



IN THIS ISSUE:

IN A FORTNIGHT By L.C. Russell Hsiao.....	1
BEIJING'S CARROT-AND-STICK STRATEGY TO DETER SOCIAL INSTABILITY By Willy Lam.....	2
CHINA'S ECONOMIC DOWNTURN: EMPLOYMENT IS THE CRITICAL ISSUE By Pieter Bottelier.....	4
BEIJING'S RESPONSES TO FALLING OIL PRICES By Wenran Jiang.....	8
CHINA'S 2008 DEFENSE WHITE PAPER: THE VIEW FROM TAIWAN By Cheng-yi Lin.....	11



Chen Xiwen, director of the Office of Central Rural Leading Group

China Brief is a bi-weekly journal of information and analysis covering Greater China in Eurasia.

China Brief is a publication of The Jamestown Foundation, a private non-profit organization based in Washington D.C. and is edited by L.C. Russell Hsiao.

The opinions expressed in China Brief are solely those of the authors, and do not necessarily reflect the views of The Jamestown Foundation.



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In a Fortnight

By L.C. Russell Hsiao

PERSONNEL CHANGES IN PLA RANKS: CHEN XIAOGONG

The top-brass of the Chinese leadership started the Lunar New Year on a sprint. The year of the ox, which began on January 26 in the Gregorian calendar, was marked by fervent planning for Chinese Premier Wen Jiabao's trip to the World Economic Forum in Switzerland. On January 30, a little over a week after his inauguration, President Barack Obama was on the phone with Chinese President Hu Jintao reassuring Beijing's concerns over U.S. Secretary Treasury Timothy Geithner's remarks on the Chinese currency as well as the two countries' trade imbalances. According to a Xinhua report, President Obama described the relationship as "the most important bilateral relations for both sides" (Xinhua News Agency, January 31). Meanwhile, China's "2008 National Defense White Paper" was quietly slipped under the doorstep of the White House on the day of the inauguration. According to military experts, the White Paper continues to conceal important details about China's military modernization, which has been the source of tension with its neighbors and the United States (*China Brief*, March 14, 2008). The White Paper, nonetheless, provides a systematic window to recalibrate U.S. perceptions toward the attitudes and outlook of China's top military planners (see Cheng-yi Lin's article in this issue). All announced in close tandem with the release of the 2008 White Paper, the Beijing leadership also elevated the ranks of a number of officers to key executive posts in the People's Liberation Army (PLA) Armed Forces and regional command (*Ming Pao* [Hong Kong], January 21). This move may signal the coming of age for the next generation of PLA leaders and illustrates a new direction that the PLA is taking in conducting military-to-military relations as the United States and China enter a new chapter in their bilateral relations.

According to multiple sources in the Chinese media, the most notable appointment is that of Deputy Chief of the General Staff for intelligence Lieutenant General Chen Xiaogong to the post of deputy commander of the People's Liberation Army Air Force (PLAAF) under the command of General Xu Qiliang. Chen is a well known “princeling”—familiar to U.S. Sinologists—and is the son of the former People's Republic of China (PRC) Ambassador to Japan and the United Nations, Chen Chu. Chen Xiaogong, 60 years old, has a long career in military intelligence, and served as a defense attaché at the PRC Embassy in Washington from 2001-2003, prior to his most recent appointment he served as the deputy director of the Foreign Affairs Office under the Central Committee and General Staff Department's Second Department (*Ming Pao*, January 21). Chen's elevation as the deputy commander of the PLAAF marks the first time in 40 years that a high-ranking army officer was made a high-ranking air force officer. Chen's illustrious career in Chinese intelligence has earned him the nickname “Little Li Kenong,” after the Chinese colonel general who was the director of the Chinese Communist Party (CCP) Central Investigation Department (Xilu.com, January 20).

Among other personnel changes verified by various Chinese sources, the central committee approved the appointment of Major General Xue Guojiang as deputy commander of the Chinese People's Armed Police (PAP), Xue is replacing retiring Lieutenant General Chen Chuankuo; the 54th Group Army (in Jinan Military District) Commander, Song Puxuan, is replacing Rear Admiral Xu Chengyun as the deputy commander of the Nanjing Military Region under Lieutenant General Zhao Keshi; Second Artillery 54 Base (in Luoyang) Political-Commissar Guo Junbo was promoted to deputy political-commissar of the Second Artillery Corps under the directive of General Peng Xiaofeng (*Ming Pao*, January 21); and Major General Ren Haiquan, the head of education at National Defense University became its vice president (*Ta Kung Pao*, January 28).

Major General Ruan Zhibo, auditor-general of the PLA Audit Bureau, the internal financial audit organization that is subordinate to the Central Military Commission (CMC) but managed by the General Logistics Department, was made the deputy commander of the Chengdu Military Region, which includes the Tibet military district, under Commander Lieutenant General Li Shiming. The appointment of Major General Ruan, 58 years old, marks the first time that an officer in the audit bureau was selected to serve in a leadership position of a major military region (*Nanfang Daily*, January 31).

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Beijing's Carrot-and-Stick Strategy to Deter Social Instability

By Willy Lam

Even as the Chinese Communist Party (CCP) leadership pulls out all the stops to resuscitate the economy, it is grappling with the even more daunting task of maintaining social stability. Apart from familiar issues such as rising unemployment (see Pieter Bottelier's article in this issue), the administration of President Hu Jintao and Premier Wen Jiabao is bracing itself for a number of sensitive anniversaries this year: the 50th anniversary of the Tibet insurrection on March 10th; the 20th anniversary of the Tiananmen Square crackdown; and the 60th anniversary of the founding of the People's Republic on October 1st. For reasons including sending a warning to potential and real “trouble-makers,” Beijing has publicized at least part of its evaluation of the law-and-order situation along with a mixture of both tough and conciliatory measures to keep the forces of chaos at bay.

For the past month or so, cadres in two topmost organs in charge of internal security—the CCP Central Commission on Political and Legal Affairs (CCPLA) and its sister unit, the Central Office for the Comprehensive Administration of Law and Order (COCALO) have held marathon sessions on how to nip socio-political instability in the bud. The COCALO, which coordinates the activities of the police, state security agents and judicial departments, has admitted that Beijing faces unprecedented challenges in safeguarding stability, deemed the party's “overriding task.” COCALO Director Chen Jiping indicated that the year 2009 would witness “an increase in social risks and the doubling of contradictions even as the law-and-order scenario becomes more severe and complex.” The situation has been exacerbated by the financial crisis. Chen noted that new contradictions caused by economic doldrums had exacerbated long standing ills. “Contradictions in the economic arena have interacted with contradictions in other arenas,” he pointed out. Moreover, various interest groups had become more vociferous in clamoring for their rights. “Feelings of dissatisfaction toward society have grown,” Chen said, adding that unnamed groupings—presumably including chronically unemployed peasants and ethnic-minority elements with grievances against Beijing might use “excessively forceful means” to try to get what they want (*Outlook Weekly* [Beijing], January 12).

