development assistance to China from Japan. By 1990, in the aftermath of the Tiananmen Square incident, Japan was one of the few Western countries to argue in favour of continued engagement with the PRC rather than diplomatic isolation and economic sanctions.

It is against this history of mutually beneficial bilateral ties that the recent sharp deterioration in bilateral relations stands out. Current public opinion polls in both countries exhibit mutual distrust and high levels of antipathy with some 80–90 per cent of respondents on both sides routinely reporting their dislike and fear of each other. These bilateral tensions are the result of a combination of five factors: changing economic power; personality politics; geopolitical and geoeconomic rivalry; China's growing military assertiveness; and the growing salience of identity politics in both countries.

Economic interdependence

As respectively the world's second and third largest economies, China and Japan could be considered natural, complementary partners. Geographical proximity, the offshore production strategies of Japanese manufacturers eager to take advantage of relatively low labour costs in China, and the Chinese economic boom, all ensured that China would eclipse the US as Japan's leading trade partner, with Sino–Japanese trade reaching US\$340 billion in 2014.¹⁷ For China, Japan has become its second most important trade partner after the US, while Japan has also become the biggest provider of foreign investment in China, contributing some US\$100 billion in 2014.¹⁸

In times of prosperity it had been assumed that this 'hot economic' relationship would compensate for strategic tensions – the 'cold political' aspects of the bilateral relationship. However, it is not clear that economic interdependence has helped to materially rein in political tensions. Indeed, popular Chinese demonstrations against Japanese businesses, prompted by historical and territorial disputes, have had a dampening effect on Japanese investment in China. In 2015, Japanese investment in the Chinese economy fell by some 25 per cent, and with the recent slowdown of the Chinese economy, there has been a marked decline in Japanese corporate confidence in the long-term future of the Chinese economy.

According to a joint CSIS/Nikkei 2016 survey, out of a sample of 3,000 Japanese businessmen, 55 per cent supported cutting back on Japanese commercial activity in China; 37 per cent argued for keeping operations unchanged, and a mere 8 per cent argued in favour of greater exposure.¹⁹ There are signs that Japanese businesses are diversifying their direct investment activity away from China towards Southeast Asia, to take advantage of lower labour costs, and while the China market will remain important to Japanese firms over the next five years, slowing growth in China and the absence of clear economic recovery in Japan are likely to limit the positive gains associated with a closer, interdependent economic relationship.

¹⁷ Bajpae, B. (2016), 'Japan and China: the Geo-economic Dimension', *The Diplomat*, 28 March 2016, <http://thediplomat.com/2016/03/japan-and-china-the-geo-economic-dimension/> (accessed 16 Jan. 2017).

¹⁸ Ibid.

¹⁹ CSIS-Nikkei Virtual Think-tank (2016), *Survey on Japan-China relations in 2016*, http://www.csis-nikkei.com/doc/japan_china_survey_summary_3rd_en.pdf.

Leadership tensions

Both China and Japan have assertive leaders, with little significant political opposition at home, who have consolidated their authority and are likely to remain in power for the foreseeable future. Thanks to Communist Party of China (CPC) rule changes in October 2016, Xi Jinping's 'core' leadership role has been strengthened and there is an expectation that he may be able to extend his time in office beyond the traditional 10-year limit. In Japan, the governing Liberal Democratic Party (LDP) has approved a new measure to allow the party presidency to be held for three, rather than the customary two, three-year terms. As a result Shinzo Abe, barring any major political crises, has a good chance of staying in power until 2021, giving him opportunities to pursue a major reform agenda, embracing not only his signature 'Abenomics' programme, but also a proactive foreign and defence policy, and domestically contentious policy of constitutional revision.

Since his election as prime minister in 2012, Abe has taken the lead in soliciting direct meetings with his Chinese counterpart, but Xi has kept his distance, agreeing to formal bilateral meetings on only three occasions. In each instance, the optics of the meetings have been carefully staged by the Chinese side to reinforce in the eyes of the Chinese public a distinctly hierarchical relationship in which Japan has been portrayed as a supplicant and subordinate interlocutor rather than an equal, sovereign state. Xi may periodically adopt a pragmatic approach towards Japan, but he is likely (as has been the case with past Chinese leaders) to continue to use domestic anti-Japanese sentiment to enhance his legitimacy.

Geopolitical and geoeconomic rivalry

Japanese anxieties about China are rooted in the belief that Xi's more assertive foreign policy is intended to challenge the US-led liberal-democratic order. The clearest expression of this challenge has been China's rejection of international efforts to mediate territorial disputes (such as Beijing's dismissal of the July 2016 Permanent Court of Arbitration tribunal ruling on the South China Sea), and the establishment in December 2015 of the Asian Infrastructure Investment Bank (AIIB). Japan views the AIIB as an attempt by China to establish its geoeconomic dominance by promoting, together with its Belt and Road Initiative, major infrastructure spending across Eurasia. The Abe administration has refused to join the AIIB and criticized it for its lack of transparency.

In response, the Abe administration has boosted its contributions to the Asian Development Bank (ADB) – an institution in which Japan, as the largest financial contributor, has occupied the presidency since its establishment in 1966. Additionally, in 2015, Japan launched a US\$110 billion initiative to support a range of Asian infrastructure projects as a way of offsetting China's growing development influence.

Japanese officials have also engaged in high profile public diplomacy initiatives, repeatedly criticizing Chinese efforts to undermine the rule of law, while also re-energizing Japan's long-standing campaign to secure a permanent seat in a restructured UN Security Council. Tokyo has also invested considerable political and diplomatic capital in promoting new initiatives, such as the Trans Pacific Partnership (TPP) – as much politically motivated as it is an economic initiative, given that it excludes China.

Allied to these initiatives have been separate bilateral efforts to counterbalance against China by cultivating a number of regional players, including the leaders of India, Russia, South Korea, the Philippines and Kazakhstan. Beyond Asia, Japan, through the Tokyo International Conference on African Development (TICAD) process, has announced a new ambitious US\$30 billion public and private sector investment campaign to offset China's own US\$60 billion African development campaign.

It is not clear how successful the Japanese response is likely to be. AIIB's membership stands at 57 and continues to grow; China as a P5 member is likely to veto any attempt by Japan to join a reformed UN Security Council; TPP, in the wake of Donald Trump's election, looks either dead or a much diminished version of itself and likely to be replaced by a new effort to promote the Regional Comprehensive Economic Partnership (RCEP), of which China is already a member. Moreover, Asian leaders, whether India's Modi, Myanmar's Aung Sang Suu Kyi, or most strikingly of all, Duterte in the Philippines, are unlikely to gravitate towards Tokyo, preferring instead to keep their options open by hedging with Beijing, rather than aligning with Japan. If anything, we should expect more tension between China and Japan as the opportunities for institutional, geopolitical and geoeconomic rivalry increase.

Military and territorial disputes

Increased risk of military conflict between Japan and China is arguably the most challenging aspect of the bilateral relationship. This is partly the result of the new assertiveness and confidence of both countries and their leaders: in Japan, this has been couched as a new doctrine of 'proactive contributions to peace'; for China, the focus has been on protecting its 'core interests', while promoting Asian values and a new security framework in East Asia. This has been reflected in the increase in defence spending by both countries.²⁰

For China, increased defence spending is intended to bolster its maritime presence in Asia. In response, over the last decade Japan has shifted its military strategy away from a focus on the Cold War era threat to its northern territories from the Soviet Union, to developing more flexible defence capabilities that address new threats to its interests in Southeast Asia. Since the drafting of Japan's first national security strategy in 2013, the country has been increasingly explicit in identifying China as a key security threat.

Japanese defence planners are worried by the recent marked increase in maritime and air-based incursions by Chinese vessels and planes into Japanese territorial waters surrounding the contested Senkaku/Diaoyu Islands. A similarly acrimonious source of contention in the East China Sea has been the Chinese decision, in October 2016, to begin operating two new gas fields, close to the Japan–China median line – actions that Tokyo views as violating a 2008 bilateral accord on peaceful joint development of gas fields in the contested waters.

