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The growth of immigrant populations, such as Guangzhou's "Little Africa," has created new challenges for stability.

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In a Fortnight

BRIEF: TAIWAN TRADE AGREEMENTS WITH SINGAPORE, JAPAN, SHOULD CALM FEARS OF PRC ECONOMIC DOMINATION

By David Cohen

For Taiwan, November has been marked by a burst of activity on the regional trade front. On November 7, Taiwan signed a free trade agreement with Singapore, a day after signing five smaller economic deals with Japan on e-commerce, pharmaceutical regulation, railways, patent recognition and search and rescue (*Taipei Times*, November 8; Focus Taiwan, November 6). Taiwan President Ma Ying-Jeou described the deals as a step toward greater regional economic integration, promising to seek a full free trade agreement with Japan, membership in the U.S.-led Trans-Pacific Partnership (TPP) and further trade agreements with Southeast Asian countries.

These deals are a step toward Ma's promise to diversify Taiwan's export markets away from the PRC. The mainland and Hong Kong currently account for by far the largest portion of Taiwan's exports, representing 40 percent of Taiwanese foreign trade. This situation has led the Taiwanese opposition to warn that the 2010 Economic Cooperation Framework Agreement (ECFA) has made the island economically dependent on trade with the mainland, threatening its independence. The Singapore deal has been under negotiation for three years, starting shortly after the signing of ECFA. The set of deals with Japan also follow an April agreement about fishing near the disputed Diaoyu/Senkaku Islands, which removed the

main irritant between the two parties. Their context also includes current efforts by both the United States and China to build new regional trade systems with the TPP and China's "maritime silk road," proposed by President Xi Jinping at the APEC summit in October (see *China Brief*, Volume XIII, Issue 21).

The Taiwanese foreign ministry described the agreement with Singapore, called ASTEP (Agreement between Singapore and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu on Economic Partnership), as a "high-quality, high-standard and comprehensive economic partnership," clearly seeking the attention of TPP participants (press release, November 7). The United States has used similar language in setting goals for the TPP, implying that joining will require substantial reforms to open the relatively protected economic structures common in Asian countries. By reaching such an agreement, Taiwan evidently hopes to demonstrate the ability and political will to make such changes.

The agreement may also pave the way for other Asian states to enter negotiations with Taiwan by demonstrating that they can do so without coming under fire from the mainland. PRC foreign ministry spokesman Hong Lei expressed Chinese approval of the mechanism used by Taiwan and Singapore to work around the One China policy, saying that "We do not have objections to foreign countries' non-governmental trade and cultural exchanges but do oppose any official ties" (Xinhua, November 7). Singapore is the second country to sign a free-trade agreement with Taiwan since ECFA, following an agreement with New Zealand in July.

While China has apparently given its blessing to Taiwan to strike trade deals independently, it has also been applying pressure for talks about the island's political status, as well as pushing for further economic cooperation. In late October, representatives of the Chinese Communist Party and Taiwan's ruling Nationalist Party discussed Taiwanese participation in the recently-established Shanghai Free Trade Zone at the party-to-party Cross-Strait Economic, Trade and Culture Forum (Xinhua, October 27). The city of Xiamen, China's closest major port to Taiwan, has also announced plans to seek approval for a free trade zone on the Shanghai model, focusing on cross-strait trade (*Shanghai Daily*, November 20).

The PRC has made substantial efforts to integrate Taiwan into its economic sphere since the Nationalist Party returned to power in 2008. ECFA is widely seen as a concessionary agreement that favored Taiwan in order to achieve the political goal of integration. But the mainland appears to be unable or unwilling to interfere with Taiwan's seeking alternatives—likely calculating that to do so would cost it the political influence it has gained with trade agreements in recent years. Beijing accepted even Taiwan's fisheries agreement with Japan, despite its uncomfortable political implications for the mainland. The agreement deprived the PRC of regular opportunities to act as Taiwan's protector, and removed Taiwan as an active player on the mainland's side of a dispute that has become extremely tense in recent years.

China's recent burst of trade diplomacy, in concert with Xi's call for top-level design for regional diplomacy, has raised fears that it plans to use its position as the top trading partner of every country in the region for political leverage (see *China Brief*, Volume XII, Issue 22). But even as China seeks to expand its economic integration with Taiwan, it has not stopped the island from seeking alternative markets. While China is a vast and attractive trading partner, its previous efforts to deploy economic coercion have been unimpressive—witness the rare earths debacle, in which a threat to limit exports to Japan inspired the growth of competitors and undermined the commodity's price. In order for it to use trade as an effective political weapon, China will have to be not only important but indispensable.

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BRIEF: THIRD PLENARY SESSION CALLS FOR PLA REFORM AND RESTRUCTURING

By Kevin N. McCauley

The reforms announced by the recent Third Plenary Session of the 18th Central Committee were headlined by economic pronouncements, but also contained ambitious language on the reform and restructuring of the Chinese military. The details remain sketchy, but according to the communiqué and subsequent press articles areas include adjusting the force mix according to the security

requirements of various directions, reducing non-combat institutions and personnel, greater innovation in military theory, strengthening military leadership, building a system to generate greater warfighting capability, reform of military colleges and unit joint training, noncommissioned officer (NCO) system, strengthening military-civilian integration, improving weapons development and procurement, and improving the joint operation command system (Xinhua, November 16; on NCO reform, see *China Brief*, Volume XI, Issues 18 and 20).

Most of these proposals are not new. Rather, they are extensions of previous rounds of reform aimed at streamlining and modernizing the Chinese military, and political endorsements of reform ideas that have already circulated among military research institutions. Of all the proposals, institutional and cultural changes within the Chinese military could be the most important. A National Defense University (NDU) publication argued that the parochial interests of the services and institutional conflicts within the People's Liberation Army (PLA) are the main constraints to transformational efforts (*SOSS*, p. 244; *100 Questions*, pp. 196–197 *). Overcoming them would require a bold initiative to alter the PLA's command and institutional structure, which currently give the Army a dominant role. Since many of the newly announced reforms have been modernization areas for the past decade, the proposal could indicate that previous efforts have fallen short of the mark, and require adjustments and reinforcements.