In a recently published speech on the law-and-order front, CCPLA Secretary Zhou Yongkang called upon the police, procuratorates and courts to acquit themselves well of the “holy task” of ensuring national security and stability. Zhou, who is also a Politburo Standing Committee member, recommended “a synthesis of methods to combat

and to prevent instability ... We must boost [abilities] to handle emergencies and strengthen professional units so as to counter terrorism and to prevent the occurrence of violent and terrorist incidents.” Zhou also stressed the “early resolution of various types of social contradictions” (Xinhua News Agency, February 1).

Foremost among the multi-pronged tactics that Zhou, Chen and other leaders have come up with is neutralizing conflicts that are engendered purely by economic factors, particularly unemployment. While the Ministry of Human Resources (MOHR) indicated that the urban jobless rate stood at a mere 4.2 percent at the end of 2008, other Beijing-based experts have pointed out that the real figure for late last year was 9.4 percent—and that this could go up to 11 percent by mid 2009. COCALO officials indicate that they are particularly worried about the job prospects for migrant workers—the six million or so students who will graduate from college this year, as well as tens of thousands of demobilized soldiers (Agence France-Presse [AFP], January 20; *Ming Pao* [Hong Kong] December 30, 2008, Xinhua News Agency, January 12). While attending the World Economic Forum in Switzerland last week, Premier Wen expressed confidence in achieving an 8 percent growth rate for 2009 (*New York Times*, January 28; AFP, January 28). It is commonly assumed among official economists that a 7 percent growth rate will translate into 25 million to 30 million new jobs a year, which should be sufficient to stave off massive chaos. Before the economy picks up speed, however, the authorities are taking urgent steps to alleviate the pangs of unemployment.

The State Council has leaned heavily on both state-controlled and private enterprises to make pledges that they will not lay off workers in the coming year. A late January report by the Xinhua News Agency said that numerous enterprises along the coast had made promises of either “not cutting staff,” or “sacking as few employees as possible.” According to Wang Guoping, party secretary of Hangzhou, Zhejiang Province, businessmen must observe social responsibilities. “Enterprises must not only be ‘economic legal persons,’” Wang said, but “they must also be ‘enterprise citizens’ and the blood of morality should course through the veins of entrepreneurs” (Xinhua News Agency, January 28). Officials and economists have given conflicting estimates of how large a proportion of China’s 150 million-odd migrant laborers have been laid off in urban factories. Chen Xiwen, director of the Office of the Central Leading Group on Rural Work, admitted early this month that some 20 million rural workers had lost their jobs due to the financial crisis. His figure was double that given by the State Council just a few weeks earlier. In any event, several inland provinces including Sichuan and Jiangxi are giving special livelihood subsidies

to jobless laborers who have returned to their birthplaces upon the closure of coastal enterprises (Xinhua News Agency, February 2; *Wall Street Journal*, January 23; *Ming Pao*, January 30).

Beijing is also putting emphasis on repairing the much strained ties between the populace and the government. The official *Outlook Weekly* reported last week that party authorities had asked all departments and regional administrations to “standardize and institutionalize” ways and means to boost communication with the masses and to receive their petitions (*Outlook Weekly*, February 1). Particular stress is being laid on buttressing the image of public security officers who are often perceived as repressive and corrupt. Deputy Minister of Public Security Yang Huanning pointed out last month that “we must ceaselessly push forward the construction of harmonious relations between the police and the people.” Earlier, Public Security Minister Meng Jianzhu asked police to do their work in accordance with “rational, peaceful, civilized and well-regulated norms.” He called upon officers to “standardize their words and actions in the course of law enforcement, and to avoid being rash and emotional in the face of provocation and [other] complicated situations” (Xinhua News Agency, January 26; China News Service, November 3, 2008).

Meanwhile, the Hu-Wen leadership is brandishing so-called “tools of proletarian dictatorship” against disgruntled elements that might employ violence means—including quasi-terrorist tactics to undermine stability. While officiating at a New Year ceremony at the headquarters of the People’s Armed Police (PAP), President and Commander-in-Chief Hu called upon the paramilitary force to “engage in comprehensive military training, step up patrols, and boost their capability in handling emergency situations and combating terrorism.” Hu demanded that PAP officers do their utmost in “safeguarding national security and maintaining harmony and stability in society” (*People’s Daily*, January 5). Moreover, the Supreme People’s Court (SPC) has vowed to play its part in upholding law and order, through means including meting out speedy and heavy sentences to hard-core criminals and state enemies. SPC President Wang Shengjun, a former CCPLA secretary general, urged all judicial cadres to “follow a firm and correct political orientation [while] promoting social stability and harmony” (Xinhua News Agency, January 15; *People’s Daily*, December 20, 2009).

Prime targets of the Ministry of Public Security, the PAP and the courts are separatists in Tibet and Xinjiang, who, Beijing believes, are colluding with “anti-Chinese elements from abroad” to foment discontent and chaos in society. Since mid-January, police and PAP officers have raided

thousands of homes and offices and detained more than 80 suspects in a “Strike Hard” campaign in the Tibet Autonomous Region. Western diplomats in Beijing have reported that since talks with the Dalai Lama broke down last winter, the authorities had taken ironfisted measures to pre-empt protests that might erupt in the run-up to the 30th anniversary of the Tibetan insurrection. In March and April last year, tens of thousands of Tibetans held dozens of demonstrations not only in Tibet, but also in four neighboring provinces to call the world’s attention to Beijing’s alleged attempts to stifle Tibetan culture and religion (*Washington Post*, January 29; Inter-Press Service, January 30).

Relatively little information has come out of the Xinjiang Autonomous Region (XAR), where a “Strike Hard” (*yan da*) movement has also been launched since early January against dissidents, separatists and other underground groupings. This is a continuation of the crackdown by police and PAP officers since the spring of 2008. As of the end of last year, some 1,300 suspects had been arrested for alleged acts of terrorism and violations of state-security laws. The official media last month quoted the Chairman of the Xinjiang Autonomous Region Nur Bekri as saying that “fighting the three forces (of terrorism, separatism and religious extremism) is an acute, complicated and long-lasting task.” Threats must be “nipped in the bud and violent terrorist activities pre-empted,” Bekri warned (*Procuratorial Daily* [Beijing], January 4; *China Daily*, January 8; Xinhua News Agency, January 9).