²⁰ China's formal annual defence budget has increased from US\$20 billion in the early 1990s to some US\$145 billion in 2015; Japan's defence spending has steadily increased since 2012 under Prime Minister Abe to some US\$40 billion in 2015; *Guardian* (2016), 'China to increase defence spending by 7-8% in 2016 – official', 4 March 2016, <https://www.theguardian.com/world/2016/mar/04/china-to-increase-defence-spending-by-7-8-in-2016-official> (accessed 16 Jan. 2017); Gady, F. S. (2015), 'Japan approves record defence budget', *The Diplomat*, 28 December 2015, <http://thediplomat.com/2015/12/japan-approves-record-defense-budget/> (accessed 16 Jan. 2017).

In the South China Sea, while Japan is not a direct party to or a claimant in any of the regional territorial disputes, the Abe administration has been critical of China's large-scale reclamation efforts and Beijing's assertion of its claim to all territories falling within the contested 'nine-dash line'.

Japan's efforts to combat these challenges have involved a reemphasis of the importance of the rule of law and rejection of unilateral action on the part of China, including Beijing's November 2013 surprise announcement of its exclusive Air Defence Identification Zone (ADIZ) in the East China Sea.

Tokyo has also sought to broaden its security options beyond its traditional reliance on the US–Japan alliance. This has included new strategic partnerships with India and Australia dating from 2006 and 2007 – including the concept of a 'Democracy–Security Diamond' consisting of Japan, India, Australia and the US, briefly promoted in 2013 – and also important new military hardware, training and defence assistance deals with key Southeast Asian states most exposed to tension with China, particularly Vietnam and the Philippines.

China is likely to remain concerned by Japan's efforts in this context, whether via closer operational alignment with the US (through the recently revised US–Japan defence guidelines), a new intelligence sharing partnership with South Korea, or continuing Japanese participation in joint military exercises in East Asia. The Abe administration's passage of important new security legislation, in September 2015, which enhanced the ability of the Self-Defense Forces to participate in a much broader range of collective self-defence activities, is a material demonstration of Japan's more proactive approach.

Looking ahead over the next five years, the main threat to regional security involving China and Japan is less tied to any of the regional actors intentionally provoking a crisis, and more likely to arise from misperception or inaccurate information. Under the Obama administration, the US has sought to provide reassurance, for example, using its military presence in the South China Sea to deter further Chinese territorial encroachment. However, a Trump-led US administration *may* break from this policy of reassurance by adopting a more assertive posture, raising in turn the risk of escalation. A key way of offsetting these and related risks is the promotion of improved confidence-building measures, including a maritime and air communication mechanism between Japan and China. The latter has been under discussion since June 2012, but has yet to be agreed. Its absence highlights both the limits to bilateral dialogue but also an important area where both Beijing and Tokyo could do more to enhance regional security.

Identity politics

Among some of China's Japan watchers, there are concerns of a sharp rightward turn in Japanese politics, reflected in the growth of nationalist organizations with an explicit revisionist agenda, such as 'Nippon Kaigi'; an arguably more restrictive media environment involving the periodic marginalization of progressive voices; and the pressure for constitutional revision spearheaded by Abe and other conservative politicians. However, offsetting such opinions are the views of prominent politicians, such as former prime minister Yasuo Fukuda, and Natsuo Yamaguchi, the

leader of Komeito, who have long argued for a constructive relationship with China and often act as an informal conduit for private and semi-official dialogue between Tokyo and Beijing.

Abe himself has been careful in handling sensitive historical issues, avoiding visiting (except in December 2013) the contentious Yasukuni shrine and using his public remarks on the 50th anniversary of the end of the Second World War to reiterate past apologies of Japanese prime ministers for Japan's wartime excesses.

If anything, Japan's official approach towards China is more pragmatic and inspired by a traditional realist agenda of protecting the national interest than it is motivated by ideological concerns. Moreover, Japanese public opinion, while concerned by China, is focused primarily on conventional economic issues. From the perspective of political self-interest and electoral politics, Prime Minister Abe is more likely to focus, at least in the short term, on securing economic prosperity rather than on divisive identity politics (a lesson he learnt from his first term as prime minister in 2006–07). This explains his call for improved bilateral ties following his meeting with Xi Jinping on the side lines of the APEC summit in Lima, on 20 November 2016.

Abe has been looking ahead to 2017 and the 45th anniversary of Sino–Japanese normalization, as well as to 2018 and the 40th anniversary of the Sino–Japan Peace and Friendship Treaty, to make the case for renewed dialogue and cooperation. Whether this overture will be welcomed by the Chinese and is sufficient to offset some of the more contentious and intractable aspects of the bilateral relationship remains to be seen.

Implications for the UK

Continuing Sino–Japanese tensions are likely to mean that the Abe administration will continue to lobby the UK government to adopt a more explicitly critical approach to China, especially on territorial disputes in the East and South China seas, human rights and the importance of upholding the rule of law. From Tokyo's perspective, Britain's membership of the AIIB will continue to rankle and Japan may be tempted to use its economic relationship with the UK (particularly its investment presence) to request the UK be more combative towards China, especially if a future Trump administration adopts a similarly confrontational posture towards Beijing. The danger for the UK is that with its international influence diminished post-Brexit, its leverage both with China and Japan will be severely limited and it may have little choice but to become less engaged in geopolitics, particularly in East Asia.

9. Sino–Russian Relations

Nigel Gould-Davies, Associate Fellow

Summary

- China's inexorable rise and Russia's 'Asian pivot' have ushered in a new phase in relations between the two countries. As a result, they are closer now than they have been for many decades.
- However, the foundations of common interest remain limited. Trade, especially in regard to energy, is the most significant area of cooperation, though this could also prove a source of friction if the two countries' different concepts of regional integration prove incompatible. At present they remain more focused on relations with the West than with each other.
- A Trump presidency creates major new uncertainties regarding the impact of US policy on Sino–Russian relations. American accommodation with Russia and confrontation with China could have the effect of strengthening the Sino–Russian relationship.

Relations between Russia and China, the biggest countries by territory and population, are globally significant. During the Cold War, their volatile relationship ranged from close ideological alliance in the 1950s to extreme hostility and border clashes barely a decade later. This shifting alignment shaped Western security policy: in particular, the US fashioned its strategy of *détente* on the fulcrum of the Sino–Soviet split.

Today, Sino–Russian relations are entering a new phase. Ties are closer and atmospherics warmer than for many decades. Xi Jinping has met President Putin more often than he has any other foreign leader. In 2013, his first visit abroad after being appointed president was to Moscow. The two leaders have since developed a strong personal rapport.

Two forces are driving these countries towards each other. The first is China's inexorable rise. Growing power and greater assertiveness pose new questions and options for China's relations with its giant neighbour, both for the bilateral relationship itself and how it fits into China's dealings with other nations. However, the more significant impetus for an improvement in relations has come from Russia. From early in Putin's third presidential term in 2012, and especially since the Ukraine crisis in early 2014, the collapse in Russia's relations with the West has impelled it to conduct an 'Asian pivot'. Above all this means a closer relationship with China. There are three key areas of cooperation: trade, security and values.

The promise of trade

Trade is the clearest area of cooperation between the two countries. A 2,600-mile border between two large economies should offer abundant opportunities for trade and investment. President Putin has made development of the Russian Far East – an area covering 36 per cent of the country's

territory but making up only 4 per cent of its GDP – a strategic priority. Russia's role as the biggest global oil and gas producer and China's rampant demand mean the energy aspect of the Sino–Russian relationship has grown significantly. Russia has made major new supply commitments, and recently allowed Chinese companies to buy stakes in energy projects having long resisted doing so. Two recent mega-deals symbolize this intimate relationship. In May 2014, at the end of a state visit to China, Putin signed a 38 billion cubic metres per annum gas supply agreement valued, at the time, at US\$400 billion. Then, in April 2016, China extended US\$12 billion in loans to help finance the Yamal liquefied natural gas project in which Chinese companies have a 30 per cent stake.

But such cooperation has limits. Mutual understanding of business cultures and practices, while growing, remains limited. Chinese companies and officials remain frustrated by barriers, often related to corruption, to doing business in Russia, which is suffering its worst economic downturn since the 1990s. In regions that stand to benefit most, local attitudes to Chinese ties, and especially immigration, can be strong. Bilateral trade fell 28 per cent in 2015, mainly due to the collapse of commodity prices and rouble devaluation. Nor does the energy relationship carry wider political significance in the way Russia might have hoped: with current global market conditions of abundant supply and depressed prices, China has many other actual and potential sources of supply.