The 2003–2005 PLA reductions included non-combat personnel and institutions, streamlining staffs, and some consolidation of military educational institutes. Since then, the PLA has conducted additional adjustments of force structure and reform of professional military education, the NCO corps, as well as researching new operational theories and methods such as integrated joint and system of systems operations. Recent PLA publications have stressed force structure, command, educational, unit training, and institutional changes required to support these emerging theoretical concepts (see *China Brief*, Volume XII, Issue 8, “System of Systems Operational Capability: Impact on PLA Transformation”).

Many of the reform areas announced by the Third Plenary Session have been a focus of discussion in

PLA publications during the past few years to support the implementation of joint and system of systems operations capabilities that could significantly increase PLA warfighting capabilities. The development of an integrated command information system and creation of a joint command structure are required to support these theoretical developments. The PLA is slowly developing a modern command information system for joint command (C4ISR), and there have been calls to create theater joint operational commands to replace the current Military Region headquarters, which are dominated by the ground forces. Several different command structures have been proposed, including functional-based and organization-based systems (China Military Online, July 1, November 25; *SOSS*, pp. 244–254).

PLA publications have also anticipated the Third Plenary Session's call for the need to streamline the force structure, optimize force composition and combined arms capabilities, and reduce non-combat units. However, forces that the PLA views as key to evolving operational theories will continue to expand and modernize, including Army Aviation, special operations, PLA Air Force (PLAAF) offensive forces, psychological warfare, cyber operations, and space operations forces (*SOSS*, p. 341; *100 Questions*, pp. 177–183).

System of systems and joint operations theory are already changing operational patterns and methods, leading to new educational and training requirements to address the lack of personnel with high-tech and joint operations experience, and train units on integrated information systems. Cultivating skilled personnel, especially joint commanders and staff, is viewed as critical to this effort (*SOSS*, pp. 342–344). Personnel training recommendations include: reforming academic training program content; increasing job rotation and cross-training efforts; expanding opportunities for joint command personnel to study abroad; and integrating academic institutes with exercises (*SOSS*, pp. 347–351; *100 Questions*, p. 236).

Some of the reform areas coming from the Third Plenary Session are already the focus of improvements and change within the PLA. Equipment modernization, unit training, professional military education, and adjustments to force structure have been ongoing to some degree over the past decade or more, although the quality of

the reforms is difficult to gauge. Developing a joint operations command structure, particularly at the theater level might be the most important recommendation, and would be a start to changing institutional and cultural impediments to transformation.

Since details of the renewed efforts have not been announced, it is too soon to say whether inclusion in a political document will lend impetus to reform and restructuring. A *South China Morning Post* article quoted current and retired PLA officers suggesting that any reform and restructuring efforts will be limited in scope, with small adjustments and improvements, but no sweeping changes (November 16). This assessment accords with this analyst's observations of change within the PLA, which is generally slow, incremental, and steady towards the overall goals, with adjustments through the process as necessary. Ongoing educational reforms within the PLA will only slowly change the culture and promote greater jointness within the PLA. Implementing theater joint operations commands would be a bold gesture that could indicate a serious move to reform the PLA at a more rapid pace.

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* *Information System-Based System of Systems Operations Study*, (Beijing: National Defense University Press, 2012), referenced as *SSOS*.

Information System-based System of Systems Operational Capability Building in 100 Questions (Beijing: National Defense University Press, Jun 2011), referenced as *100 Questions*.

Xi's Power Grab Towers over Market Reforms

By Willy Lam

While the recent Third Plenary Session of the 18th Chinese Communist Party (CCP) Central Committee was expected to unveil major initiatives in economic liberalization, what has struck Chinese and foreign observers most is the weight that the leadership has

given to enhancing state security, particularly centralizing powers in the top echelon of the party-state apparatus. The CCP's monopoly on power. The plenum set up a National Security Committee (NSC) to better coordinate the work of departments handling functions that range from police and counter-espionage to the media and foreign affairs. Given that apart from the NSC, President Xi will most likely also head a newly established Leading Group on the Comprehensive Deepening of Reform, the already formidable powers of the party General Secretary and Command-in-Chief will be augmented further.

A paragraph in the plenum communiqué, which was released on November 12, said that the NSC was set up to “perfect the structure of state security and national-security strategies, so as to [better] safeguard national security.” “We must improve the ways of social governance, stimulate the energy of social organizations and bring about innovation of systems to effectively prevent and end social contradictions and improve public security,” the document added (Xinhua, November 12; *People's Daily*, November 12). While the official media has given scant details about the NSC, it is expected to be a state organ whose status is on par with commissions and leading groups—such as the Central Military Commission and the Leading Group on Foreign Affairs (LGFA), which are also headed by Xi—that report directly to the Politburo Standing Committee (PBSC), China's highest ruling council. In his explanation of the “Resolution on Certain Major Questions regarding the Comprehensive Deepening of Reforms” (hereafter “the Resolution”), the full text of which was released on November 15, Xi noted: “The NSC's main responsibilities are to formulate and implement national security strategies, to push forward legal construction on state security, and formulate the goals and policies of national security work.” Referring to the connection between external and internal threats, Xi said: “Our country faces the double pressure of protecting national sovereignty, security and developmental interests from outside [threats] and safeguarding internal political safety and social stability” (Xinhua, November 15; China News Service, November 15).

While the NSC shares its name in Chinese with the U.S. National Security Council, it is believed to be focused primarily on internal security. This includes combating challenges posed by “hostile anti-China forces from

abroad.” Within the party’s highest echelons, there are already two units—the LGFA and the Leading Group on National Security—that perform roles similar to that of the American NSC. Reports in the non-official China media and the Hong Kong press have published several possible lists of ministries and ministerial-level units that will send senior representatives to the new body. Each list is slightly different, but there is a substantial overlap, all of them including the following bodies: the People’s Liberation Army, the People’s Armed Police (PAP), the Ministry of Foreign Affairs (MOFA), the Ministry of Defense, the Ministry of Public Security, the Ministry of State Security (MSS), the Ministry of Trade, the Department of Propaganda and the International Liaison Department (ILD). The NSC will be chaired by President Xi. The two Vice-Chairs are expected to be Politburo member Meng Jianzhu, who is in charge of the Central Political-Legal Commission (CPLC), the country’s top law-enforcement body; and Politburo member and Director of the Central Policy Research Office Wang Huning, who is Xi’s top diplomatic advisor. Its secretary general is tipped to be either CPLC Secretary General Wang Yongqing or the Deputy Minister of Public Security Fu Zhenghua, who is deemed a Xi protégé. Full details of the components of the NSC and its principal officials, however, have yet to be released by the authorities. (China Review News [Hong Kong] November 14; *Ming Pao* [Hong Kong] November 14; *Apple Daily* [Hong Kong], November 13).