Equally nettlesome for the authorities are efforts by intellectuals and other “bourgeois-liberal” elements to clamor for political liberalization to coincide with the 20th anniversary of the June 4, 1989 massacre. Despite the detention of big name dissidents and other acts of intimidation by state-security personnel, more Chinese have put down their names on the Internet in support of the pro-democracy Charter 08 Movement (*China Brief*, December 12, 2008). Moreover, a few dozen overseas-based dissidents led by Wang Dan, the charismatic student leader of the 1989 demonstrations, are stepping up pressure on Beijing to allow them to return to China. Their campaign, entitled “We want to go home” (*wo men yao hui jia*), called on CCP authorities to observe universal human rights norms and the goals of a “harmonious society,” which were raised by the Hu-Wen leadership in 2004. Activist Christian minister Zhu Yaoming of Hong Kong, who is aiding the overseas dissidents, said Beijing should “let these Chinese citizens return home without prior conditions” such as writing documents of contrition (*Ming Pao*, January 30).

Assuming that the forces of discord can be minimized, the

Hu-Wen team may be able to celebrate the 60th anniversary of the founding of the People’s Republic in style. Yet the gargantuan military parade planned for October 1 has itself become a subject of controversy. Numerous postings on China’s online chat rooms have opposed the extravaganza on grounds ranging from wastefulness to the fact that the show of force may stoke the “China threat” theory. This is despite assurances by military authorities that the proposed budget, around 300 million yuan, is much less than that incurred by the 1999 parade (AFP, January 29; Military.club.china.com, January 9). It seems apparent then, that while tough tactics employed by the CCP leadership have failed to cow disaffected and recalcitrant elements, conciliatory gestures have yet to produce the desired effect of enhancing trust and harmony. A massive outbreak of disorder could not only take the halo off Beijing’s much-ballyhooed “China model” but also pose a frontal threat to the CCP’s “perennial ruling party” status.

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China’s Economic Downturn: Employment is The Critical Issue

By Pieter Bottelier

The economic slowdown in China started in the second half of 2007: well before the effects of the subprime crisis in the United States began to be felt internationally. The initial downturn was orchestrated by the Chinese government, which aimed at cooling an overheating economy (GDP growth in 2007 was recently adjusted upward to 13 percent!) and at controlling a property market bubble that was considered potentially dangerous (Xinhua News Agency, January 15). The government was also concerned about the stock market bubble, although less inclined to intervene. Japan’s prolonged economic stagnation following the simultaneous bursting of property and stock market bubbles in 1990-1991 was clearly on the minds of Chinese policy makers when they intervened in the property market by tightening credit (especially for mortgage and construction loans) and making it harder to get land for construction.

The government succeeded, perhaps more quickly and more dramatically than it had expected, in achieving these objectives. Housing prices leveled off or began to fall in some major cities in the second half of 2007. Property markets slumped, causing a sharp contraction in new construction and an associated drop in demand for building materials such as steel, copper, cement, glass and aluminum. To make things worse, the stock markets of Shanghai, Shenzhen and Hong Kong collapsed simultaneously at the end of October, around the same time that housing prices in some major cities such as Shenzhen started a steep decline. This further reduced business and consumer confidence. The demand for cars and other consumer durables, already subdued because of the slowdown in new housing sales, further contracted. Exports, which continued to grow briskly in 2007 and at a slightly slower rate during the first half of 2008, suddenly slumped in October—the month after the collapse of Lehman Brothers in the United States—and turned negative in November, for the first time since 2001.

In the first half of 2008 China's earlier inflation worries were removed from the front burner by fears that the domestically engineered slowdown might intensify and consequently generate high levels of unemployment, especially in construction. Export industries were also beginning to lay-off workers, but at a moderate rate. This was before policy makers knew that the subprime crisis in the United States would trigger a global recession that would affect China through a sharp contraction in demand for its exports. The post-Olympic economic slowdown that many had predicted did in fact occur—but for reasons that had not been anticipated.

Since banks in China had little exposure to derivatives based on American mortgage loans, the direct financial effects on China of the subprime crisis in the United States were minimal. The indirect effects, however, are serious. Export growth collapsed and lay-offs in export industries intensified in the fourth quarter of 2008 when the whole world came under the spell of the financial crisis. Thus, China's economic slowdown, which had started in the second half of 2007 as a result of domestic policy action, was unexpectedly compounded by a severe export slump that kicked in during the fourth quarter of 2008. It is now clear that banks in China are negatively affected by the recession, but since they were generally in good shape before the crisis, there is no threat of a banking crisis. In fact, with government encouragement, bank lending in China expanded sharply in December 2008 and January 2009, which may suggest that China's recession will bottom out sooner than later.

EFFECTS OF THE DOWNTURN ON EMPLOYMENT IN CHINA

Hard (un)employment data are scarce in China, but the little that has been officially reported, combined with abundant anecdotal evidence presents a rather grim picture (*China Brief*, December 19, 2008). Most international attention has been focused on lay-offs in China's export-oriented industries in the coastal zones, but that is probably not the most important problem category for understanding the employment challenge that Beijing faces. There have been significant lay-offs in small and medium scale enterprises (SME) that supply large state-owned enterprises (SOE) producing construction materials. Many of these SMEs are privately owned and started their operations as spin-offs from state enterprises that used to be vertically integrated before the aggressive SOE reforms of the late 1990s. Due to the slump in new construction, demand for building materials dropped precipitously. The first victims of this slump were not the SOEs—they enjoyed fat profits in earlier years and are encouraged by the government to avoid lay-offs as much as possible and accept lower earnings instead—but the thousands of SMEs that supply them or serve as sub-contractors. However, if the recession lasts much longer or intensifies, even SOEs may begin to lay off workers as profits disappear.

The third and probably most important source of lay-offs in 2008 was the construction industry itself. Including informal day workers (not included in China's official employment numbers for the construction sector after 2002); the author estimates the total employment in construction at the end of 2007 to be at 55 million. In Table 1 below the author assumes that 10-20 percent of construction workers were laid off in 2008, because of the property slump.

No official information is available on lay-offs by SMEs or construction companies in 2008. The following table pulls together government estimates of lay-offs in export-oriented industries and the author's own provisional estimates of what may have happened in the other two categories of enterprises mentioned above.