China is proving itself a tough and pragmatic economic partner. The 2014 gas deal was concluded, after years of negotiation, on price terms favourable to China. The Yamal loans were offered at an interest rate of Euribor plus 3.3 percentage points (compare this with the Euribor plus 0.9 percentage points European bank consortium loan to Gazprom in 2014). Russian experts understand that Chinese investment supports projects that promote China's interests but will not provide significant free capital of the kind currently restricted by Western sanctions.

Defence production and sales are a promising area of cooperation. China values Russia's expertise in avionics and other military technologies, as its recent purchase of Su-35 fighters attests. But here, too, Russia has concerns about Chinese reverse engineering for future domestic production. As China's own defence export industry grows it is increasingly competing with Russia for sales to other markets.

The balance of security

While defence cooperation is a matter of trade for Russia it is a matter of security for China. After Xi Jinping took part in the 2016 Moscow commemoration of the end of the Second World War there was some speculation that the broader security relationship could deepen. Both countries oppose US deployment of a Terminal High Altitude Area Defense (THAAD) system in South Korea. But few other security issues have led to such specific policy agreement. Rather, each has sought to strike a balance in its position on disputes involving the other: neither actively supporting – which would risk entanglement – nor needlessly antagonizing through inaction. For example, in the Ukraine crisis China expressed 'understanding' of Russia's annexation of Crimea in 2014 while declining to recognize Russia's sovereignty over it. In the South China Sea dispute, Russia has in turn decried 'international interference' but carefully avoided committing itself to China's position – while providing succour after the UNCLOS arbitral ruling against China by taking part in joint military drills in the region.

But this delicate balance may be tested where Russian and Chinese interests differ in relation to third parties. For example, Russia enjoys its best relationship, but China one of its most problematic, with Vietnam. Furthermore, China has in the past made its displeasure known over Russia's granting of recognition to Abkhazia and South Ossetia following the 2008 Russo–Georgia conflict – understandably, given its reluctance to see any erosion of the principle of territorial integrity, in light of its concerns over Taiwan and Tibet.

Common values

A third area of cooperation arises from similarities in the two countries' political systems. China and Russia are authoritarian and place a higher value on strong state sovereignty. They appear to be learning from one another in imposing restrictions on civil society, including the recent passage of laws tightening up restrictions on NGOs in both countries. They share an interest in limiting the spread of ideas of democratic accountability and human rights, and in resisting evolution of global norms and institutions that challenge the principle of 'non-interference in internal affairs'.

The two countries can coordinate their Security Council vetoes to block western initiatives. They are also sharing practices in monitoring, and tightening control of, cyberspace. Cooperation is for the most part negative in nature, based on resistance to change rather than the pursuit of shared goals, which limits what they can achieve together. Unlike the heyday of the Sino–Soviet alliance, the two countries do not seek to spread a coherent alternative ideological blueprint. Nor do they share a cultural heritage. Today, commonality of values, as of security interests, is a weak bond.

The geopolitics of regional integration

Ironically, the stronger shared interest of trade may prove a source of competition as well as cooperation. During a visit to Kazakhstan, in 2013, Xi Jinping announced plans for a 'new Silk Road' as part of China's grand, though still vague, Belt and Road Initiative to build international trade and infrastructure routes. As this develops it may complicate the Sino–Russian relationship in three ways.

First, Russia is watching the balance of influence in Central Asia carefully. China has already displaced Russia as the dominant trade partner in the region, and the unmatched largesse it can bring to infrastructure projects and other forms of assistance is attractive to local elites – though often not to public opinion harbouring deep visceral anxieties about Chinese encroachment. While speculation about Chinese designs on territories lost to Russia in previous centuries is much exaggerated, China's political influence could follow economic engagement in countries that Russia still considers part of its backyard.

Second, it remains unclear how China's ambitions will mesh with the Eurasian Economic Union, a more intrusive and less generous integration project. Presidents Putin and Xi have agreed in principle to harmonize these two approaches to regional cooperation, though it remains unclear how this will be achieved.

Third, China's fostering of infrastructure connectivity across the continent will improve transit to Europe, a major destination for its goods and investments. Premier Li Keqiang's eight-day tour of Eurasia in November 2016 pointed to the wider strategic interest this creates. His trip included a visit to Latvia – the first by any Chinese premier – to take part in a meeting with Central and Eastern European prime ministers. Many of these leaders are alarmed by Moscow's assertiveness following the annexation of Crimea. This is especially true of Latvia, an EU and NATO member state that, with its large Russian minority, is a potential flashpoint. Li's visit highlighted China's growing interest in European stability at a time when Russian actions undermine this.

While the Sino–Russian alignment is shaped by shared interests, it is also constrained by the other bilateral global relationships each has. For China, the developed West is an indispensable partner. Chinese and Western economies are deeply interdependent, and China prizes Western technology and education. Above all, China's global rise will require careful navigation of its relations with the West. Xi's vision of a 'new type of Great Power relations'²¹ is implicitly a 'G2' with the US in which Russia does not figure. China will seek to avoid choosing between the West and Russia. But if it has to, it is unlikely to sacrifice its interest in strong and effective relations with the West.

The US and European allies also remain the principal fixation for Russia. Although its 'Asian pivot' has been prompted by estrangement from the West, Russia's energies and activity remain focused there – preoccupied, even more than before, with combating Western values and influence, and securing control of geopolitical 'space' around it against perceived threats. Culturally and economically, too, Russian elites remain overwhelmingly Western oriented. Oligarchs have not made significant investments in China or sent their children to be educated there. Just by its presence the West has until now divided China and Russia more than it has united them.

A Trump Effect?

The election of Donald Trump as US president creates major new uncertainties in American foreign policy. Trump's campaign statements cast doubt on three post-war pillars of US strategy: multilateral security alliances, an open international economic order and a strong commitment to freedom and democratic values. Trump has also suggested reaching an accommodation with Russia and punishing China for alleged unfair currency and trading practices, and hinted at scaling back US commitments to European and Asian alliances.

It is too soon to know whether such statements will be translated into clear and consistent policies. But one possibility is that US policy will seek to improve relations with Russia, while aggravating them with China. This could strengthen the Sino–Russia relationship both by making it less likely that China would prioritize relations with the US over Russia, and by giving Russia greater freedom of action. In short, a more fluid international environment now poses two questions. The West needs to consider not only 'how will Sino–Russian relations affect Western interests?' but 'how will US policy affect Sino-Russian relations?'

21 Zeng, J. and Breslin, S. (2016), 'China's "new type of Great Power relations": a G2 with Chinese characteristics?', *International Affairs* 92(4), <https://www.chathamhouse.org/publication/ia/china-s-new-type-great-power-relations-g2-chinese-characteristics> (accessed 10 Jan. 2017).

Conclusions

Three broad conclusions emerge. First, China and Russia share interests that are real but limited. They have different motives for the relationship and lack a common vision of how it should develop. Consequently, there is little instinctive understanding or significant degree of trust between them.

Second, whether Russia recognizes it or not, the relationship is inherently asymmetric. Russia is *demandeur*: it seeks a closer alignment more urgently than China does, but has relatively little to offer beyond greater access to raw materials. China enjoys many more options, and values Western relationships more highly to achieve its most important goals.

Third, their paths of development will diverge in ways that may weaken rather than strengthen prospects of a close alliance. China will continue its rise, whatever domestic uncertainties beset it, while Russia's apparent resurgence masks a longer-term decline stemming from dependence on raw material exports (including to China), failure to reform and adverse demographic trends. China's growing relative strength will sit uneasily with condescending Russian stereotypes of it. This could provoke an anxious and resentful reaction in Russia.

As in the past, Sino–Russian relations have wider implications. The West should pay attention to how they develop and avoid clumsy policies that could drive the two countries closer together. But the West should also be sceptical of any self-serving warning that a failure to accommodate either of them will lead to a stronger anti-Western alliance. In particular, China is not a 'card' to be played by Russia, but a pragmatic major power guided by its conception of national interest. It is therefore important that US policy does not now cause China to define those interests in ways that drive it into a genuine alliance with Russia.

10. India and China: A Complex Relationship

Gareth Price, Senior Research Fellow

Summary

- Long-standing border disputes will continue to hamper relations between India and China. But this does not mean that India and China will not interact economically or work together (at times in the face of Western opposition) if their national interests coincide.
- Under Prime Minister Narendra Modi this dual policy of competition and collaboration has intensified.
- **For the UK:** Attempting to balance closer relations with India and China, along with Pakistan, at the same time will prove immensely challenging.