Foreign Ministry spokesman Qin Gang linked the NSC to China’s campaign against the “Three Evils,” saying that the commission “will make terrorists, separatists and religious extremists very nervous.” The Three Evils are a crossover between foreign and domestic security concerns, usually described as sources of domestic instability caused by the meddling of other countries or non-state groups. According to Li Wei, Head of the Anti-Terrorism Research Center of the China Institute of Contemporary International Relations, the NSC is “geared toward handling the increasing number of major incidents and mishaps that will impinge upon our country’s security and interests.” Li indicated that the NSC’s concerns include non-traditional security issues including economic and financial security, environmental safety, terrorism and piracy (*People’s Daily*, November 14; China Review News [Hong Kong], November 13). Given the CCP’s long-standing belief that many of the country’s destabilizing agents are abetted by hostile foreign

countries—which seem bent on subverting the socialist system via mechanisms such as “color revolutions” or “peaceful evolution”—internal order can only be upheld through obtaining sound intelligence from units such as MOFA, ILD, MSS as well as military-intelligence units. As the *Global Times* pointed out, “social transformation has resulted in the profusion of contradictions within China.” “Foreign forces are increasingly keen to challenge China by exploiting our internal problems—and their levers for doing so have become more numerous,” the party mouthpiece added. The paper cited as example the growing number of accidents involving ethnic minorities, “which have turned ugly owing to China’s radically changed external environment” (*Global Times*, November 13; Sina.com, November 13). Given the leadership’s growing awareness of what the *Global Times* calls “the mega concept of security,” the current top organ for maintaining security—the party’s Central Political-Legal Commission, which is in charge of the police, the prosecutor’s office and the courts—does not have enough resources to cover all aspects of national security. Moreover, the reputation of the CPLC has been dealt a heavy blow as Zhou Yongkang, the former PBSC member who headed the commission from 2007 to 2012, is believed to have been under investigation for alleged corruption (*South China Morning Post*, October 22; BBC Chinese Service, October 21). Chinese media, however, have yet to disclose details about the relationship of the NSC and the CPLC.

Quite a number of liberal intellectuals are alarmed by the NSC’s apparent similarity to the all-powerful internal-security units in the former Soviet Union. According to economist Xia Yeliang, a former Peking University professor and noted public intellectual, “the authorities are very worried about stability despite the apparent achievements in economic development.” “The NSC will make better use of the military, the [quasi-military] PAP, spies and even anti-corruption agents to promote internal security,” he told the Hong Kong media. “There are parallels between the NSC and the KGB [under the Soviets].” Internationally recognized dissident Hu Jia noted that the NSC is a “much-strengthened version of the Central Political-Legal Commission.” “The spirit of the KGB is alive and well in China,” he asserted. Beijing-based human-rights lawyer Liu Xiaoyuan asked this rhetorical question: “The CCP has set up the NSC to uphold state security, can we set up a people’s security

commission to safeguard the security of the people?” (Thehousenews.com [Hong Kong] November 13; VOA Chinese Service, November 13).

Given President Xi’s concerns about stability—and the maintenance of a strong leadership—it is perhaps not surprising that while the plenum communiqué indicated that market forces would be playing a “decisive role” in the allocation of resources, party members and the business community alike are asked to “unshakably consolidate and develop the public ownership system, uphold its dominant status... and incessantly strengthen the vitality and influence of the state-owned economy.” (Hong Kong Economic Journal, November 14; *South China Morning Post*, November 13). The Resolution, however, made pledges about gradually allowing private enterprises to get into the financial sector and also incrementally allowing peasants to monetize their plots of land through means including using them as collaterals. The Resolution also vowed that the construction of free trade zones such as the one that recently opened in Pudong, Shanghai, would be “speeded up.” As expected, the one-child family policy was partially liberalized. A couple may have two kids if either the husband or wife is a single child (Xinhua, November 15; CCTV News, November 15). In discussions in the run-up to the plenum, Premier Li Keqiang, who is the PBSC member with responsibility for the economy, has reiterated that wherever possible, “the government should allow the market to do its job.” The communiqué and the Resolution, however, have put the emphasis on “top-level design,” meaning that the party-state leadership should firmly control whatever kind of economic and social transformation that meets Beijing’s criteria of “striking a balance between reform, development and stability.” As the Resolution pointed out, the authorities must “boost society’s harmonious factors to the largest degree” and “raise the level of social governance so as to safeguard state security and to ensure social order.” “We must push forward the modernization of the institutions of social governance,” it added (Xinhua, November 15; China News Service, November 13).

To ensure the success of reforms, the plenum also decided to set up a Leading Group on the Comprehensive Deepening of Reform. The *Wen Wei Po*, a Chinese-controlled Hong Kong paper, and Phoenix TV, which has close ties to Beijing, have reported that President

Xi will most likely be the head of this Leading Group, which will supervise policies regarding reforms in the economy, politics, culture, society, the environment and party construction (*Wen Wei Po*, November 15; Phoenix TV Net, November 14). That Premier Li has not been given control of the Leading Group is also confirmed by descriptions of the Plenum. Xi rather than Li was named as the Head of the team drafting the Resolution, while two Sub-Heads of the drafting team were the PBSC member in charge of ideology, Liu Yunshan, and PBSC member Zhang Gaoli, who is Executive Vice-Premier (Xinhua, May 15, *People’s Daily*, May 15). While the exact tasks of this top body have yet to be delineated, will the establishment of yet another high-level organ exacerbate the bureaucratic nature of China’s decision-making process? After all, one of the first efforts of Premier Li upon becoming head of government last March was to streamline the structure of the State Council. Moreover, the National Development and Reform Commission, a “super-ministry” that is often dubbed a mini-State Council, has for the past decade been responsible for the design and implementation of different types of reforms (*Ta Kung Pao* (Hong Kong), November 6; China News Service, September 2).

