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Introduction

The global strategic architecture is in a process of rapid change. The simultaneous rise of India and China is leading to a shift in financial, economic and commercial focus from Europe to Asia. This is a time when competition is inevitable, confrontation unthinkable and cooperation a necessity. An exchange of views between senior policymakers and experts of the United States and India becomes an imperative that cannot be overlooked.

It would appear that India lacks a grand strategy as it rejected being pigeonholed right from the early years of independence and was loath to follow in imperial footsteps. This characteristic of Indian policy which goes back to Nehru may be tenuous given recent developments within India and rapid changes taking place in the world. There is an absence of a world view in Indian political and strategic circles that could inform a comprehensive strategy to deal with emerging developments. The Curzonian views of India's potential to play an appropriate role in the Indian Ocean and its surroundings continue to form the basis of sustained inquiry on India's future role and capabilities.



It is clear that India has evolved significantly in the last decade. The possibility of an Indo-US nuclear deal has brought about a material change in India's relationships globally and within the region. Economically, where it once could do little right, India is seen as doing everything right. This too, is a major factor in the

strategic reevaluation of India by others within the region and elsewhere. This is a process that can now neither be stopped nor repressed. Another matter that merits consideration is the growth of cultural self-confidence in India. India's soft power is beginning to have an influence that is looked upon favourably. India is today a maturing state, one that is increasingly comfortable with its reality and potential.

While India's neighbours continue to view it with some suspicion India sees itself as a benign, non-threatening country which does not have any aggressive designs. Over the last half a decade this has had an impact. While each of India's South Asian neighbours today suffer from instability and infirmities, in none of these is India seen as a cause. Instead India's support is sought to ameliorate their difficulties. It is a fundamental tenet of India's strategic objective that its neighbourhood should be tranquil, peaceful and cooperative and India is engaged constructively with all its neighbours in such a fashion.

The strategic relationship between India and the United States is an important new element that challenges or raises questions relevant to Indian policy at practically every point. This is a far-reaching new process of strategic engagement which will remain a particular challenge to India. After the Cold War there were numerous high-level visits by American military officers that could be viewed as evidence that the Pentagon had discovered the possibilities of India's potential before the US State Department had. The fact that there was a deployable military capacity which could reach outside India's borders was a reality that the American military establishment recognized and that is a very important element in the evolving relationship.




While India and China are generally believed to be rivals, other possibilities also exist. If the two countries join forces on certain contentious issues such as the Kyoto Protocol, global energy cooperation, global warming and others, they could well change the rules of global politics. The relationship between the two countries need not necessarily be that of rivalry, but can also be one of cooperation.

I. China's grand strategy (as viewed by the United States), India's grand strategy and the United States strategy towards China

INDIA AND GRAND STRATEGY

Scholars of Indian political thought have found it difficult to identify a coherent strand of strategic thinking that pervades Indian policy. India's desire to play a global role has been understood to be a function of India's civilizational status. While India may not formulate doctrines of foreign policy, there is no denying that strategic thinking does inform policy decisions, making India's foreign policy both continuous and resilient. India has, therefore, been able to enforce changes in policy and without making grand announcements. Three distinct phases can be identified in India's foreign policy since independence.

The first phase was from 1947 to 1967. A record of India's global thinking is to be found first in the time of Jawaharlal Nehru when guidelines for India's foreign policy were laid down. Instead of adopting the Curzonian view of India's place in the world which was essentially imperialistic in nature, Nehru formulated a policy based on the realities of the Cold War. He was determined that India should play an active role in international affairs despite formidable domestic challenges. Newly independent India was to follow an independent foreign policy to avoid struggles between the two blocs. Apart from this, India was to be the champion of those who suffered colonial oppression and assist the poor, the dispossessed, the weak and those who were discriminated against. When Nehru's faith in Asian solidarity and resurgence led by India and China came to naught he advocated non-alignment. While India played an active role in the Non-Aligned



While India may not possess a single comprehensive global strategy, it certainly does possess a well-formulated global outlook.

Movement (NAM), it participated independently in international affairs as well. This was manifested at the end of the Korean War in 1952, at the Indochina peace talks in 1954, during the deadlock in the United Nations over the entrance of new members in 1955 and in peacekeeping operations under the UN, particularly in Lebanon in 1957 and the Congo in 1960. This engagement with the international order was what characterized Nehruvian internationalism, but received a fatal blow with the Sino-Indian war of 1962. The neglect of domestic developments during this period had made the eventual loss of India's global clout somewhat inevitable.