Around 37 per cent of the global population live in China and India, now the world's largest and third largest economies,²² respectively. The importance of both countries on the international stage has risen dramatically over the past couple of decades. However, whether their growing power will lead to greater competition or cooperation – or, as now, both at once – is far from clear.

The current relationship between India and China is often framed in terms of their historical links, but despite cultural and religious contacts – as well as some trade – the two countries have had little direct political interaction on account of Tibet lying between them. Tibet became part of the imperial agendas of Britain and Russia in the nineteenth century. While Tibet was not the main focus of this expansion of empire, its control by a weak China served the purposes of both Russia and Britain. However, China refused to recognize British attempts to demarcate the border, creating problems that have lingered until today.

In the early years after Indian Independence, relations between the two countries were positive. But border disputes soon dominated the relationship. Occasional border skirmishes occurred throughout the 1950s and, in 1962, China invaded northeast India and Ladakh, before declaring a unilateral ceasefire and withdrawing behind the contested border.

The war left a lasting legacy within India and relations have waxed and waned since. A number of confidence-building measures – including mutual troop reductions, regular meetings of local military commanders and advance notification of military exercises – were introduced in the 1990s, and border trade, which had stopped after the Sino–Indian War, resumed in 1992.

India imposed quantitative restrictions on Chinese imports until 2001; since then trade has risen dramatically, although it is tilted heavily in China's favour. Meanwhile, the border disputes remain

²² In terms of purchasing power parity, excluding the European Union.

an unresolved sore and occasional troop stand-offs have taken place in the Himalayan mountains. At the same time, India and China have cooperated in international groupings, such as BRICS, and in climate change negotiations.

The election of Narendra Modi in 2014 led to expectations of a more 'robust' Indian foreign policy towards China. Certainly, Modi has been keener than his predecessors on demonstrating closer relations between India and the US and its other Asian allies. However, Modi has also been more committed than his predecessors to enhance economic ties between India and China. If the pre-Modi period can be described as both competitive and cooperative, Modi's tenure thus far could be seen as a step up from that.

Growing economic ties

Both trade and investment links have increased dramatically over the past 15 years, although the bulk of the trade and investment flows from China to India. In 2014–15, India imported Chinese goods worth US\$60.4 billion. However, its exports to China stood at just US\$12 billion. The trade deficit, US\$48.4 billion, rose by one-third from the previous year. Overall trade fell marginally in 2015–16 but the trade deficit increased to US\$53 billion.²³

There have been long-standing concerns that the bulk of Indian exports have been low value-added raw materials, in particular iron ore. Indeed, one reason for the increased trade deficit in 2014–15 was the Indian crackdown in illegal mining.

However, despite concerns over the deficit, those engaged in trade with China are supportive of Sino–Indian relations. Furthermore, India's priority is economic growth rather than any particular foreign relationship. If India is to take advantage of its youthful population it will require sustained economic growth, and this in turn requires investment – both foreign direct investment and domestic investment in India's infrastructure. To achieve this, India seems increasingly willing to put security concerns to one side to attract Chinese investment. Furthermore, Chinese firms are as aware as any from the West that India is one of the few bright spots in an otherwise largely gloomy global economy. Investment in India by Chinese companies in 2015 was reported to have increased six-fold year-on-year to just under US\$900 million, most of this being small investments.²⁴ From June 2016 Chinese firms started buying larger companies in India and in the quarter beginning June 2016 Chinese investment surged to US\$2.3 billion.²⁵

²³ *The Economic Times* (2016), 'India's trade deficit with China jumps to \$53 billion in 2015-16', 1 August 2016, <http://economictimes.indiatimes.com/news/economy/foreign-trade/indias-trade-deficit-with-china-jumps-to-53-billion-in-2015-16/articleshow/53492853.cms>.

²⁴ *The Economic Times* (2016), 'Chinese investments in India increased by six times: Report', 24 May 2016 <http://economictimes.indiatimes.com/news/economy/foreign-trade/chinese-investments-in-india-increased-by-six-times-report/articleshow/52418055.cms>.

²⁵ Sunkara, K. (2016), 'Chinese investment in India shoots to \$2.3 bn in past 3 months against \$1.35 bn in 2000-16', 30 August 2016, <http://www.vccircle.com/news/economy/2016/08/30/chinese-investment-india-shoots-23-bn-past-3-months-against-135-bn-2000-16>

Lingering border disputes

The two countries have been unable to resolve their border disputes and the occasional troop standoffs that result. India's former foreign secretary, Shyam Saran, recently noted that, 'The expectation is not that problems will be solved, the expectation is that the two countries will make sure that relations don't fall off the cliff.'²⁶ Annual meetings in which both sides agree to disagree but decide to meet again the next year are as much as can be hoped for.

Since China recognized India's claim over Sikkim in 2003, there are only two major outstanding border disputes. India claims Aksai Chin, a 38,000-square-kilometre territory controlled by China since the 1950s. India's claim stems from the fact that Aksai Chin had been part of Ladakh, in turn part of the former state of Jammu and Kashmir, but the area was not demarcated during the colonial era. The road connecting Xinjiang and Tibet passes through Aksai Chin. China also appropriated the 58,000-square-kilometre Trans-Karakoram Tract in 1963. Pakistan gave this territory, which had formed part of Pakistani-administered Kashmir, to China, possibly to cement relations or in recognition that Pakistan would be unable to defend the region. India recognizes neither Aksai Chin nor the Trans-Karakoram Tract as Chinese territory.

China in turn claims that the northeast Indian state of Arunachal Pradesh is part of China. Under the 1914 Simla Accord between British-run India and Tibet, Arunachal Pradesh (then the North East India Frontier Agency) formed part of India. However, China argues that the government of Tibet was not sovereign and thus did not have the right to conclude treaties. China's claim is based on Arunachal Pradesh previously having been part of Tibet.

There seems little likelihood of any final agreement on these issues. Occasionally a swap – whereby India accepts Chinese control of Aksai Chin in return for China accepting Indian control over Arunachal Pradesh – is mooted but neither country has displayed much interest in pursuing such a course of action. Aside from occasional nomads and officials, few people live in Aksai Chin or the Trans-Karakoram Tract. People do, however, live in Arunachal Pradesh. Part of India's strategy to defend Northeast India (invaded by the Chinese in 1962) was its under-development (in terms of infrastructure) as a means of making any potential invasion difficult. Over the past decade, this approach has changed, and infrastructure has been upgraded including road-building and the construction of military airfields.

International negotiations

In international forums, India and China have been happy to put political differences to one side and work together provided that both countries' national interests coincide. The Copenhagen Climate Change Conference of 2009 is a case in point. At the meeting, China's then premier Wen Jiabao met with India's prime minister, Manmohan Singh, and the countries put forward a position

²⁶ Kazmin, A. (2016), 'India and China reset links at key time', *Financial Times*, 14 August 2016, <https://www.ft.com/content/d6aaa68e-5fbb-11e6-ae3f-77baadeb1c93> (accessed 22 Nov. 2016).

paper, along with Brazil and South Africa, urging developed countries to fulfil their environmental commitments.

Similarly, the two countries worked through the G20 following the global financial crisis to promote reform of the international economic order. Partly in response to Western criticism of the BRICS' lack of institutions, the members established the New Development Bank as an alternative to the Bretton Woods institutions.

However, when national interests do not align, India has used international forums to express its displeasure at China. While the US and China ratified the Paris climate agreement in 2016, India's position is less clear. India is the third largest carbon emitter, behind the US and China, though its per capita emissions are much lower. Earlier in 2016, China had vetoed Indian membership of the Nuclear Suppliers' Group (NSG). Subsequently, India's foreign ministry declared that its application for NSG membership 'has acquired an immediacy in view of India's INDC envisaging 40 per cent non-fossil power generation capacity by 2030. An early positive decision by the NSG would have allowed us to move forward on the Paris Agreement.'²⁷

China, South Asia and the Indian Ocean

China's long-standing close relationship with Pakistan is an irritation to India. Chinese construction of infrastructure in Pakistan and elsewhere in South Asia or across the Indian Ocean raises concerns about future intentions. While India sees the benefit of regional connectivity, it is opposed to the China–Pakistan Economic Corridor (CPEC) on the grounds that it traverses the disputed territory of Kashmir. Modi's recent threat to campaign over human rights abuses in Balochistan highlighted ongoing insecurity in that province. Balochi nationalists have targeted, and even killed, some Chinese workers in the province. If Chinese workers cannot be protected, plans to develop infrastructure may not come to fruition.