Given the likelihood that President Xi, not Premier Li, will take the helm of this leading group, the question of whether too much power has been vested with the supremo—and whether some form of power struggle has broken out between Xi and Li—has been raised. There are also doubts about whether Xi’s insistence on party leadership of economic policy would contradict the pride of place that Li seems to be giving to market forces. The plenum communiqué and Resolution put a lot of emphasis on the fact that “comprehensively deepening reform must require strengthening and improving party leadership, and fully developing the core leadership function of the party in taking charge of the whole situation while coordinating [the needs] of different sectors.” The documents also called upon “party committees of all levels to earnestly fulfill the leadership responsibility over reform.”

In the eyes of Chen Ziming, a famed theorist of reform, the much-anticipated Third Plenum has turned out to be more a question of power than of reform. “With Xi Jinping becoming the head of the two new committees [set up at the plenum], he has tightened his stranglehold

on the reins of power,” Chen said. “We still do not know enough of Xi to tell what he is about to do. He can go down the road of [the reformist former Taiwan president] Chiang Ching-chuo or he could become another [Cambodian dictator] Pol Pot.” (*Ming Pao*, November 14; *Ming Jing News* [Hong Kong], November 12). The tortuous history of China’s reforms seems to show that the quasi-superpower has yet to undergo tougher tests before it can hit upon a formula that will satisfy both the rulers’ urge to control and the people’s desire to liberate their production forces.

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Economic Reform in the Third Plenum: Balancing State and Market

By Nicholas Borst

China’s top leadership met this November to set a course for the country’s next wave of reform. President Xi Jinping promised a “comprehensive approach” to reform prior to the plenum and the official “Decision on Major Issues Concerning Comprehensively Deepening Reforms” largely delivers on this promise in the economic realm, where large changes in fiscal policy, competition policy, factor pricing, and state-owned enterprise reform are outlined. (The “Decision,” made public November 16, serves as the main source for this article). The document sets out an impressive list of declared goals for economic reform, but the true test will occur when implementation runs up against the power of vested interests.

At its core, the strategy for reform revolves around

creating and a more market-based and competitive economy. The key challenge to achieving this goal is establishing a proper relationship between government and the market. To reach the next state of economic development, the Chinese government recognizes that it must become comfortable with allowing a greater share of economic activity to occur outside the scope of government influence. A reduction to government interference with factor pricing, removing regulatory barriers to investment, and reforms to state-owned enterprises are all outlined necessary reforms.

The call to adjust the state’s relationship to the market echoes a speech given by Premier Li Keqiang this March on the need to cut regulatory red tape and for the government to focus on providing public goods. The move to restrict the government’s role in the economy represents a major shift in attitude and ideology for a government historically defined by interventionist impulses. The plenum report calls for the government to relax the approvals process, give enterprises independence in making investment decisions and for the central government to avoid regulating micro issues and focus on macroeconomic coordination.

The plenum report calls for the market to play a “decisive role” (*juedingxing zuoyong*) in the allocation of resources in the economy. This represents an elevation from previous party documents, which assigned the market a “fundamental role” (*jichuxing zuoyong*) in resource allocation. This change in language reflects a step forward in the continued reduction in the number of official price controls. Areas that are specifically targeted in the report include the prices of water, oil, natural gas, electricity, transportation and information technology.

Related to the goal of increasing competition and reducing government interference in the economy, the plenum report affirms the critical role of the private sector and companies of mixed ownership in the economy. Critically, the report identifies the non-state firms as an important part of the socialist market economy system in China. This is representative of a continued evolution in official thinking towards embracing and fostering the growth of the private sector. The report calls for establishing equal rights, rules and opportunities for non-state firms in the economy. Achieving this goal will mean finding a way to

inject more competition into the state-dominated areas of the economy. Private and mixed ownership firms have become the dominant source of growth in the Chinese economy and the future of economic development will rely on creating more space and equality of opportunity for these firms to grow.

One of the most specific goals called for by the report is the allocation of a greater share of state-owned enterprises profits to the national budget. This is a progression of the goal for a higher rate of dividends to be paid, set out in the income inequality plan released by the State Council in February (Caixin, February 6). The plenum report calls for 30 percent of SOE profits to be paid to the state budget by the year 2030. This is a large change from the status quo: according to an IMF estimate, only 0.4 percent of SOE profits went to the national budget in 2011. These funds will provide much-needed resources for the government during a time of slowing revenue growth and should be targeted towards an expansion of the social safety net in order to facilitate economic rebalancing.

The plenum document calls for the relaxation of investment restrictions and further opening to international investment and competition. A specific example of this in the report is the call for an expansion of the negative list approach for investment approval. The adoption of a negative list approach would open up all areas of the economy not explicitly prohibited to investment. This is a significant improvement over the current positive list approach which requires investors to seek government approval. The key to the effectiveness of such a policy change is whether the scope of areas prohibited will be significantly reduced. Such a move would increase competition in currently protected areas of the economy and allow foreign investors to receive national treatment.

The Shanghai Free Trade Zone received a strong signal of support in the plenum decisions report. When the FTZ was officially launched at the end of September, no high-level Chinese leaders attended the opening ceremony, generating concern in the international media that Beijing had abandoned the project (*The Economist*, September 30; *Wall Street Journal*, October 7). Without high level support, the Shanghai Free Trade Zone would be destined to go the way of the other special economic

zones created in recent years in Shenzhen (Qianhai) and Tianjin (Binhai), which have largely floundered. The plenum report removes any such doubts by identifying the Shanghai Free Trade Zone as a “major measure” by the government to promote further economic reform and experiment with policies which may be expanded to the rest of the country.