TABLE 1. ESTIMATED NUMBER OF LAY-OFFS IN 2008 IN THREE CATEGORIES OF ENTERPRISES

Category of enterprise	Lay-offs (million)	Explanation
Export-oriented firms in coastal China	6.5-9	Mostly migrants – government estimate
SMEs supplying construction material SOEs	5-10	Mostly migrants – author estimate
Construction companies	5.5-11	Mostly migrants – author estimate
Total	17-30	Mostly migrants – very rough estimate

The author's estimate of 17-30 million unemployed migrants at the end 2008 is broadly consistent with an estimate of "about 20 million" included in an official statement by Chen Xiwen, director of the Office of the Central Leading Group on Rural Work, in Beijing on February 2 [1]. To get a picture of the total non-agricultural unemployment at the end of 2008, we have to add the officially reported 4 percent registered urban unemployment at the end of 2007 (8-9 million people), yielding an estimated total of 25-39 million, or roughly 5-8 percent of China's total non-agricultural labor force of about 500 million.

The unemployment situation may further deteriorate in 2009, even with fiscal stimulus and overall GDP growth of 7.5 percent. The author places the estimate of the total number of non-agricultural job seekers in 2009 at 39-48 million, as shown in Table 2.

Assuming that China's GDP will grow 7.5 percent in 2009 and that the growth pattern will remain as capital intensive as it was in recent years [2], the total number of new jobs created in 2009 will be only about 6-7 million. Unless, (1) China's growth pattern suddenly becomes much more employment intensive, (2) a much larger number than the assumed 50 percent of laid-off migrants start farming,

TABLE 2. ESTIMATED (NET) NON-AGRICULTURAL JOB SEEKERS IN 2009

Job seekers in 2009 (million)	Explanation
9-15	Migrants laid-off in 2008, assuming that 50 percent of them will start farming
9-10	Author estimate of registered urban unemployment at the end of 2008 based on a provisional government estimate of 4.2 percent
1.7	Government estimate of 2008 university graduates unable to find a job that year
6.1	Government estimate of university graduates in 2009
13-15	Author estimate of other graduates entering the labor market for non-agricultural jobs
39-48	Total – a rough estimate

or (3) the various stimulus programs succeed in creating many additional jobs, total estimated non-agricultural unemployment at the end of 2009 would be 33-42 million, or 7-8 percent of the non-agricultural labor force at that time (author's estimate). Total non-agricultural employment may shrink by 1-1.5 percent in 2009. The overall employment picture in 2009 presents even more serious challenges for Beijing than the contraction of state sector employment by 45 million jobs over 5 years that followed the aggressive SOE reforms started by then Premier Zhu Rongji in 1998.

From a socio-political perspective, the two most sensitive categories of unemployed for the leadership in Beijing probably are migrants and university graduates. Anecdotal evidence suggests that many of the workers who were laid-off in 2008 are second generation migrants who are disinclined to return to farming, even if they have the option to do so. Local governments will be faced with the difficult choice between: forcing unemployed migrants to return to their rural villages under China's household registration (*hukou*) system; subsidizing local employment or unemployment benefits from scarce fiscal resources; or accepting open unemployment in their district.

The problem of unemployed university graduates is new in China, but politically and socially not less troublesome than the problem of unemployed migrants. In this respect, China's labor market is beginning to resemble India's, where large numbers of university graduates have been unemployed or underemployed for many years. Of China's 5.6 million university graduates in 2008, 1.7 million are reported to have been unable to find a job (*Ming Pao* [Hong Kong], December 15, 2008). The main blame for this is thought to be a disconnect between some of China's higher education programs and market needs, but the slowing economy must also have been a factor. The projected number of university graduates for 2009 is 6.1 million (*Ming Pao*, December 15, 2008).

There is no short-term solution for China's unemployment problem other than to maintain a high overall growth rate and to generate as many jobs as possible through fiscal stimulus. In the medium-term the solution lies in changing the growth pattern such that labor/GDP elasticity increases, adjusting education programs to market needs, and demographic dynamics. China's total labor force is projected to peak in the next 7-8 years and to start shrinking at a rate of 0.5-1.0 percent per annum for several decades thereafter [3]. While a shrinking total labor force will take some pressure off China's chronic employment problem, it is important to realize that the urban part of the total labor force will continue to grow for decades.

GOVERNMENT MEASURES TO COUNTER THE DOWNTURN

It did not take the government long to realize that the economy had been hit by a double whammy: the residual effects of its own efforts to cool the property bubble in 2007 and the international financial crisis that broke in 2008. Already in November 2008 the government announced plans for a major fiscal stimulus plan and began preparing other measures to counter the socio-economic effects of the sharp downturn. A comprehensive plan, including all measures to stimulate growth, protect employment and minimum incomes, is not yet available, but the following initiatives have been announced:

- Reduced lending rates and eliminated lending quotas.
- Softer terms for mortgage loans.
- Easier access to finance for SMEs.
- Programs to help university graduates start their own business.
- Restored export tax rebates to pre-crisis levels.
- Stop further nominal RMB/US\$ appreciation, from around July 2008.
- A RMB 4 trillion (\$586 billion) fiscal stimulus investment program for 2009 and 2010.
- Increased recurrent central budget expenditures for a wide range of social programs, including education, rural health insurance, income support for rural and urban poor, and pensions.
- Temporary reductions in employer contributions to medical insurance, unemployment insurance and other pay-roll deductions for urban workers.
- Allow unemployment insurance funds to be used for job-retraining and subsidies to employers for up to 70 percent of local minimum wage.
- SOEs are encouraged to avoid lay-offs as much as possible by accepting lower profits.
- A conversion of the Value Added Tax (VAT) system from production-based to consumption-based.
- Extended rural land use rights and made them

tradable (to boost agricultural productivity)

Several of these measures are already under implementation. The big question is whether the government will be able to avoid large scale civil unrest. Since the cause of the crisis is widely perceived to be external, while the government is seen to be making unprecedented efforts to create and extend social safety nets, the odds appear to be in Beijing's favor.

In light of the government's aggressive and apparently well-organized efforts to fight the recession, its experience with running fiscal stimulus programs (1998-2003), the new flexibility of China's economy and the relatively strong position of its banks, the recession may bottom out in the first half of 2009. The author believes that serious deflation can be avoided. Yet, because of the substantial residential property overhang in major cities, it is unlikely that high growth (by Chinese standards) will be resumed anytime soon. It is more important, however, for China to restructure its economy than to resume double digit, but unsustainable growth. If China succeeds in rebalancing its economy, it may, after some years, be in a stronger position that it was when it entered the crisis.

CONCLUSIONS AND IMPLICATIONS FOR THE UNITED STATES

The present crisis has underlined the growing importance of China's role in the global economy and global governance. The United States, European Union and other rich countries should make more serious efforts to capitalize on China's willingness to be a stake holder in the nascent global order. None of the existing "G" groups (e.g. G-8, G-20) is well suited to effectively integrate China into global governance systems. Moreover, China—and major developing countries—have to be given much greater voice in multilateral agencies such as the IMF and the World Bank.