The second phase from 1967 to 1997 addressed the deficiencies of Nehru's strategy. First, Mrs. Indira Gandhi who was a realist scaled down India's ambitions from global to regional proportions in order to become effective in the immediate region rather than to be hyperactive in the world. Second, economic stability was continually emphasized even as India faced difficult economic conditions at home. The focus remained on a steady improvement in agricultural production and on the growth of industries. Third, technological excellence was encouraged and poverty was not to be a barrier to high achievements in high technology. The first nuclear test in 1974 and the launching of the indigenous space launch vehicle in 1980 attest to this. Finally, Mrs. Gandhi did not allow the obligations of NAM to stand in the way of India's security interests which were sought to be secured through a landmark security arrangement with the Soviet Union in 1971.



Rajiv Gandhi carried on the tradition of consolidating India's domestic situation but also attempted to revive some of Nehru's internationalism. While he was successful in Africa, two major initiatives that he took of trying to mediate between Moscow and Washington and another major initiative for global disarmament, which he proposed in 1988 at the UN, made little headway.

P V Narasimha Rao, the third Prime Minister during this period, was a quiet realist and amongst his many successful initiatives was the launching of economic reforms in 1991, normalization of relations with Israel in 1992 and the Look East policy which brought India closer to Southeast and East Asian countries.

The third and current phase spans the last ten years. There has been a complete change in India's foreign policy and its global outlook, without specific announcements to the effect and no formulation of doctrine. There has been a change in foreign policy from the inside without a corresponding change on any external manifestation.

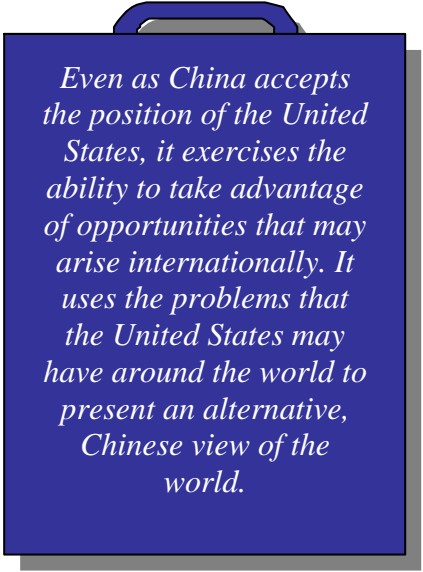
There are three major departures in the current situation from the first principles laid down by Nehru. One is the distinct shift from idealism and moralism to pragmatism. The second is the distinct economic content to foreign policy. The third is a clear prioritization of global relations – countries of strategic importance, the neighbourhood and defining areas of strategic importance.

While India may not possess a single comprehensive global strategy, it certainly does possess a well-formulated global outlook. While accepting the United States as the leading power of the world, India does not accept the privileges that the United States has allocated to itself like unilateralism or the right to pre-emptive action. At the same time India continues to aspire to be a global player and it also seeks formal admission to the highest decision making bodies whether regional or international. India shares the current global concerns about the safety of the sea lanes, proliferation of WMD, spread of illegal arms and narcotics, the fight against international terrorism and other issues of international importance. India continues to believe in free markets and in open international trade. It sees globalization as a challenge but also as an opportunity. At the same time, it acknowledges that the rules of international trade need to be made more equitable and is not hesitant to voice differences with the United States and Europe on global trade issues.

CHINA AND GRAND STRATEGY

India and China are similar in the sense that neither professes a grand strategy. There is no denying however, that decisions taken by China in the sphere of foreign policy are strategic. While China has not laid out an explicit strategy for itself, it has identified certain principles and goals that are often expressed in political slogans.

It is sometimes believed that China seeks to replace the United States as the predominant power in East Asia but a closer study does not yet reveal such ambitions. It seems that China recognizes the benefits it reaps from the public good of the US security system. Today, it speaks in terms of welcoming, not wanting to change the US security structure in East Asia. Not only does China receive the benefit of stability, it does not have to take responsibility for public goods and can focus on its priority interests, which are clearly domestic. The one exception to China's acceptance of the US security system and the US security commitments is Taiwan.