Fiscal imbalances between the central and local governments are also highlighted in the report as an area for reform. The report identifies the need for a rationalization of revenues distribution between local and central government based on their respective responsibilities. The core of the problem is the mismatch between revenues and expenditures for local governments. The plenum report calls for adjusting the system of transfer payments from the central government and improving the division of responsibility between localities and the center. These changes seem modest compared to the problem being addressed, a fiscal crunch which has led to an unprecedented local government borrowing spree. The growth rate of local government debt is unsustainable, and much of the financing has occurred through murky channels. The report calls for improved budget transparency and mechanisms to identify budgetary risks. Another important reform outlined is the expansion of the property tax, which could serve as an important source of revenue for local governments. A property tax was initially unveiled in Shanghai and Chongqing several years ago, but it has not generated significant revenue, nor been expanded to other cities. Presently, property taxes in Shanghai and Chongqing municipality account for less than one percent of local government revenue (Economic Observer, March 18). A wide-reaching property tax would provide a more sustainable source of revenue for local government and help deflate the property bubble.

The section on financial reform in the plenum report contained no major changes, instead calling for a continued implementation of existing reforms such as liberalizing interest rates, opening the capital account, increasing the proportion of direct financing in the economy, and establishing a deposit insurance scheme. These policies have been on the agenda for a while and the plenum report contains little in the way of specific implementation goals. The most innovative proposal in the document is the call for allowing private capital to

establish small and medium sized financial institutions. If acted upon, it could help break the near-monopoly role the state currently plays in the allocation of capital. Unfortunately, private financial institutions are unlikely to make much progress as long as distorted interest rates lead banks to compete on market share rather than risk management.

Despite the numerous and wide-ranging call for economic reform, there exists a fundamental tension within the document that is difficult to reconcile. The communiqué calls for the strengthening the position of state-owned enterprises and reaffirms their leading position in the economy. This conflicts with the overarching themes of allowing the market to play a greater role in economic outcomes, increasing competition and ensuring equality opportunity for non-state firms. All of these policies would result in a further withering of the position of state-owned enterprises.

Since China adopted the goal of establishing a socialist market economy during Third Plenum in 1993, Chinese policymakers have struggled to strike the right balance the state and the market. The core tenet of the social market economy strategy is to use market mechanisms to improve the efficiency of the economy without fully transferring to a capitalist economic system. The strategy of the Chinese government has been to gradually reduce interference with prices and allow the market to determine an increasing share of economic outcomes.

The transition to a more market-based economic system has been difficult for state-owned enterprises. Burdened with large workforces, inefficient corporate structures, and the requirement to provide extensive social benefits, state-owned enterprises shrank in profitability in the 1990s. To rectify the situation, Premier Zhu Rongji embarked upon a massive reform effort in the late 1990s, restructuring some state-owned enterprises while shutting down others. The result was a considerable improvement in the health of many state-owned enterprises during the 2000s. Unfortunately, these trends have shifted in recent years with the efficiency and profitability of state owned enterprises once again falling far behind their mixed ownership and private sector counterparts (China National Bureau of Statistics (2013); for a discussion of the data, see “China’s Credit Boom: New Risks Require New Reforms,” Peterson Institute for International

Economics policy brief).

At a fundamental level, the more the Chinese economy allows the market to determine economic outcomes, the faster the state-owned enterprises will slip away in to irrelevance. Chinese state-owned enterprises are likely to only remain dominant in the sectors where they have been granted administrative monopolies or where economies of scale lead to natural monopolies. Chinese policymakers must reconcile the fact that a modern market-oriented economy will not be one where state-owned enterprises continue to occupy the commanding heights. The politics of this transformation will be difficult as state-owned enterprises represent are one of the country’s strongest vested interests and wield considerable policy influence.

China’s third plenum was a strong herald for future reform and it proposes solutions to many of the most critical economic problems facing the country. The scope and scale of reforms decided by the plenum mostly meet the expectations set by the top leadership of a comprehensive approach to reform. Moving forward, the key indicator of progress will be the pace and detail of policy implementation documents due to be released over the next few months. The newly established Leading Small Group for Comprehensive Deepening of Reform may give the leadership sufficient power to force through some difficult reforms (See “Xi’s Power Grab Towers over Market Reforms,” in this issue). While the signs for economic reform are hopeful, vested interests in China are likely to resist many of the policies announced. Sustained momentum for reform from the highest levels of the Chinese government will be necessary to achieve the full potential of the third plenum.

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Firm Warning, Light Consequences: China's DPRK Policy Upholds Status Quo

By Seong-hyon Lee

The belief that China has shifted its foreign policy on North Korea has been unusually robust during this year's Korean crisis. China is said to have responded with unprecedented toughness to its intractable neighbor's recent nuclear test. However, further scrutiny of the available body of facts and information that have shaped such views finds little support for this interpretation.

China was genuinely angered by North Korea's provocations, but it imposed only *pro forma* economic sanctions in response, with little real impact on North Korea's economy. In fact, China-North Korea trade continued to increase at the height of China's purported punishments. Nor was Beijing's anger felt in the Chinese cities bordering North Korea, where informal cross-border trade continued.

Beijing's bedrock North Korea policy remains unchanged: It views Pyongyang as a strategic net asset in regional politics, and is not about to abandon its Cold War ally. At the end of the day, China's reaction to the nuclear test was about maintaining its credibility and saving face after being defied by a client state, rather than changing the regional dynamics in accordance with Washington and Seoul's hopes (correspondence with Stephanie Kleine-Ahlbrandt, U.S. Institute of Peace, November 2013).

China is widely seen as the only country with any leverage over the North, and also virtually its sole aid supplier. China has long been blamed by the international community for "shielding" the North from international criticism despite the latter's various belligerent acts. Beijing perceives Pyongyang as a useful "buffer zone" against the United States and its allies—a mentality that goes back to the Cold War period. However, both leading up to and following North Korea's most recent test, China spoke out much more openly than it has against most similar actions in the past, and supported UN sanctions in response to the test.

China's baseline policy toward the Korean Peninsula has

long been characterized by the "Three No's": "no war, no instability, no nukes" (*buzhan, buluan, wube*), in descending order of importance (*Ta Kung Pao*, April 10; ifeng.com, April 10; Global Times Online, June 27). Beijing does not support the DPRK's nuclear brinksmanship, but it is much more concerned about the risks of regime instability and fundamentally seeks to preserve the status quo. China's leaders have made it clear that they would prefer to a less aggressive Pyongyang, but their goal is regional stability and they are not interested in a strategy that might weaken the regime.