Some Indians argue that rather than being reactive to Chinese infrastructure plans, India should develop its own initiatives, either to complement or to compete with China. One area of cooperation is a major regional infrastructure initiative: the Bangladesh, China, India, Myanmar Corridor.

There is some concern in India over possible future military use of the planned infrastructure, and by sporadic appearances of Chinese military in the Indian Ocean. For instance, in late 2014, a Chinese nuclear submarine appeared in the port of Colombo in Sri Lanka. Since then, India appears to have placed pressure on its neighbours (Pakistan aside) to limit military cooperation with China. Many of these neighbours, however, play China and India off against each other for their own economic benefit. Meanwhile, China frequently vetoes Indian attempts to get the UN to sanction Pakistan-based militant groups.

²⁷ Ayres, A. (2016), 'What does India's NSG bid have to do with the Paris Climate Accord?', *Forbes*, 9 September 2016, <http://www.forbes.com/sites/alyssaayres/2016/09/09/india-the-nuclear-suppliers-group-and-the-paris-climate-accord/#5a5904902221> (accessed 22 Nov. 2016).

India and the US

Generally, India's interest in China has not been reciprocated. Only by demonstrating closer ties between Delhi and Washington has India given China more reason to pay it attention. At the same time, China's relations with Pakistan have implications for Delhi. In the past, Pakistan's lenders of last resort were in the Gulf. But in recent years the relationship between Gulf states and Pakistan seems to have cooled. Pakistan's refusal to join Saudi and Emirati military action in Yemen – for understandable domestic reasons – was taken badly by the Gulf States. The fact that details of the proposed China–Pakistan Economic Corridor were published soon after suggests that China has in effect taken the role previously held by Saudi Arabia as Pakistan's lender of last resort.

This provides opportunities and threats to India. On the positive side, China's desire for 'stability' could play a positive role. In Afghanistan, for instance, the 2+2 peace talks (involving the US and China along with Pakistan and Afghanistan) provide a mechanism in which China's interests correlate with those of India.

Future threats

In the future, environmental issues are likely to play a greater role in the India–China relationship. Water resources are a particularly contentious issue. China's construction of dams on the upper reaches of the Brahmaputra (the Yarlung Tsangpo), along with a suggestion of diverting water from the river, have caused particular consternation in India.

There are arguments as to why Indian fears may be overblown. China has repeatedly said that the diversion scheme is not going to be implemented. Furthermore, the dams could be used to prevent floods downstream in India, and most of the water in the Brahmaputra comes from rainwater in India rather than China (although some of this rainfall is in the disputed state of Arunachal Pradesh). Data sharing between China and India regarding water levels – and thereby improving flood predictions – is increasing but India's ability to utilize this data and provide warnings to threatened populations downstream is limited. The potential impact of climate change – which many argue is already being seen – requires more data sharing and dialogue, between India, China and potentially Bangladesh over shared waters.

But along with the potential threat to water supply, the dam construction is symptomatic of a sense that the fates of China and India are intertwined as never before. Previously the Himalayas acted as a giant buffer between Indian and Chinese civilizations.

Another potential future threat revolves around the Dalai Lama and his succession. That the Dalai Lama is based in India has long been a cause of concern to China. While China frequently accuses the current Dalai Lama of fermenting unrest in Tibet, most analysts take the opposite view – that without the Dalai Lama there would be more unrest in Tibet. Aside from the threat of violence, the search for his successor after his death – he is currently 81 years old – could trigger geopolitical tension depending on where his successor is found. This has led to the bizarre situation in which the current Dalai Lama has suggested that he may not be reincarnated, while Chinese government officials have argued the opposite, with one official saying 'Only the central government can decide

on keeping, or getting rid of, the Dalai Lama's lineage, and the 14th Dalai Lama does not have the final say.²⁸

Conclusions

Clearly there is an adversarial angle to the relationship between India and China, but that does not mean they are unwilling to work together on a number of issues for which they share similar national objectives. Divergent political systems do not preclude cooperation in forums such as BRICS, or in climate change negotiations. Competition projected onto the bilateral relationship – beyond the reality of border disputes – appears less substantive than it did a decade ago. For instance, there now appears to be greater consensus that rather than being a site for competition between India and China, Africa has the capacity to accept investment from both countries.

As before Modi, India's attitude to China continues to reflect divergent interests within India. Indian businesses argue for greater engagement; Indian hawks for greater scepticism. If there has been a change under Modi, it has been to do more of both: to enhance economic engagement with China – welcoming Chinese investment in Indian infrastructure, for instance – while elucidating and acting upon Indian concerns and demonstrating growing ties with Japan, Vietnam and the US.

If the UK is to be seen as relevant, it needs to be visible. By pooling sovereignty, the UK has had a presence in a number of Asian forums through its membership of the EU. The UK's participation in the EU has also benefitted the EU in turn by increasing its clout. In the event of the UK leaving the EU, will it have a sufficiently high-profile Asian presence? The decision to open a naval base in Bahrain at least gives the UK military a regional foothold but overall, more likely, the UK's relevance to intra-Asian developments will diminish in the future.

²⁸ Reuters (2014), 'Dalai Lama's star waning in the West, China official says', 18 December 2014, <http://www.reuters.com/article/us-china-tibet-idUSKBN0JX08M20141219> (accessed 22 Nov. 2016).

11. China's Energy Policy

Michal Meidan, Associate Fellow

Summary

- By 2021, China's energy profile will change substantially as the country increases the proportion of renewables in its energy mix. However, coal will remain the dominant fuel and the transition to renewables, combined with the country's economic slowdown, will be a politically challenging process as powerful state-owned companies will be reluctant to shoulder the resulting social and economic costs.
- Managing the diverging interests of central and local governments, as well as corporate actors, will be a determining factor in the government's ambitious state-owned enterprise reform plan.
- Beijing will open up the energy markets to non-state actors, but this will reduce its ability to shape outcomes as it has in the past, leading to uneven implementation of the reform process.
- Oversupplied global oil and gas markets, and slower demand growth, suggest China's approach to energy security will evolve rapidly.

China's transition from a statist to a market-guided economy with a greater emphasis on environmental sustainability has been at the heart of Xi Jinping and Li Keqiang's macroeconomic agenda. The Chinese leadership has reiterated its commitment to pursuing these structural changes, shifting from an export-oriented growth model towards a more consumer-driven development path, even though Premier Li Keqiang has likened the process to 'taking a knife to one's own flesh'.²⁹ It is undoubtedly a difficult and, at times, bumpy trajectory. Moreover, the country's economic restructuring is also leading to a political realignment as many of China's powerful interest groups – including state-owned energy companies, coal miners and metals conglomerates – which have benefitted from China's tremendous growth in the last four decades, are now losing ground financially and politically. Furthermore, now that the Chinese economy accounts for over 10 per cent of global imports,³⁰ over 35 per cent of global oil demand growth and a fifth of Asian gas demand, every bump resulting from the reforms will be felt well beyond China's borders.

²⁹ Bloomberg News (2015), 'China's Li Vows to Ensure Growth Amid Reforms That Cut Flesh', 15 March 2015, <https://www.bloomberg.com/news/articles/2015-03-15/china-s-li-vows-to-prop-up-growth-as-he-seeks-painful-reform> (accessed on 16 Jan. 2017).

³⁰ IMF (2016), 'Spillovers from China's Transition and From Migration', October 2016, <https://www.imf.org/external/pubs/ft/weo/2016/02/pdf/c4.pdf> (accessed 16 Jan. 2017).

Changing paradigms

China's economic slowdown and energy restructuring will require adjustments from energy producers that seemed to have assumed that the country's insatiable appetite would continue indefinitely. Indeed, coal mines around the world – and in China – that had been developed with its hunger for commodities in mind, are now suffering from the collapse in demand. Similarly, oil producers that had grown accustomed to Chinese demand growing at 5–6 per cent a year on average now have to make do with a paltry 2–3 per cent.³¹ Even China's natural gas demand – which holds great promise as a bridge fuel between fossil fuels and renewable energy in the 'green' revolution – is struggling to meet expectations. This is because the prices of competing fuels (mainly oil and coal) have been in freefall and implementing a rigorous domestic regulatory environment has proved a long and slow process.