In the present situation, the greatest risk is that the international crisis will trigger cascading protectionism around the world, undermining both letter and spirit of the WTO and associated agreements. This would be catastrophic for many poor countries and make it harder to avoid depression in rich ones.

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NOTES

1. Chen Xiwen's statement was based on a survey of rural migrants in 15 provinces conducted by his office in January 2009. The survey showed that 15.3 percent of respondents reported to have lost their job in 2008 or were unable to find employment. The government's estimate of the total number of rural migrants in China is 130 million.

2. The estimated average labor/GDP elasticity from 2000-2007 was about 0.11. That means that every 1 percent of GDP growth generates employment growth of 0.11 percent. Total employment in China at the end of 2007 is officially estimated at about 770 million (about 5 times the U.S. labor force), including 276 million farm workers and 494 million non-agricultural workers. Official employment numbers for 2008 are not yet available. If GDP growth in 2009 is 7.5 percent, the associated increase in total employment would be 6-7 million jobs.

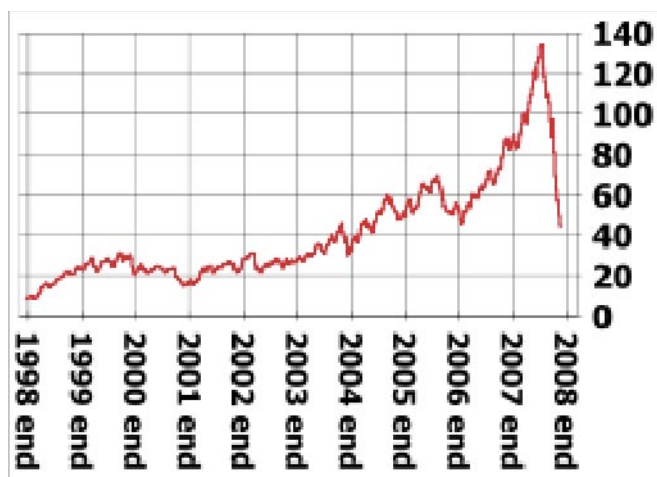
3. See for example: Richard Jackson & Neil Howe, *The Graying of the Middle Kingdom. The Demographics and Economics of Retirement Policy in China*. Center for Strategic & International Studies (CSIS) and Prudential Foundation, April 2004.

Beijing's Responses to Falling Oil Prices

By Wenran Jiang

Oil and other commodity prices have been declining as major economies of the world go into a recession, but the Chinese are now more convinced than ever that their country had very little to do with the sharp climb and subsequent nose dive of oil prices in the past five years. [See Chart below, world oil price started to climb in a sustainable manner since 2003 at an average price of \$31 per barrel that year, reached its peak in the middle of 2008, and then plunged to \$35 year end. It took only 5 months for the price of oil to plummet from \$150 to under \$40.] Chinese officials and energy company executives instead maintain that China was a victim of increasing oil prices, and that a large amount of its \$1.95 trillion foreign reserves have to be used to import more than 40 percent of its daily consumption [1]. While China's intensified domestic energy development program and its "go-out" strategy were designed to cope with a prolonged period of high oil prices, the recent drop in the global energy market has presented new sets of challenges to Beijing's energy security.

TABLE 1. PRICE FOR UNITED STATES OIL FROM 1999 TO NOVEMBER 2008 (US\$)



Source: eia.doe.gov

NEW NATIONAL ENERGY ADMINISTRATION

The booming Chinese economy was confronted with a severe energy shortage shortly after entering the 21st century. Yet the Energy Bureau, under the National Development and Reform Commission (NDRC), was under-staffed and overwhelmed by day-to-day administrative tasks. With the worldwide rise of energy prices, there were growing calls for the Chinese leadership to strengthen its government institutions to deal with the mounting challenges in the energy sector. A major study published jointly by the World Bank and China's State Council (the cabinet) urged the establishment of the Ministry of Energy [2].

However, the long-anticipated Ministry of Energy did not materialize in China's overall "super ministries" reform program last year. Although it has been argued that an independent and strong Energy Ministry is crucial to China's long-term energy security, experts suggest that those with vested interests in the status quo have sufficient influence to thwart such development. Among them are the top three Chinese national oil companies and various government bodies which currently manage the country's different energy sectors [3]. In balancing the complex relationships involving many ministries and agencies regarding energy and resources, China's new energy bureaucracy is named the National Energy Administration (NEA). Under the dual leadership of the State Council and the NDRC, NEA does not have full ministry status but is headed by the deputy minister of NDRC with a ministerial ranking, Zhang Guobao. This energy management reshuffle not only expanded the administrative scope of the NEA by absorbing a number of functions from other agencies but is also in the process of setting up nine director-general level bureaus with almost four times the size of the original

Energy Bureau personnel under the NDRC [4].

The new functions of the NEA were re-defined in important ways. First, it will take more responsibilities for research on key energy issues and macro-control at the policy level. Second, it will undertake day-to-day supporting duties assigned by the newly established National Energy Commission, a high-level strategic and coordinating body that replaced the National Energy Leadership Group, the latter was established in 2005 headed by Premier Wen Jiabao and was in charge of formulating mid- and long-term national plan for China's energy development [5]. Third, it will emphasize energy conservation, new energy technology and clean energy development. Fourth, it will take over the management of China's Strategic Oil Reserves, enhance international energy cooperation, and secure energy supply. Finally, it will participate in domestic energy price reform [6].

DOMESTIC POLICY IMPLICATIONS

The most significant sign of NEA's assertiveness was the publication of a detailed account of China's new strategic thinking on energy authored by Zhang Guobao, head of the NEA, at the end of 2008. Euphemistically describing the current energy situation as "opportunities" within "crisis" (*wei zhong zhi ji*), Zhang outlined the challenges and opportunities associated with the global financial crisis [7].

Zhang identified the symptoms of the crisis as the decreasing demand in the energy sector, such as oil and coal; declining prices of oil, coal and related products; and the deterioration of operating conditions of energy enterprises such as electricity generation, petro-chemical and coal plants. These new developments, as conditioned by the international financial crisis, demand new thinking and new adjustments. And Zhang clearly sees more opportunities as he elaborated how China will proceed with a series of new energy policy measures.

First, China's energy strategy will be in concert with the broader \$600 billion stimulus package that Beijing had already announced. This means boosting domestic demand and further building up China's energy infrastructure: three new nuclear power plants (\$17.5 billion), the second West-East gas pipeline of 5,300 kilometers (km) and related projects (\$44 billion), plus a range of other coal, electricity generating and transmission projects.