Even as China accepts the position of the United States, it exercises the ability to take advantage of opportunities that may arise internationally. It uses the problems that the United States may have around the world to present an alternative, Chinese view of the world.

The primary goals of the PRC may therefore, be identified as domestic. The foremost amongst these is the maintenance of Communist Party

(CCP) rule in China. Since a return to ideology is no longer possible, the CCP has to produce results that are essentially two fold – 1) building up comprehensive national power that is economic, military and political and 2) develop soft power in order to safeguard territorial integrity. It would seem then that China is willing to be patient and focus on the domestic and posit external affairs as a function of domestic needs. It requires a peaceful international environment to focus on domestic development. Nevertheless, the complexities of the domestic and the external preclude a definitive assertion on the issue.

A Chinese strategy in foreign relations would include three slogans - 'Peaceful development', 'harmonious society' and 'harmonious world,' This is the externalization of the concept of "harmonious society" and it is undefined but it does represent an interest in a peaceful international environment to prevent distractions from development needs. This can be understood as a function of China's extreme reliance on international trade and investment.



Even as China accepts the position of the United States, it exercises the ability to take advantage of opportunities that may arise internationally. It uses the problems that the United States may have around the world to present an alternative, Chinese view of the world. It talks about win-win solutions and mutual respect for democracy in international relations especially as it speaks of a harmonious world.

China categorizes external relations into three types. The first is major power relations. This is similar to the Indian emphasis on major powers. This is where interests are most wrapped up economically as the major powers have the ability to aid China's development.

The second is the periphery. The concern about the periphery that is Central Asia, Southeast Asia and Northeast Asia is related to cross-border challenges, the so-called colour revolutions in Central Asia and the threat from radical Islam. Preventing the development of anti-China blocks is a serious concern, particularly in respect of the United States, US alliances and its military presence in Northeast Asia and Southeast Asia. China may wish to leverage relations on the periphery against the United States and is therefore emphasizing commonalities and of 'putting aside differences.'

The third set of relations is those with the developing world, particularly Latin America and Africa. Here the focus is on natural resources, energy, need for new markets for products, to gain support within the United Nations and connected to this is the territorial integrity issue in the form of the Taiwan factor.

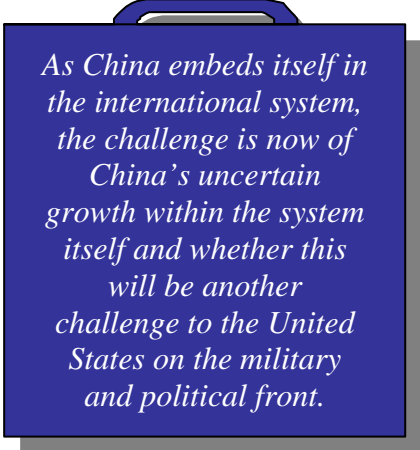
China's military development raises interesting questions in the face of this understanding of China's goals and foreign relations. While China

seeks to safeguard its domestic economic interests through military development, the question that emerges is, at whose expense potentially? How will China settle all the remaining border disputes and tensions? How will it work out competing interests with the United States and India in the region?

China has stated in no uncertain terms that it is not a challenge to the US-dominated international system and that it does not aspire to the position of an international leader. But, China can be seen as facing the problem of balancing its self-identity as a developing country with its increasing global responsibility as an economic power and as a member of the UN Security Council. While China may not wish for a leadership role, a large part of the world expects China to play some sort of a leadership role in the world. At the same time, China wants to be part of global decision making processes. This is an important question and there is much debate regarding China's international role. How China defines itself in the future will therefore, be extremely important.

INDIA, CHINA AND THE UNITED STATES – CLASH IN STRATEGIES?

There is no serious disagreement or obvious point of conflict in the strategies of the three countries though there may exist certain apprehensions and misunderstandings. In the India-US relationship there are no basic disagreements and relations have been transformed remarkably in the last six years. There are however, important areas of difference. First, the United States needs to adjust its power projection in areas and countries which India considers to be a part of its strategic neighbourhood. So far it has worked well in India's immediate neighbourhood. American policy with regard to Nepal or Sri Lanka or Bangladesh or even Pakistan is well-coordinated with India but when it comes to countries like Iran or Iraq or the Gulf region, there are serious differences. A second major area of difference is on the issue of terrorism. Despite a Joint Working Group (JWG) on terrorism from 2000, India and the United States have been unable to agree either on a basic definition of terrorism or on a common course of action to deal with international terrorism. The large residue of mistrust in both countries from the Cold War period also continues to be a factor.