Over the next five years, as China's energy landscape undergoes its transition, the country will grapple with a number of policy challenges. First, for it to deliver on its international environmental pledges, large conglomerates in the coal and metals sectors will need to shut down or pay higher costs for more sustainable processes. And in the context of already strained budgets, these industries – that are also large employers and taxpayers – will resist change. Local officials will need to juggle their desire to align with Beijing's policies while maintaining social stability and finding new sources of growth and employment. That said, China's environmental commitments will remain a top priority regardless of the fate of international accords as the social, economic and political costs of the country's deteriorating air quality are rising. Moreover, the 'green revolution' dovetails with the structural adjustments of the Chinese economy, slower economic growth and an effort to move up the industrial value chain and develop cutting edge technologies. These imperatives suggest that China's goals of capping its coal use and introducing more renewable sources into its energy mix will be met.

Second, the Chinese government is opening the energy sector to private investors. While this is aimed at increasing efficiencies in resource allocation and forcing large state-owned companies to become more competitive, it is also limiting the state's ability to control situations. Beijing has already made considerable progress in liberalizing oil and, to a lesser extent, gas trading. But in the oil sector, this has exacerbated a domestic supply glut that is now leading China to export more to Asia and abroad, which damages the profitability of the largest state-owned refiners. In natural gas, however, private importers still face considerable barriers as they try to tap the burgeoning domestic market. If Beijing breaks the state-owned companies' monopoly, it could inhibit the country's ability to spur domestic gas production and lay the infrastructure required for connecting users to natural gas supplies. As a result, liberalization efforts will progress in fits and starts, with Beijing slowing the process at times due to resistance from state-owned major companies, even though the government's anti-corruption drive has weakened their overall ability to shape decision-making.

³¹ Author's calculations using figures available from the National Bureau of Statistics of China, <http://data.stats.gov.cn/easyquery.htm?cn=AO1>.

One step forward, two steps back?

Pricing also remains a key impediment to the development of natural gas markets, as the government seeks an elusive pricing formula that will keep domestic prices low enough to spur demand, but high enough to incentivize production while also remaining competitive with oil and coal. These experiments with prices – which are set to continue given that Beijing has pledged to move towards market-driven pricing by 2020 – will also impact investors and markets. If prices are too high, natural gas demand will collapse but if prices are too low, domestic supplies will plummet and constrain the appetite for imports. This will make China's supply and demand outlook extremely challenging, but producer countries will need to plan accordingly.

One thing is clear. Over the next few years Beijing, in its commitment to change, will experiment with the regulatory environment. Already, in Xi and Li's four years in power, new policy proposals have come thick and fast. Despite this, change remains slow given the need to adjust to a web of interests at the local and corporate levels. In this context, the government's state-owned enterprise reform plan will loom large in the next five years. The government has pledged to rethink the role of the state in the economy, but while Beijing will promote more market-driven pricing mechanisms and create new opportunities for non-state actors, it will still seek to retain ownership of strategic assets and the dominance of state-owned companies. This will balance the seemingly contradictory imperatives of the Third Plenum of 2013: giving the market an essential role, but granting the state a decisive position in reform. Whether or not foreign companies will participate remains an open question.

Energy security 2.0

China's domestic adjustments will be felt well beyond its borders. The shift in thinking about energy security is becoming increasingly apparent as domestic consumption habits have changed alongside slower economic growth and plummeting global prices. Gas supplies, for example, have gone from being extremely scarce in 2014 to looking increasingly plentiful: Chinese gas demand growth has fallen from double digit rates over the past decade to under 5 per cent last year³² but with supplies geared up for stellar growth, Chinese buyers can afford to be pickier. Not only have Chinese companies secured enough supplies to meet demand, but lower global gas prices will prompt them to renegotiate contractual terms, by adding flexibility into the supply terms, including redirecting cargos between import terminals or even reselling them. With other Asian buyers also reviewing some of their contracts, major Chinese companies will follow suit. Indeed, government pressure for greater financial discipline outweighs the reputational risks associated with contract renegotiations. Going forward, government policies will seek to reinvigorate gas demand, but even support and subsidies will not lead to the transformative growth that Beijing had previously planned for.

In oil, a number of factors are informing a more sanguine approach by Chinese policymakers to supply security: in the context of China's slowing demand growth and oversupplied global oil

³² Author's calculations using figures available from the National Bureau of Statistics of China, <http://data.stats.gov.cn/easyquery.htm?cn=A01>.

markets, the country's import bill has fallen dramatically. Moreover, lower oil prices have allowed China to fill its strategic petroleum reserves considerably, acting as a buffer against supply disruptions. Chinese companies are increasingly expanding their presence throughout the supply chain. They are no longer focusing only on exploration and production as they did in the past, and even in their exploration and production activities, greater international scrutiny has led to more robust corporate social responsibility programmes. But now, Chinese companies are becoming more selective shoppers, capable of bidding against the world's leading oil majors, and developing a presence in shipping, trading and refining as a means of becoming global actors, capable of influencing international benchmarks.

Even the vulnerabilities associated with supply cut-offs through maritime transport routes will seem increasingly manageable as Beijing's ability to project power in the South China Sea grows, while the Belt and Road Initiative will seek to enhance China's strategic presence in ports around the globe and over the land routes through Central Asia.

As China's global energy footprint expands, its views of energy security will also evolve. Beijing's own energy transformation and 'green revolution' will make it more actively engaged in the global climate architecture – even if the US under Trump decides to review its climate policies – while its exposure to global oil and gas markets, pricing structures and trading practices will draw it more closely to global institutions. Chinese corporate practices are increasingly aligning with their international peers, because of the practicalities of closer cooperation, pressure from host governments and demands from Beijing to enhance financial discipline and become more competitive globally. Yet China will still opt to keep some institutions, such as the International Energy Agency, at arm's length. While Beijing benefits from coordination with Western-dominated institutions, it does not stand to benefit from being bound by their rules and, even as it seeks to increase transparency in data reporting, Beijing will still prefer to progress at its own speed and under its own terms. At the same time, China's growing presence overseas makes it more vulnerable to political instability abroad as well as turmoil in currency markets. But Beijing will not look to displace Washington as the provider of global energy security, even if the US under Trump opts to reduce its global security and diplomatic engagement. Rather, it will seek to adapt global energy markets and mechanisms to its needs.

This suggests both coordination and competition with the EU and the UK. China's growing global footprint in energy producing countries, especially in the context of uncertainty surrounding the US's approach to the Middle East, could pave the way for more engagement with the EU and the UK on regional issues. But even though the UK may be perceived as a like-minded partner for China if it opts for a less interventionist foreign policy, given its declining global weight post-Brexit, London will likely be the third stop for Chinese officials after Brussels and Berlin.

On climate change, shared views and goals will likely allow China, the UK and the EU to present a common outlook, especially as the US seems set to step back from its leading role globally. That said, frictions will arise as Chinese firms continue to seek export markets for solar power, wind turbines and nuclear plants. Chinese exports will increasingly be regarded as a competitive or a security threat, requiring clarity on the rules of investment in order to avoid diplomatic clashes.

12. China and the Intergovernmental Organizations

Kun-Chin Lin, Associate Fellow

Summary

- The next five years will be crucial for China to establish a more prominent position on new norms, the global agenda and reforming intergovernmental organizations (IOs).
- The country's impetus to reform IOs builds on the current leadership's recognition of China's status as a geopolitical power, and will reassure domestic elite interests that there is direction and substance to President Xi Jinping's vision.
- Providing a multi-tier governance framework for China's increasing investments abroad, as mandated by the Belt and Road Initiative, reducing China's exposure to international political criticism, and political risks resulting from US unilateralism will be China's medium-term objectives within IOs.
- **For the UK:** the UK needs to recognize and safeguard against its eroding legitimacy as a global leader in IOs. Promoting its traditional expertise on crucial issues of interest to China such as climate change, maritime governance, public-private partnership, university-led scientific innovations, financial services development, and international law would enhance the UK's global partnership with China across issue areas of complex interdependence.