Second, China will speed up the re-structuring of its energy mix: expanding large electricity generating plants while reducing the number of small ones; re-organizing coal mining by focusing on 13 large national coal mining

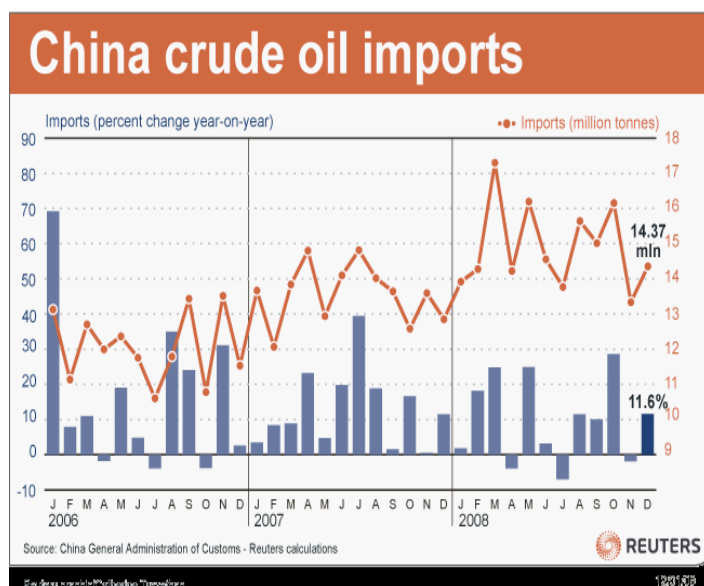
areas with large-scale, modernized operations; increasing the share of electricity generated from nuclear power plants; putting more resources into the renewable energy development; and encouraging the development of large energy enterprises.

Third, China sees the lower energy and commodity prices of late as providing breathing space for the much-needed but complicated on-and-off domestic product oil price reform. Despite the fluctuations of oil prices, the government seems committed to an "indirect and controlled connection" between domestic and international product oil prices.

Finally, China is likely to take advantage of the low oil prices not only for importing more oil but also for filling up its strategic petroleum reserves (SPR), a task that was delayed by the persistence of high energy prices in recent years. Zhang indicated that China's first phase of SPR, already in place, has a stockpile capacity of about 100 million barrels of oil, and the second phase now under construction will accommodate 170 million barrels (*Huanqiu Shibao*, January 8).

Reuters reported that China was filling nearly 40 percent of its third strategic reserve base of SPR Phase I in Huangdao in the last two months of 2008, with more filling expected for January 2009. State-owned Sinopec and PetroChina have also been stockpiling their commercial reserves as well (*Reuters*, December 29, 2008; January 12). But statistics released by the Chinese customs show that in both November and December, Chinese imports of oil decreased substantially (*Caijing*, January 15).

TABLE 2.



There is no official confirmation that the first phase of stockpiling has been completed but as current regulation stands, it would still only meet less than 30 days of China's need in case of an import cutoff. In contrast, the United States and most Western major economies have up to three months of reserve storage. There are also doubts on the wisdom of rushing to stockpile more oil. Zhou Dadi, former director-general of NDRC's Energy Research Institute, argues that there is no consensus on what should be the right amount of SPR a country should hold. As the cost of storage is high and the utility is low, China may not need to have a huge SPR (*Caijing*, December 26, 2008).

IMPACT ON GO-OUT STRATEGY

Speculation that China's move to stockpile more oil for its SPR may drive up oil prices have not materialized. In fact, the U.S. Department of Energy also announced in early January the addition of 12 million barrels to its own SPR due to low oil prices, and so far the market has not responded with any clear trend either [8].

China is also working hard on a number of pipeline projects that began last year. China and Russia reached an agreement last year that a Russian oil pipeline will be built to China's Northeast. But most notable is the beginning of the construction in July 2008 of a natural gas pipeline starting at the border of Turkmenistan and Uzbekistan, running through Uzbekistan and Kazakhstan, and finally connecting with China's second phase of West-East Pipeline in the Northwestern Xinjiang Autonomous Region. This ambitious project has gone through multi-year, multi-country negotiations with large Chinese investments. The first component is the 1,818-km, \$7.3-billion pipeline outside China, in Uzbekistan and Kazakhstan; the second is a natural gas production sharing agreement that will satisfy part of the pipeline's capacity; and the third part is a second West-East gas pipeline inside China [9].

This project is important to China's overall energy strategy in many ways. First, it will increase the share of natural gas in China's overall energy mix (currently at 2.8 percent in contrast to the global average of 23 percent). Second, it will reduce China's growing dependency on the Mideast and African energy imports (currently at over 80 percent) [10]. Third, the use of natural gas will decrease the use of coal, thus reducing the country's overall greenhouse gas emissions.

What is less clear is how Chinese energy companies will re-adjust their acquisition activities in other parts of the world given that they, like other companies, have all been caught off guard by the sharp decrease in oil prices in recent months. The dilemma facing both the Chinese energy

policy makers and large Chinese oil companies today is exemplified by Sinopec's recent purchase of Tanganyika Oil, a Canadian company with its main assets in Syrian oil blocks [11].

When Sinopec International Petroleum Exploration and Production Corporation, through its wholly owned Mirror Lake Oil and Gas Company Limited, offered RMB \$2.5 billion (\$2.1 billion) to acquire Tanganyika Oil last September, the oil price was hovering around \$90 per barrel. But by December, the price had dropped to about \$40. Yet there was no revision of the deal and both the State Council and NDRC went ahead with the required government approval (*Wall Street Journal* [Chinese edition], December 22, 2008)

Many see such a commitment, especially in the face of large financial losses, as a move for the sake of credibility. Others, one of which being the chairman of China's State-owned Assets Supervision and Administration commission, question the wisdom of putting so much money abroad without immediate benefits when there is so much need for cash in dealing with the domestic economic downturn (*Caijing*, December 15, 2008). Yet others, represented by China Petroleum and Chemical Industry Association, view the purchase as a healthy long-term investment in the expectation that the oil price will go back up again in the near future. The latter camp seems to have the upper hand. Only days after the Tanganyika acquisition, Sinopec reportedly offered \$130 million to Urals Energy, a London-listed oil-producing company with a Russia focus. The price tag is supposed to be five times higher than the firm's market value, and the news also generated a 100 percent increase in the shares of Urals Energy (*China Daily*, December 28, 2008).