Yet this time around, China's attitude was seen very differently. Viewing China's response as unusually harsh, many analysts perceived a reordering of Chinese priorities on the Korean Peninsula (38 North, July 2). China, they wrote, was now signaling that it would make denuclearization its first order of priority in dealing with North Korea, supporting U.S. goals (CSIS paper: "Reordering Chinese Priorities on the Korean Peninsula," November 2012).

Firm Warnings

In the days leading up to the recent nuclear test, the Chinese government engaged in considerable efforts to dissuade Pyongyang from the move. China's then-deputy Foreign Minister, Cui Tiankai, reaffirmed Beijing's disapproval of Pyongyang's third nuclear test when he said that China "resolutely opposes" the move (news video seen on ifeng.com, February 5). Diplomatic sources in Beijing told the South Korean daily *Chosun Ilbo* that the Chinese Foreign Ministry summoned North Korean Ambassador Ji Jaeryong twice to demand that his country cancel the test (February 7).

China's state-run *Global Times* also warned Pyongyang in an unsigned editorial that there would be a "heavy price" if the imminent nuclear test went ahead. It also threatened that China would cut off aid (February 7).

"China Rebukes North Korea"

When, despite all these efforts, North Korea went ahead with a nuclear test on February 12, China was visibly upset. China made a show of getting tough on North Korea by implementing UN sanctions. Some Chinese people even staged protests in front of the North Korean embassy, and the government allowed media

to criticize the country. Furthermore, Deng Yuwen, the deputy editor of the Central Party School's *Study Times*, published an Op-Ed in the *Financial Times* titled "China should abandon North Korea," which drew worldwide attention, sparking speculation that China had finally lost patience with its neighbor (February 27).

China's anger appeared to reach a climax in April, when Communist Party chief Xi Jinping said in a speech at the Boao Forum, "No one should be allowed to throw a region, and even the whole world, into chaos for selfish gain" (Xinhua, April 7). It instantly made international headlines. Given its context, it was taken as a veiled rebuke. Dramatic headlines appeared in the wake of Xi's speech, such as: "China rebukes North Korea, says no state should sow chaos" (Reuters, April 7), "China signals North Korea to stop throwing the 'world into chaos'" (*Los Angeles Times*, April 7), "Chinese President Xi Jinping expresses concern over North Korea's rhetoric" (*Washington Post*, April 7).

Even U.S. President Barack Obama publicly said that China was "recalculating" its North Korea policy (AFP, March 13). But interviews with members of the Chinese security community reveal that the reality was quite different. Obama's remark was seen in China as a politically calculated statement, designed to publicly pressure China to conform to the American "responsible stakeholder" framework (Author's interview, April 17).

Re-examining the Evidence:

Deng Yuwen's Editorial

Deng's article, coming from a senior official in an important organization, was cited as a major piece of evidence about private debates about the DPRK alliance among the Communist Party leadership. Otherwise, the logic went, Deng would not have dared to risk his career by writing such a bold piece. Some also believed that the Chinese foreign ministry had been involved in "pre-consultation" before granting Deng a green light to publish.

However, in an interview with the author, Deng said that he did not consult the foreign ministry (March 27). The article, he said represented only his personal views. Deng's article had in fact been rejected for publication by several Chinese media outlets before he translated it into

English and tried his luck with the foreign media. When the foreign ministry saw the article, it lodged a protest with the Central Party School. In a clear indication that the piece did not represent an official position of the Chinese government, Deng was eventually fired (*Chosun Ilbo*, April 1).

Xi's Condemnation of "Selfish Gain"

Deng was not the most senior figure in China who raised false hopes in the outside world about Beijing's policy toward Pyongyang. Xi's statement about "throwing the world into chaos for selfish gain" was read as further evidence.

Xi's veiled language was confusing enough to even a Chinese audience that some Chinese academics confirmed to their Western counterparts that Xi was referring to North Korea. However, this interpretation was rejected by the Communist Party's official *People's Daily* a few days later (April 9). It stated: "The Chinese and foreign media have speculated, who harbors 'selfish gain?'" It went on to catalogue turmoil in Libya, Egypt and Tunisia, noting that "Western countries" are responsible for them, referring to the United States and its allies.

The Communist Party's English-language mouthpiece, *China Daily*, was even more blunt. In an editorial titled "Xi's Security Outlook," it again listed global hot spots from the Syrian crisis to territorial disputes in the South China Sea (April 10). It argued that many of the world's security woes today can, in one way or another, be traced back to the pursuit of "selfish gains in disregard of regional and global security needs." Again, this editorial from *China Daily*, meant to clarify Xi's comment, explicitly mentions a "global" security crisis. A state with global outreach, subject to Xi's criticism and which has involvement in different global hotspots ranging from the Middle East to the South China Sea, is clearly the United States and not North Korea.

Economic Sanctions

Many members of the U.S. policy community argue that China's seemingly stringent implementation of UN-mandated sanctions prove that it is moving to support the U.S. effort to increase economic pressure on the DPRK. After the UN adopted a punitive resolution against the nuclear test, Li Baodong, the Chinese ambassador to

the United Nations, told reporters: “We want to see the resolution completely enforced,” a stark departure from China’s previous grudging attitude toward sanctions (Hankyoreh, March 7). International media also reported that China had stopped providing oil to North Korea in February (Reuters, March 21). Coming in the same month as the nuclear test, this was read as sign of anger. In April, China’s Ministry of Transportation (MoT) sent out a directive to relevant government agencies, including the Customs Office, to “strictly enforce the UN resolution” on North Korea (MoT, April 17). Then, in May, China’s state-owned Bank of China reportedly cut off its dealings with North Korea’s Foreign Trade Bank (*Financial Times*, May 7).

Yet China’s punitive actions were more symbolic than substantive. China made it clear that it was clamping down only on “illegal” trade activities. That meant that “legal” trade behaviors would be left intact, including the annual Chinese shipment of 50 tons of oil to North Korea. In an interview with the author, a Chinese security expert based near the border dismissed reports that oil shipments had been interrupted (May 2013). During the author’s own field study in Dandong in May, local business people reported that Sino-North Korean border trade there remained largely intact.