China's role in IOs established through multilateral agreements will be shaped by three main dynamics in the next five years: its sway in the global political economy, the country's realization of itself as a great power, and consequences of its major policy frameworks including the Belt and Road Initiative. A mutual adaptation process of IOs to Chinese priorities will be driven by the pragmatic imperatives of other nations needing to cooperate with China, in order to face daunting transnational security, economic and sustainability challenges.

It would not be accurate to characterize the desire for reform of IOs as Chinese interests against Western values – particularly regarding representation in the UN and international financial institutions (IFIs) – the pressures for reform of IOs come from both advanced industrial and lower and middle-income countries, as well as corporate and civil societal interests. China does not wish to place itself under the spotlight by making overambitious demands or by fanning a widespread assumption of its revisionist intentions. China has been an overwhelming beneficiary of the post-Second World War multilateral architecture, and will seek to shape it to mitigate risk to China's expanding global commitments. An effective use of IOs would have positive spillover effects on domestic political and economic stability. Three international-domestic linkages will be crucial in the run up to the Communist Party of China (CPC) Party Congress in 2022, when Xi's successor as general secretary is due to be announced:

1. Xi's legitimacy and legacy: Xi has staked his reputation on rejuvenating the CPC and in embarking on policies and projects that demonstrate national strength. The actual causality may work in both directions, but there is little doubt that Xi is causing systemic shakeups unmatched since those resulting from the Tiananmen Square incident of 1989. His success will depend a great deal on how much leeway he has when engaging in international forums, to allow other countries to adopt a moderate response to fluctuations in Chinese diplomatic postures that are often driven by acute domestic tensions. China's efforts to entice individual ASEAN countries into bilateral negotiations in the context of South China Sea disputes and military escalation provide an excellent case in point. Recent diplomatic overtures by Malaysia and the Philippines have shown a remarkable accommodation with China's hard line stance in the South China Sea. It is likely the Trump's presidency will generate a focal point for China to conduct a pan-Asian discourse with anti-US undertones.
2. Economic governance: Just as it did when China joined the international community in the 1970s, in part to establish a safer strategic environment for its rise as a manufacturing and trading power, China today assigns a functional value to IOs for helping its economy make the tough transition to a domestic consumption-oriented, higher-value added and technology-intensive manufacturing and services economy. Continuing with the accession to the WTO, Beijing has staked great hopes in IOs and market forces being able to solve the most difficult problems of state-owned enterprises: monopolies in key sectors, chronic overinvestment and capacity surpluses, financial repression and squandering of savings, and principal-agent failures in the Chinese bureaucracy. For example, the internationalization of renminbi via the inclusion of the currency in the IMF's Special Drawing Rights basket, and signing of various bilateral agreements on current swap and settlement and renminbi offshore hubs is expected to drive domestic financial market reforms that would improve capital use efficiency. Domestic Chinese scholars have universally recognized the economic motivations behind the Belt and Road Initiative. However, many harbour scepticism on whether business as usual could lead to improved returns on overseas investment. IOs, such as the AIIB and IMF, could play a significant role in shaping the quality of investments and projects under the Belt and Road Initiative by implementing stringent governance requirements.
3. Political risk mitigation: China's optimal long-term strategy to temper the reactions of major powers to its rise – ranging from protectionism in trade to normative criticisms of diplomatic support for other authoritarian governments – hinges on framing debates and allocating resources through IOs. The alternatives have proved less appealing over time. Bilateral agreements seeking to emphasize power asymmetries in China's favour work only on weak and dependent nations, and even so-called 'win-win' approaches to low and middle-income countries are subject to hedging strategies that introduce a great deal of unreliability, as a result of competition from the US and Japan offering better deals in Southeast Asia. The Chinese economic diplomacy of 'buying' international support, generous to a fault in some regions, has been criticized at home for serious opportunity costs. Militarization on China's periphery to assert physical control over sea lanes and territories and discourage challengers has diverted significant resources from pressing domestic uses. At the same time, China's continuing drive for military modernization has stimulated reactions from its neighbours. In short, IOs are arguably the most cost-effective way of providing a stable and responsive environment for China's global expansion.

The most significant policy that ties together the above three rationales is the Belt and Road Initiative. Committing Chinese investment in countries with poorly developed regulatory, legal and market conditions will expose Chinese officials and private firms to major risks that could precipitate bilateral diplomatic crises or corruption of the public–private role delineation. Having the AIIB vet some of these projects with sufficient due diligence and with requirements such as forestry certification programmes would help, for example, Chinese firms to address criticisms from NGOs for large-scale harvesting of timber in Southeast Asia. Ideally, with harmonization of good governance requirements in domestic legislation, financial markets, and relevant IFIs, the renminbi will not have to stop at Xi's desk for every overseas direct investment project in trouble.

China's capacity to contribute to IOs has risen steadily and it has proven to be a quick learner – as evidenced in its ability to effectively use the WTO's Dispute Settlement and Investment Mechanism, set the tempo in climate change mitigation negotiations, energize regional blocs in the Middle East and Africa, and adapt its core non-intervention principle in UN peacekeeping. Even where it has encountered setbacks, such as the recent arbitral tribunal award in favour of the Philippines' claims against Chinese rights and actions in the South China Sea,³³ China has acted quickly to garner critical legal viewpoints from around the world and invest in domestic human resources to enable it to develop more credible legal arguments to open up debates on the UN Convention on the Law of the Sea. With the headquarters of the BRICS Development Bank and AIIB based in Shanghai and Beijing respectively, China will benefit from learning about these organizations from the ground up, with the sociological benefits of being able to train staff alongside Western personnel and shape organizational behaviour with local culture. Financially, China has stepped up its commitments to IFIs, regional economic integration initiatives, and UN peacekeeping. In short, it would be difficult to dismiss China's stake in existing IOs on the face of these deepening and widening commitments. One would be hard pressed to imagine a plausible scenario in which China threatens withdrawing from a major multilateral regime. In fact, with US President Donald Trump advocating an 'America-first' approach to global politics, China has an even greater stake in investing in international regimes, as well as more room for leadership. It is instructive that Beijing's immediate reaction to Trump's election was to call for reaffirmation of commitment to the Paris climate change deal and to announce a renewed push for regional integration via the Chinese proposal of the Free Trade Area of the Asia-Pacific (FTAAP).

This is not to say that China is accepting of the institutional designs and power asymmetries embedded in IOs. Adjusting vote shares in the IMF and the World Bank remains a pressing demand, and renminbi internationalization and specific bilateral energy deals could hardly move beyond the Asian region without the explicit cooperation of major Western powers. Discourse wise, the Washington consensus versus Beijing consensus is largely obsolete given the prolonged global political economic malaise that all countries have faced since 2008. Instead, a new China model will reflect Beijing's realization that former reference points for China's international status are flawed – either as a developing country that sought exceptions to multilateral commitments, or as China demanding other powers recognize its exceptionalism – not so long ago framed in a non-credible historical narrative of a 'harmonious rise'. Instead, Chinese leaders in 2021 will aim to stand as equal partners with the US and other great powers in world forums, negotiation tables, and

³³ See section by Bill Hayton on page 20.

decision-making bodies, with a clear expectation that Chinese views will receive fair debate and consideration. Practically, it may mean an influential Chinese voice shaping preconditions for UN humanitarian intervention, or Beijing leading other countries to define 'common and differentiated responsibilities' under the Paris climate agreement, or the AIIB establishing new rules on the forms and schedule of recipient countries' repayments. However, the potential cost of IO leadership and contribution to peacekeeping may very well go up with Trump's reduced collective security commitment and increased cost-sharing demands on allies, as Chinese peacekeepers may find themselves more exposed in the line of fire without the coverage of American forces.

China's changing identity and role in IOs reflects a shift from Deng Xiaoping's paradigm of cautious participation in IOs in order to gain access to the collective resources of regional and global regimes, and to provide political stability during its exit from isolationism in the late 1970s. It is not entirely accurate to pin this change on Xi Jinping's active discourse on national power, but there is an underlying strand of reasoning that suggests that access and membership cannot guarantee China's current interests, in the face of complex power plays to preserve US dominance and stem Western economic decline. The legitimacy offered by IOs is no longer about gaining global acceptance of China within the Western framework, but about giving Beijing a degree of control over collective decisions on global affairs, which would provide effective leverage on even more pressing issues of maintaining domestic stability. This positive scenario could be derailed if Trump were to support the significant upgrading of Taiwanese military capabilities and push for the nuclearization of South Korea and Japan, or if US–Russia relations were to improve in the direction of undercutting China's leverage over Vladimir Putin, and hence Chinese influence in the Russian Far East, Central Asia and South Asia.