As China embeds itself in the international system, the challenge is now of China's uncertain growth within the system itself and whether this will be another challenge to the United States on the military and political front.

India embarked on a process of normalization of relations with China with Rajiv Gandhi's visit in December 1988. Nevertheless, suspicions about China's intent are still common in the Indian strategic community. China's close military partnership with Pakistan, China's clandestine assistance to Pakistan for its nuclear and missile program, the so-called string of pearls strategy adopted by China, that is, the naval facilities

which China has created in India's neighbourhood in Myanmar, Bangladesh, Sri Lanka and in Pakistan and China's naval expansion in the Indian Ocean area, are some issues which trouble Indian thinking. These issues having been raised, the outlook on the whole remains positive for bilateral relations between India and China. Economic relations have grown impressively and China is India's second largest trading partner. The two have worked in tandem in regional cooperation groupings such as the ARF, SAARC and SCO. On the issue of energy security, too, there is greater dialogue and cooperation.

American apprehensions about China are seen as stemming from the suspicion that China wishes to supplant the United States in Asia. As China becomes a stakeholder in the international system however, there is little to base this suspicion on. The primary difference between the United States and China may well be the difference in the values espoused by the two countries in international affairs. The United States is concerned particularly about China's actions in international aid – Chinese aid is unconditional in the interests of promoting its economic interests around the world, in countries such as Sudan and Zimbabwe. There are questions whether this promotes values that the United States and other states care about such as human rights, and labour and environmental standards. There are also questions whether China is promoting its economic development model to challenge the so-called Washington Consensus of democracy-based economic reform.



The issue of Taiwan is of the utmost importance in the Sino-US relationship. While the issue is increasingly downplayed in bilateral relations, the United States has a security commitment to Taiwan and it is compelled to be prepared for the worst-case scenario. The Quadrennial Defense Review identifies China as the only military threat to the United States in the long term and the Pentagon is quite clearly preparing for any eventuality. At the same time the State Department is reaffirming that the policy towards China is not that of containment but one of engagement. The US strategy used to be to embed China in international institutions, to try to link it up, to bring it into the international system so that it would not try to challenge it from the outside. As China embeds itself in the international system, the challenge is now of China's uncertain growth within the system itself and whether this will be another challenge to the United States on the military and political front. China and the United States do however cooperate in international affairs whether it is on North Korea or on Iran. The US State Department is therefore, looking to China as part of the solution, not as part of the problem, this is a change that was quite stark in the aftermath of 9/11. Japan continues to be a factor in these relations and while it is a close ally of the United States, China does have some very serious issues with

Japan. However, China is content so long as Japan does not seek to reinvigorate its leadership role in East Asia.

On the whole therefore, it would seem that the three countries have the ability and the incentive to cooperate and no essential clashes in grand strategies seem to exist. The re-emergence of Japan in East Asia, American and Chinese threat perceptions and India's fear of losing ground to its larger neighbour however, have the potential to steer the strategies of these nations in directions that may not always be complementary.

II. China's regional military outreach

The PLA today is almost a decade and a half into a period of sustained reform and modernization that is unprecedented in its history. The first point to be noted is that this process of modernization is a transformative process because the PLA is trying to change the military from its traditional ground force orientation to a military that places equal emphasis on the navy and the air force. It is an attempt to transform a military that was designed to fight long wars of attrition and to prevent a land invasion of China into a military that is focused on defending Chinese interests in short, high-intensity campaigns. Therefore, instead of relying on large numbers of forces to compensate for technological deficiencies, it has tried to become a military that aspires to fight with state-of-the-art technical capabilities. This transformation is unprecedented because it is a systematic approach that is well-considered, and addresses everything from hardware and technology to logistics and the human side of PLA life.