Nevertheless, such debates demonstrate that China's energy policymaking process is far from being a monolithic bloc. Chinese officials, business leaders and their foreign counterparts are all exploring the implications of China's "go-out" strategy at the moment of economic crisis and oil price uncertainty [12].

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China’s 2008 Defense White Paper: The View from Taiwan

By Cheng-yi Lin

Beijing published the 2008 edition of “China’s National Defense” (hereafter White Paper) on the cusp of U.S. President Barack Obama’s historic inauguration on January 20th. The past three editions (2002, 2004, and 2006) of the White Paper were all published in the final month of every other year, but this time Beijing purposely delayed its release for almost three weeks. An incident wherein Beijing exhibited similar behavior was in July 1998 when it released the 1998 edition of the White Paper on the same day that ministers of the Association of Southeast Asian Nations Regional Forum (ARF), a landmark security dialogue among mainly Southeast Asian states, were

meeting in the Philippines. The meeting coincidentally called upon its members to have more transparency in their defense planning. On both occasions, it is clear that Beijing deliberately choose the timing of the release to indicate its intention to accept the common practice of confidence-building measures (CBMs) in the Asia-Pacific and project an image of a responsible stakeholder.

Although the White Paper argues that China “is still confronted with long-term, complicated, and diverse security threats and challenges,” leaders in Beijing believe that “China’s security situation has improved steadily” [1]. The White Paper mentions that “China’s overall national strength has increased substantially, its people’s living standards have kept improving, the society remains stable and unified, and the capability for upholding national security has been further enhanced” [2]. Most importantly, the White Paper reveals that Beijing’s threat perception in the Taiwan Strait has been greatly reduced. The White Paper, however, explicitly said that China’s military capabilities will continue to grow even as the Taiwan issue thaws, verifying that a Chinese national security strategy looking beyond Taiwan is taking shape.

WHAT IS SAID AND NOT SAID IN THE 2008 DEFENSE WHITE PAPER

Beijing harps that the new White Paper provides previously unreleased information and reflects new changes to the previous editions. For instance, the current edition includes developments in the People’s Liberation Army (PLA) Army, Navy, Air Force and the Second Artillery Force organized by separate chapters rather than grouped into the same chapter like previous editions (*Defense News*, January 26). Some notable developments in each branch of the Chinese armed forces highlighted by the White Paper include: acquiring capabilities of high mobility with three-dimensional assault in the Army; integrated sea-air capabilities for offshore defensive operations in the Navy; integrated air-land capabilities for both offensive and defensive operations in the Air Force; and surface-to-surface missile equipment system comprising both nuclear and conventional missiles with different ranges in the Second Artillery Corps.

Most importantly, the White Paper describes when and how China plans to use its nuclear weapons. The White Paper outlines three different operational scenarios (i.e., under peacetime, nuclear crisis and nuclear attack) for nuclear escalation. The nuclear missile force of China’s Second Artillery Corps will go into a state of alert when facing a nuclear crisis to deter the enemy from using nuclear weapons against China. Beijing’s leader will then use nuclear missiles to launch a counterattack against

the enemy when it comes under a nuclear attack. The conventional missile force of the Second Artillery Force is responsible for conducting medium and long-range precision strikes against key strategic and operational targets of the enemy [3].

While building a modern military, China continues to skip doing certain things in the process of mechanization (i.e. enhancing hardware and acquiring more advanced operational platforms) and strives to achieve leapfrog development in key areas. Therefore, it adopts a policy of composite development of mechanization and informationization (i.e. digitalization of weaponry, information system network, and integration of battle elements, particularly applicable to military command, control, and communication). The PLA is also transforming a strategy from winning a local war with the condition of high-technology to winning a war under the condition of informationization. By 2020, the PLA will accomplish the goal of mechanization and make major progress in informationization (*China Brief*, November 24, 2008) [4].

Even though PLA experts have known the geographical locations of the three fleet commands, the 2008 White Paper was the first to explicitly identify Qingtao as the site for the North Sea Fleet, Ningbo for the East Sea Fleet and Zhejiang for South Sea Fleet. Nevertheless, the White Paper, as usual, did not provide any details on the new Chinese destroyers, frigates, submarines and warplanes that have made the PLA Navy more capable in projecting its power in the region. Reports on the building of aircraft carriers were also not confirmed in the White Paper [5].

The White Paper fails to address concerns over Chinese missile deployments targeting Taiwan and U.S. forces stationed on bases surrounding Taiwan. Moreover, Beijing avoided the chance of explaining its anti-satellite (ASAT) test in January 2007, which remains a major sticking point in Sino-U.S. political-military relations, as well as the decline of a port visit by the USS *Kitty Hawk* to Hong Kong in November 2007. To soothe U.S. security concerns, the White Paper did, however, acknowledge that China and Russia jointly submitted in February 2008, a draft Treaty to the Conference on Disarmament on the Prevention of the Placement of Weapons in Outer Space and the Threat or Use of Force against Outer Space Objects [6].

Beijing cautions in the White Paper that China is facing “the superiority of the developed countries in economy, science and technology, as well as military affairs.” More importantly, China “also faces strategic maneuvers and containment from the outside” [7]. While not pointing a finger at the United States, it is indirectly condemning the United States as its major adversary. China publicly warns

the United States for its arms sales to Taiwan and claims that this will cause “serious harm to Sino-U.S. relations as well as peace and stability across the Taiwan Straits” [8]. Beijing suspended its military exchanges program with the United States in response to the \$6.5 billion arms sales package that the Bush administration sanctioned in October 2008, but with the new Obama administration, the resumption of military relationship is expected to take place soon.

In addition to the United States, Beijing lists separatist forces such as those supporting “Taiwan independence,” “East Turkistan independence” and “Tibet independence” as threats to China’s “unity and security.” The White Paper claims that Beijing has succeeded in thwarting “Taiwan independence” from seeking “de jure Taiwan independence,” therefore, the situation across the Taiwan Straits has taken a significantly positive turn [9]. Beijing believes that cross-strait relations have improved because the Chinese Communist Party (CCP) and the Kuomintang (KMT) have resumed negotiations on the basis of the “1992 Consensus.” The White Paper, however, did not reflect the policy articulated by Chinese President Hu Jintao on December 31, 2008, concerning cross-strait discussion of military CBMs between Taiwan and China through increased military contacts and exchanges.