Given this context, the UK has much to offer that can complement and influence China's enhanced role in IOs. Its medium-term actions should start with reducing geopolitical uncertainties in trans-Atlantic relations and the European continent, contributing to an inclusive global knowledge base to speed up Chinese development of scientific and social scientific frameworks for climate change regime-building, and providing crucial public–private linkages in, for example, finance, transport, sustainable energy use and urban planning. First, while the UK would undoubtedly benefit from signing bilateral trade and investment agreements with China as soon as possible, it needs to acknowledge China's caution as it braces for greater political uncertainties in Europe: with the political disarray in Italy after the rejection of constitutional reform and upcoming elections in France and Germany. Second, as China's strongest advocate in the EU in recent years, the UK could play a new, post-Brexit role as a bastion of liberalism in contrast to the rising trade protectionism from Brussels. However, it would find it challenging within the confines of this emerging bilateral relationship to seek to bring Beijing more in line with UK foreign policy values of human rights, humanitarian intervention, democracy, and universal applications of international law such as the law of the sea. In Chinese estimations, the UK and EU members have not formed a unified front on multilateral trade, investment, and climate change negotiations for at least a decade, and have had a limited say in the hard security issues dominated by US interests. Hence further polarization among and within EU member states would only harden Chinese leaders against criticisms. In short, as Brexit and Trump's proposed presidential agenda are likely to undermine Western powers and their version of globalization, both the UK and EU are likely to lose their strategic value to China relative to other regions. However, it may be possible for the UK to attain a more constructive and stable relationship with China compared to those the country has with the EU and US.

About the Authors

Rod Wye has more than 30 years' experience working as a government analyst specializing on China and East Asia for the Foreign and Commonwealth Office. He retired as head of research on Asia at the FCO in 2010. He served twice as a first secretary in the British Embassy in Beijing in the 1980s and the 1990s where he was responsible for reporting on Chinese domestic affairs. He was also deputy head of the FCO China Hong Kong department from 1999 to 2002.

Kerry Brown is professor of Chinese Studies and director of the Lau China Institute at King's College, London. From 2012 to 2015 he was professor of Chinese Politics and director of the China Studies Centre at the University of Sydney, Australia. Prior to this he worked at Chatham House from 2006 to 2012, as senior fellow and then head of the Asia Programme, directing the Europe China Research and Advice Network (ECRAN) from 2011 to 2014. From 1998 to 2005 he worked at the British Foreign and Commonwealth Office, as first secretary at the British embassy in Beijing, and then as head of the Indonesia, Philippine and East Timor section. He lived in the Inner Mongolia region of China from 1994 to 1996. He has a MA from Cambridge University, a Post Graduate Diploma in Mandarin Chinese (Distinction) from Thames Valley University, London, and a PhD in Chinese politics and language from Leeds University.

Tim Summers is a senior consulting fellow for the Asia programme at Chatham House. He teaches at the Centre for China Studies, The Chinese University of Hong Kong (CUHK), and consults commercially on China. He is the author of *Yunnan – A Chinese Bridgehead to Asia* (Chandos, 2013), which brings together his interests in China's regional political economy and international interactions. He was previously a British diplomat, culminating in a posting as consul-general in Chongqing, southwest China, from 2004 to 2007. He holds a PhD in Chinese studies from CUHK, and an MA from Queens' College, Cambridge. He is based in Hong Kong.

Steve Tsang is an associate fellow of the Asia Programme at Chatham House, director of the China Institute at the School of Oriental and African Studies, and an Emeritus fellow of St Antony's College, Oxford. He previously served as the head and professor of contemporary Chinese studies at the School of Contemporary Chinese Studies and as director of the China Policy Institute at the University of Nottingham, as well as director of the Asian Studies Centre at St Antony's College, Oxford. He has published very extensively on the politics, international relations, security and history of the Chinese mainland, Taiwan and Hong Kong. He has developed an analytical concept called 'consultative Leninism' for understanding the nature of politics in the People's Republic of China. His latest book is *China in the Xi Jinping Era* (Palgrave, 2016), the product of a joint project with colleagues based at the Central Party School of Beijing.

Bill Hayton was appointed an associate fellow at Chatham House in 2015. He is the author of *The South China Sea: the struggle for power in Asia* published by Yale University Press and named as one of *The Economist's* books of the year in 2014. His previous book, *Vietnam: rising dragon*, was published in 2010, also by Yale. He has given presentations about South China Sea and Southeast Asian issues for think-tanks and government institutions in the UK, US, the Philippines, Malaysia, Indonesia and Singapore. His written work has been published in *The Economist*, the *South China Morning Post*, *The Diplomat* and the *National Interest*, among others. Bill has worked for the BBC

since 1998 and currently works for BBC World News television in London. In 2006–07 he was the BBC's correspondent in Vietnam and spent a year in 2013 embedded with Myanmar's state broadcaster working on media reform.

Dr J. E. (Jim) Hoare retired from HM Diplomatic Service in 2003. His last post was establishing the British Embassy in North Korea. He has pursued a second career as a broadcaster, writer and occasional teacher on East Asia. Much of his work concerns North Korea but he also has expertise on China and Japan. He has published several books, some with his wife, Susan Pares, also a former diplomat. He is a graduate of Queen Mary University of London (BA, 1964) and the School of Oriental and African Studies (PhD, 1971).

John Nilsson-Wright is senior research fellow for northeast Asia with the Asia Programme at Chatham House, senior university lecturer in Japanese Politics and International Relations at Cambridge University and an official fellow of Darwin College, Cambridge. He was head of the Chatham House Asia Programme from March 2014 until October 2016. He has a BA in Politics, Philosophy and Economics (PPE) from Christ Church, Oxford; an MA in International Relations and East Asian Studies from SAIS, Johns Hopkins; and a DPhil in International Relations from St Antony's, Oxford. He has been a visiting fellow at Tohoku University, Yonsei University and Seoul National University, a member of the World Economic Forum's (WEF) Global Agenda Council (GAC) on Korea and is a director of the UK–Japan 21st Century Group.

Nigel Gould-Davies teaches at Mahidol University in Thailand. He has previously been a visiting professor in international relations at Yangon University and, from 2010–13, held senior government relations roles in the international energy industry in Central Asia and Southeast Asia. From 2000–10 he served in the British Foreign Office, where his roles included ambassador to Belarus, head of the economic department in Moscow, and project director in the Strategy Unit of the Policy Planning Directorate. He received his BA and MPhil from Oxford University and his PhD from Harvard University.

Gareth Price is a senior research fellow at Chatham House. His work focuses on the domestic politics and economics of the countries of South Asia, the relations between them, and their broader international relations. His recent research has explored how water affects regional relationships, and how new thinking could prevent water from becoming an additional cause of regional tension. Before joining Chatham House, he worked for the Economist Intelligence Unit as an analyst/economist covering South Asia, and before that as a political risk consultant for Control Risks Group. His PhD focused on the politics of northeast India.

Michal Meidan is an associate fellow with the Asia Programme at Chatham House. Her focus is on China's politics and political economy, the Chinese energy sector, and Chinese foreign policies and the geopolitics of energy. She is the Asia analyst at Energy Aspects and a research associate at the Oxford Institute for Energy Studies. Before joining Energy Aspects in 2016, she was the director and founder of China Matters, an independent consultancy focusing on the politics and geopolitics of the Chinese energy sector.

Kun-chin Lin is a university lecturer in politics and director of the Centre for Rising Powers at the University of Cambridge. He received his BA from Harvard and MA and PhD from UC Berkeley, and was a Leverhulme postdoctoral fellow at The University of Oxford. He had taught at King's College London and the National University of Singapore. He serves on the advisory and editorial boards of top academic publications including *Business & Politics* and the *Political Economy of Public Policy Series* (Palgrave MacMillan). He is a member of the Frost Sullivan's Board of Economic Advisors, the academic board of the newly established Growth, Innovate and Leadership (GIL) University in Malaysia, and a collaborating partner of the Global Biopolitics research group based at King's College London. He frequently offers expert opinions for the media and at conferences and events around the world on topics of the political economy of China, infrastructure and energy policies, regulatory diffusion, and regionalism in Asia.

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