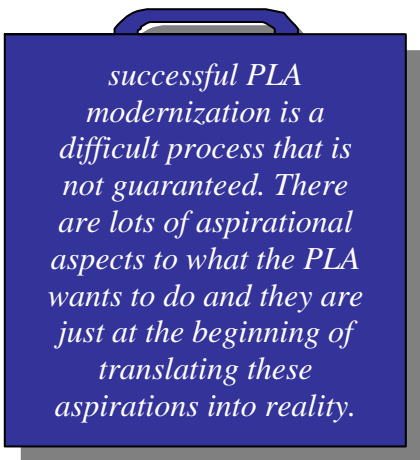


The second point to consider is that of the drivers of this transformation. It seems logical for professional military planners around the world to determine defence requirements and set priorities. First of all, this requires a capabilities assessment to reveal current capacity followed by a contingency-based assessment that is intended to predict what future scenarios the military may face. From the point of view of the PLA, a capabilities-based assessment will include several elements. First, the phenomenon of modern warfare as demonstrated by the British in the Falklands War of 1982 made the PLA's own capabilities appear poor and irrelevant. The 1991 Gulf War in particular, forced the leadership of the PLA to confront the reality that the armed forces of China were incapable of fighting a 'state of the art' late twentieth century war. Therefore, since 1993, the PLA has been retooling itself to be able to engage in 'local war under modern informationized conditions.' This is envisaged as a conflict fought for limited political and geographic objectives, short in duration but decisive in strategic outcome and characterized by joint service operations using air, land and sea dimensions.

Bearing in mind a capability-based assessment of this kind, it becomes clear that even if there was no Taiwan contingency, the focus of the PLA would still be on the same factor of modernization. This is not to say that the PLA is not concerned with several 'contingencies', among which the foremost concern is the issue of Taiwan. In Chinese strategic thought there is a term translated as 'major strategic direction.' This strategic direction can be best understood by realizing that all of the possible contingencies that the PLA has to deal with are maritime in nature. Taiwan is a maritime problem, disputes with Japan in the East China Sea and disagreements in the South China Sea are maritime in nature, as is the dependence upon sea lanes for communication. Most importantly, the economic centre of gravity in China today is on the eastern seaboard and vulnerable to attack from the sea. Therefore, to protect the economic centre of gravity in the country it is necessary to buy strategic space by having a strong sea capability.

Third, the near and mid-term goal for China is to field the premier military force in the Asia-Pacific region, one capable of defeating other regional militaries on its periphery and that offers a credible deterrent from intervention by outside forces.

Looking to the future, it is clear that Beijing's global economic interest has now become coupled with a global political interest. It is not yet clear whether that means the PLA will look to build forces that will be globally relevant, but that this is certainly an option for the future should not be ignored.



successful PLA modernization is a difficult process that is not guaranteed. There are lots of aspirational aspects to what the PLA wants to do and they are just at the beginning of translating these aspirations into reality.

What does this mean for India and the United States? First, successful PLA modernization is a difficult process that is not guaranteed. There are lots of aspirational aspects to what the PLA wants to do and they are just at the beginning of translating these aspirations into reality. The planned endpoint is unknown, but it can be surmised that successful execution will turn the PLA into one of the most operationally capable military forces in East Asia.

Second, a modernized PLA that could project and sustain military force in a region, coupled with China's economic prowess, has the potential to alter the geostrategic and geopolitical landscape in Asia for the first time since the end of the Second World War.

Third, as the PLA seeks to increase its strategic depth the US armed forces and the PLA are increasingly going to encounter one another more frequently. This highlights the importance of finding bilateral ways to avoid incidents at sea and having procedures in place in case they do occur.

THE STATE OF THE CHINESE NAVY

The first thing to consider is that every military has to confront inter-agency competition for finite resources. Therefore, the fact that Beijing is putting serious money into the PLA Navy means that the political leadership of China has been convinced that the interests of China can only be secured with a robust naval force. This represents a historic departure from the strategic traditions of China.

Five interrelated factors need to be considered. First, as already mentioned, there is the doctrine of major strategic direction. Second, considering American strategic reach and capacity, China believes it is necessary to possess a maritime component capable of defending against US involvement in Taiwan or US power projection against the east coast of China. Following the Soviet model, this component is based upon a need for open ocean surveillance to locate, identify, monitor and track enemy vessels. That requires a dependence on space and possibly –on remotely piloted vehicles (RPVs) and other long-distance and direct surveillance platforms. Land-based aircraft may be used to launch cruise missiles to attack ships and submarines. The PLA Navy is also heavily investing in submarines.