In the White Paper, China indicated that it has formulated a military strategic guideline of active defense for the 21st Century. This active defense guideline include four components: winning local wars in conditions of informationization; emphasizing the prevention and deterrence of crises and wars; enhancing the capabilities to counter various security threats; and setting up a logistical mechanism of military mobilization and civilian-based economy, science, technology, information and transportation mobilization [10]. In different chapters of the White Paper, the PLA like the United States, is focused on the new task of its armed forces in handling the challenges of military operations other than war (MOOTW) in areas such as counter-terrorism, stability maintenance, emergency response, peacekeeping, emergency rescue and disaster relief [11]. The PLA Navy is also committed to developing a capability of countering non-traditional security threats in distant waters, which explains Beijing’s decision to dispatch a mini-fleet to the Gulf of Aden in the Arabian Sea for protecting its national surface ships from piracy.

The White Paper disclosed the trend in defense budget increases throughout the past three decades. For example, the average annual increase of defense expenditures in the 1978-1987 was 3.5 percent, 14.5 percent in 1988-1997, and 15.9 percent in 1998-2007. Arguably, the increase

reflects its rapid economic growth but also exhibits its need to meet “the requirements of the RMA (Revolution in Military Affairs).” From 2006 to 2008, the PLA’s defense expenditure grew even more significantly. The defense expenditure was RMB 297.938 billion (about \$38 billion) in 2006 and RMB 355.491 billion (about \$45 billion) in 2007, up 20.4 percent and 19.3 percent respectively over the previous year [12]. In a longer time span, Chinese defense spending has risen sharply—from about RMB 16.7 billion (\$2.4 billion) in 1978 to about RMB 417.7 billion (about \$60 billion) in fiscal year 2008, roughly a 25-fold increase. The official figure, however, is much lower than the estimations by different Western defense-related organizations. For example, the White Paper claims that China’s defense expenditure budget in 2007 was around 1.38 percent of China’s GDP, but the Stockholm International Peace Research Institute (SIPRI) calculates that the real figure might be around 2.1 percent of GDP [13].

OVERSEAS CONCERNS

In the 2006 White Paper, Beijing’s leaders was more concerned over the Democratic Progressive Party (DPP) under former President Chen Shui-bian for pushing a pro-independence agenda, such as the name rectification campaign and constitutional reform. Then, Beijing warned that political developments in Taiwan remained a challenge that “must not be neglected,” and that the “struggle to oppose and contain the separatist forces for ‘Taiwan independence’” poses a “grave threat to China’s sovereignty and territorial integrity” (*China Brief*, January 24, 2007) [14]. As demonstrated in President Hu Jintao’s end-of-year “six-point proposal” toward Taiwan, Beijing is far more confident now about the prospect of eventual unification than it was during the past eight years. The new political climate after the 2008 Taiwan’s presidential election greatly altered Beijing’s threat perceptions in the Taiwan Strait.

Although Taiwan’s defense ministry shunned away from making a public statement on the 2008 White Paper, experts in Taiwan argue that there is little new information revealed in the White Paper. While Beijing continues to warn the United States over its arms sales to Taiwan, the Obama administration has no urgent need to consider providing Taiwan with new weapons after the Bush administration announced \$6.5 billion in arms sales to the island. The Ma Ying-jeou government, restrained by the economic downturn and pressure to preserve the political gains from cross-Strait rapprochement, might find less economic and political imperatives to request more advanced U.S. defense hardware including the F16C/D and diesel submarines. Taiwan has long had proposed CBMs with the Chinese

military, such as making defense information more transparent, limiting military deployments, establishing communication channels, and setting up verification measures. Although the 2008 White Paper fails publicly to endorse the future direction of cross-Strait CBMs, it is likely that think tanks in Beijing and Taipei will have more opportunities to talk on issues to “stabilize cross-Straits relations and ease concerns about military security” (Xinhua News Agency, December 31, 2008).

Speculation in the Chinese media continues that Beijing might consider removing or freezing the numbers of its surface-to-surface missiles targeting at the island. The new scenario, however, could pose a security dilemma for the Ma Ying-jeou government and the Obama administration, because Beijing will fully take advantage of this dramatic gesture to weaken justifications of future U.S.-Taiwan military cooperation.

Two days after the publication of the White Paper, President Ma spoke to Taiwan’s military and urged them to combine hard with soft power to safeguard the island’s security. Ma argued that through military readiness, Taiwan could deter a war in the Taiwan Strait. Ma also proclaimed that “resolute defense and effective deterrence” is always the goal of Taiwan’s defense [15]. Nevertheless, both Ma Ying-jeou and Barack Obama will face one chilling reality—that the military balance in the Taiwan Strait is tilting in favor of the PLA.

Compared to Taiwan’s low-keyed response to the White Paper, the Japanese media have been much more vocal. In an editorial of the *Asahi Shimbun* it expressed disappointment because the White Paper “said nothing about China’s reported plans to build new nuclear-powered submarines equipped with ballistic missiles and aircraft carriers” and its “silence about these projects has only increased international unease.” The editorial furthers its critique by commenting that “the report didn’t refer to any review of China’s military capabilities in response to the improvement in relations with Taiwan” (*Asahi Shimbun*, January 23).

In the White Paper, Beijing toned down the pronouncement of its security concerns over Japan’s military modernization compared to its 2006 edition. Japan, however, is particularly concerned that the PLA is building a blue water navy that will pose a security challenge in the overlapping territorial claims over the disputed islands in the East China Sea (*Japan Times*, January 23).

Taiwanese and Japanese concerns are not exceptions. In a Senate Armed Service Committee testimony on January 27, U.S. Secretary of Defense Robert Gates identified the

threats of Chinese military buildup by stating that “the areas of greatest concern are Chinese investments and growing capabilities in cyber and anti-satellite warfare, anti-air and anti-ship weaponry, submarines, and ballistic missiles.” Gates believes that “modernization in these areas could threaten America’s primary means of projecting power and helping allies in the Pacific” [16]. The United States, however, stated that it has “the capability in place to deal with any Chinese threat for some time to come” (*Washington Times*, January 27).

CONCLUSION

Even with further reduction of tension in the Taiwan Strait, China has decidedly maintained its rapid pace in building a high-tech and digital armed force with the ability to counter conventional and nuclear threat or to handle complex issues related to human security. Beijing has shown that its defense planning is already beyond Taiwan’s capability and could potentially challenge Japan and the United States in the Western Pacific. Undeniably, Beijing has made progress with each different edition of the White Paper since 1998, but it still conceals a great deal of defense information that shrouds its intent. Japan as well as the United States, and to a lesser extent Taiwan, are not reassured by Beijing’s latest Defense White Paper. By keeping its strategic planning from being completely transparent, it could strengthen China’s psychological defense vis-à-vis its potential adversaries. Partial revelation of China’s defense information to meet the minimum standard of CBMs, while playing up the role of a responsible stakeholder, appears to be the strategy and intent behind the publication of China’s 2008 National Defense White Paper.

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