It was also not clear whether the restrictions on trade between the Bank of China and North Korea’s Korea Trade Bank had any impact. These exchanges had been very limited from the start. Furthermore, after the 2007 Banco Delta Asia incident, in which the United States froze many of North Korea’s international bank accounts, North Koreans who regularly conduct business in China switched to cash dealings, or borrowed Chinese-name accounts. Doubts about the effectiveness of the UN sanctions and the Chinese cooperation were confirmed when trade between China and North Korea hit a record high of \$4.69 billion during January–September 2013, a 4.5 percent increase over the same period last year (*Donga Ilbo*, November 6).

Nor was it a departure from past practice for China to agree to punitive UN resolutions: North Korea has so far conducted three nuclear tests; China agreed to punitive resolutions after all three of them. While China prefers lesser measures in response to North Korea’s conventional missile tests, a nuclear test is China’s

threshold for accepting UN resolutions against North Korea, according to a Chinese security expert with a government think tank (Author’s interview, February 2013).

Most recently, China issued a list of goods banned for export to North Korea. Yet Hong Lei, a spokesman for China’s Ministry of Foreign Affairs, drew a clear line, stating that “punishment is not the goal,” “It is to encourage denuclearization on the Korean peninsula” (Reuters, September 24).

Conclusion

China’s plans hardly matched the hopes of the United States and its allies. As the *Global Times* wrote a week before the nuclear test: “It is unlikely that China will punish North Korea as harshly as countries like the United States, Japan and South Korea would prefer, and the friendship between the two sides is not going to end. The West should understand this clearly” (February 6). Around the same time, a Chinese expert predicted that “China will join the UN to condemn North Korea and we will have a cooling-off period. But after some time passes, ties will be back on a normal track. We need each other strategically in East Asia” (Author’s interview, February 2013).

China has clearly not joined with the international community to place the Kim regime under long-term pressure. Instead, Beijing seeks to get the attention of North Korean leaders without destabilizing the country, aiming to preserve the existing situation.

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Strike Hard Against Immigration: China's New Exit-Entry Law

By Melissa Lefkowitz

In July of this year, China enacted its first major reform to its immigration policy since 1986. Passed by the National People's Congress Standing Committee in 2012, the Exit-Entry Administration Law, which has replaced the Law for Foreigners and the Law for Citizens, features harsher penalties for visa overstays and unauthorized work. This new law, along with China's upcoming revisions to its permanent residency application system, makes abundantly clear the fact that China has little interest in becoming a receiving country for transnational migrants. Yet, as the country with the second highest GDP in the world, porous borders and strong incentives to maintain healthy diplomatic relations with the global South, it is necessary for China to rethink its piecemeal policies and opt for a more comprehensive strategy toward international immigration.

Although this is not the first time China has cracked down on visa applications—visa issuance was severely restricted to foreigners leading up to the 2008 Beijing Olympics—this is the first time that foreigners will face detention and investigation for overstaying their visas (up to sixty days “if the case is complicated”). Foreigners working illegally will now face detention (five to fifteen days) or monetary fines of up to 20,000 RMB (\$3,260 USD). Previously, the penalty for unauthorized work did not exceed a monetary fine of 1,000 RMB (\$163.00 USD). Companies and institutions that provide fake certificates or invitation letters to unqualified foreigners will be fined up to 10,000 RMB (\$1,630.00 USD) per person, and be responsible for the cost of their deportation. The fines will not exceed 100,000 RMB (\$16,290 USD), as opposed to 50,000 RMB (\$8,145.00 USD) in the previous law. Lastly, foreigners who own companies and delay paying wages to workers will be prevented from leaving the country (*China Daily*, July 1).

Historically, China has not been a destination country for labor. For centuries, China has sent its workers abroad, as Chinese companies have in recent years in establishing operations in Africa. Yet significant inflows

of labor have emerged over the past decade. According to a 2011 Brookings Report, China's transnational migrants are increasing at an “unprecedented scale,” or ten percent annually since the year 2000, according to Yang Huanming, vice-minister of the Ministry of Public Security (Brookings, September 8, 2011; Xinhua, June 30, 2012). China's 2010 census, the first to record the amount of foreigners residing in the country, documented approximately 594,000 foreigners living in China in 2010 (*South China Morning Post*, July 1; China National Bureau of Statistics, *Major Figures on Residents from Hong Kong, Macao and Taiwan and Foreigners Covered by 2012 Population Census*, April 29, 2011).

International enclaves can be found throughout the country, in such varied locations as Shanghai and Beijing Municipalities, Guangdong, Jiangsu, Fujian, Yunnan, Zhejiang, Shandong, and Liaoning Provinces, and Guangxi Zhuang Autonomous Region. Residents of international communities are of both legal and illegal status, and attempts to decipher how many people live permanently in these areas are often inconclusive (Brookings, September 8, 2011). For instance, it is estimated that between 20,000 and 100,000 Africans reside in Guangzhou's thriving small-scale trade community, otherwise known as “Little Africa” (*World Policy Journal*, February 18, 2011). While China's National Tourism Administration Agency collects figures on how many foreigners enter the country per year for tourism, family visits, meetings and employment (approximately 27 million in 2012), local registration authorities often fail to produce official statistics on permanent foreign residents (China National Tourism Administration, *2012 Statistics (by Entry Purpose)*, January 17; *Eurasian Geography and Economics*, 2009).

Narrow Path to Residency

China's Nationality Law states that naturalization may be acquired through an application process, under the conditions that the applicants are relatives of Chinese nationals, have settled in China, or have “other legitimate reasons” (*Nationality Law of the People's Republic of China*, 1980). Foreigners can also establish long-term residence in China through a permanent residency permit, otherwise known as the “Chinese green card,” which is not a step toward citizenship. However, one would be hard-pressed to find an official permanent resident or

naturalized citizen anywhere in the country. Since 2004, when China began granting permanent residency permits to foreigners, only an approximate 5,000 people have been awarded the coveted permit, called the “hardest to get in the world” by the *Southern Metropolis Daily* (*Southern Metropolis Daily*, September 6, 2013; *China Daily*, November 19, 2012, October 17, 2012). The low number of permanent resident card holders is in no small part due to the fact that the program was and continues to be geared toward high-level personnel and overseas Chinese: employees who belong to companies that promote China’s economic, scientific and technological development, individuals who make relatively large direct investment in China (over \$500,000 USD) or have made “outstanding contributions” that are of special importance to China, and relatives of Chinese citizens who plan on residing permanently in China (*China Daily*, August 21, 2004, October 16, 2006).

According to Qu Yunhai, deputy director of the Entry and Exit Administration Bureau, the Ministry of Public Security and the Ministry of Foreign Affairs are in the process of developing a new draft regulation that will feature lower requirements for green card applicants (*China Daily*, October 17, 2012). An expert privy to the ministry’s recent activities, Liu Guofu of the Beijing Institute of Technology, has said that the draft regulation will target immigrants in the technology field who have lived in China for ten consecutive years (*China Daily*, November 19, 2012). Both Qu and Liu’s remarks suggest that even with a relaxation in application requirements, the majority of foreign long-term residents of China will not be considered eligible for permanent residency status.

Effects of this law have already begun to receive media coverage. In August, *Shanghai Daily* reported that immigration authorities at Shanghai’s two airports have documented close to 500 cases of overstays since the law took effect in July. A Dutchman was the first to receive the maximum 10,000 RMB (\$1,630.00 USD) fine, but Americans, Japanese, Canadians, French and Singaporeans came soon after, receiving fines that totaled 430,000 RMB (\$70,053 USD) (*Shanghai Daily*, August 20).

However, little is known about the law’s impact on China’s population of foreigners who are not high-level personnel and do not plan to exit the country soon.

Although it is illegal for individuals to hire foreigners, it is becoming common practice in metropolises such as Beijing, Shanghai and Guangzhou for households to hire Filipino maids, who enter the country on tourist visas and either reside illegally or attain business visas through agencies once they expire (*China Daily*, February 11, 2011; *Beijing Today*, August 13, 2010). Despite the risk of being deported, Filipinos are attracted to China’s prevailing salary of 4,000 RMB (\$650.00 USD) per month. It is significantly higher than the \$450.00 USD they receive in Singapore, where the majority of Filipino domestic workers are currently located (*Jakarta Globe*, June 2, 2012). Guangzhou, Shenzhen, and Yiwu are home to the world’s largest trading hubs for small-scale commodities, attracting long-term traders mainly from Africa, South Asia and the Middle East (Business Insider, November 3, 2011). The One Child policy has also impacted transnational migration to China. The high ratio of males to females has led to a demand for “foreign brides,” who are trafficked into China from countries such as Russia, North Korea, Vietnam, Laos, and Myanmar (Brookings, September 8, 2011).

Stability and Soft Power

Without a plan for the development of a comprehensive approach to international immigration, China has had to rely on a cocktail of regulatory mechanisms, addressing issues as they arise. Immigration control has proved especially difficult in Guangzhou, where the post-2008 limits on long-term visa issuance spawned a black market for “genuine,” or year-long, visas (*The Globe and Mail*, August 23, 2012). In 2009, during a police raid on illegal residents, two Nigerians attempting to escape arrest threw themselves through a window. Both were seriously injured, and rumors of their deaths fueled Guangzhou’s first-ever immigrant riot. In response to this, Ojukwu Emma, president of the Nigerian community association in Guangzhou, signed an “amnesty agreement” with the local Public Security Bureau, promising to assist the police with immigration control in return for the promise that overstayers would be allowed to return to China legally after paying their visa-related fines (*The Globe and Mail*, August 23, 2012). Yet, four years later a second riot broke out, this time over the death of Elebechi Celestine, a Nigerian trader who died in custody following an argument with a taxi driver. With the policy of social stability maintenance (*weiwen*) still a top priority for

China's president Xi Jinping and the rest of the Chinese leadership, China is likely to make efforts to move away from addressing international immigration on a case by case basis (Brookings, September 26).

It is also important to view flare-ups in Guangzhou in the context of China's diplomatic and economic relationships with Africa. China is now Africa's largest trading partner (Carnegie Endowment for International Peace, February 9, 2012). In a white paper on "China-Africa Economic and Trade Cooperation" published by the State Council in August of this year, "promoting South-South cooperation" was cited as one of China's primary achievements in the Sino-Africa relationship over the past several years (Xinhua, August 29). However, it has faced mixed receptions in African countries. In an open letter to the *Financial Times* in March 2013, Lamido Sanusi, the Governor of the Central Bank of Nigeria, criticized China for taking Nigeria's primary goods and selling back manufactured products, calling these practices "a new form of imperialism" (*Financial Times*, March 11). Sanusi's plea to Nigerians to "wake up to the realities of their romance with China" is indicative of larger tensions that may threaten China's thriving export trade with the country and the greater continent (see Carnegie Endowment for International Peace, February 9, 2012).

In recent months, China has shown signs that it will confront its migration challenges with pragmatism rather than force. In July of 2013, following a visit to China, Nigerian president Goodluck Jonathan announced the approval of a Nigerian consulate in Guangzhou, answering a request that Nigerians in the area have been making for years (*The Guardian Nigeria*, July 21). In China's southern border region, where President Xi and Premier Li Keqiang have plans to strengthen economic ties, proactive efforts to manage border crossings have begun to take shape (*South China Morning Post*, October 12). In Dongxing, at the China-Vietnam border, the Chinese government recently established a free trade zone to accommodate the 7,000 Vietnamese traders who cross the border every day. A similar situation has been set up in Ruili, China's border city with Myanmar, which accommodates approximately 30,000 cross-border workers across multiple industries. China's official news outlets have described these free trade zones as models

for the future of China-ASEAN cultural and economic exchange (Xinhua, August 19).

Conclusion

As the experiences of the United States and the European Union have shown, transnational migration is not an easy pill to swallow. However, according to the recently released UN Department of Economic and Social Affairs' *International Migration Policies 2013*, a summary of migration policies in over 190 countries, 91 percent of "developed" countries have established integration policies for international immigration. China belongs to the majority (53 percent) of "developing" countries that lack policies geared to integrate non-nationals into their respective societies (UN, *International Migration Policies 2013*, September; Law and Border, September 7). While China's own internal migrant population of 236 million will take first priority over external migrants, it is in China's best interest to take account of the fact that its not-so-new role in the world order will inevitably lead to a greater influx of people in search of jobs and new lives (Xinhua, September 10). Before these proverbial ships arrive, the government may want to consider how it can avoid pitfalls in dealing with the world's floating population.

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