The third driver is the deterrence of Taiwanese independence. The Navy can play only a relatively modest role in deterring Taiwanese political leaders from making a declaration of independence. However, with its armoury of some 900 ballistic missiles, the Navy does have a big role to play in keeping the United States out of the bay. Also, in terms of the Taiwan contingency, the Navy's job is to get the PLA Army to Taiwan although it is up to the PLA Air Force to gain air superiority over the Straits in order for this to be possible.

The fourth driver is the historically novel situation where sea-borne trade drives the economic growth of China. According to some sources, between 65 per cent and 75 per cent of China's GDP is tied up in imports or exports, most of which is transported by sea. The latest defence white paper recognized the extent of China's involvement in globalization. Indeed, China is now particularly dependent on sea-borne energy shipments of oil and liquefied natural gas, placing a responsibility on the PLA Navy to protect sea-lanes.

Another 'demand signal' placed on the PLA Navy, and also a somewhat novel idea for the institution, is that of being a responsible stakeholder. Such responsibilities usually include sending forces to participate in UN peacekeeping missions and stability operations. Thus, the movement towards China becoming a responsible stakeholder places increased demands on the Navy.


THE IMPLICATIONS

Thus, it can be surmised that the PLA Navy has come up with a coherent plan to deal with anti-axis (especially US action) in case of a conflict over Taiwan. What is more problematic for commanders is the new notion of the peacetime use of the Navy and the four related structural issues mentioned above.

There are three essential areas under examination: the doctrine in terms of the military reach of the Chinese forces, past experience and current postures and scenarios, and the capabilities that China has for military outreach.

There have been three main defensive strategic postures emanating from China in the last fifty years – people's war under modern conditions, local war under hi-tech conditions and now local war under 'informationized' conditions. This leads to three main points of focus for the Chinese forces – first, unresolved territorial disputes which include maritime territory as well as the disputed borders with India and Bhutan; second, the maritime sphere, which can probably be included under unresolved territorial disputes; and third, Taiwan's drift towards independence and the national strategy of China to contain such a movement.

Past experience shows that China had only limited political and military objectives during the Korean War of 1951-1953, the 1962 India-China border clashes, the 1969 Sino-Soviet clashes and the 1979 war with Vietnam. These objectives were limited in extent and relatively confined to the peripheries of the Chinese mainland.



if one is in Beijing the strategic view reveals only one coastline: one-third of which is effectively blocked by a South Korea, Japan and US military alliance. The southern third is blocked by Southeast Asia while the middle is dominated by Taiwan.

The main lessons learnt from the overstretch and overextension of Chinese forces during the Korean War was the importance of air power. In 1950-51 the PLA invasion of Tibet indicated future areas where the PLA would march in any future conflict with India. In 1962, the objectives in military and political terms were limited to the vacating of disputed lands and so the ceasefire agreement was immediately announced in November 1962. The Sino-Soviet conflict led to a major strategic transformation in PLA forces from about 1971. The weakness of Soviet tanks was evident and so the Chinese started building up tactical nuclear weapons and anti-tank guided weapon systems from that period onwards.

The next major experience for the PLA came from the 1974 Paracels occupation when fighting against the North Vietnamese which indicated the rise of the sea power faction under Deng Xiaoping's rule. In particular, Admiral Liu Huaqing propounded the modernization of the Chinese Navy, and from then on there was significant expansion which was further aided by the 1992 National People's Congress resolution for

extending the security perimeters of the country by about 200 nautical miles. Most recently, this has effectively been extended to about 1,000 nautical miles and it is expected that the PLA Air Force will also extend into the South China Sea in the future.

The next skirmish was the 1979 Vietnam campaign where the relatively high figure of PLA casualties were a major factor in Deng Xiaoping's famous conclusion that the PLA was bloated, triggering extensive modernization efforts. Logistics had been extended during the conflict and unable to support the troops on the front. The concept of joint operations was also enunciated at this point of time.

As of 2006, the Chinese have 25 infantry divisions (including rapid action ones), 33 infantry brigades, 9 armoured divisions, 11 armoured brigades, 3 artillery divisions, 15 artillery brigades and 2 marine brigades. The Navy has 5 destroyers, 45 frigates and 213 amphibious vessels, 69 conventional submarines and is developing new Sung and Ming classes.

If one looks at the responsibility of the special battalion and the 15th Airborne Army it is clearly geared towards regional responsibilities. This means they have to have transport, logistics, replenishment and deployment patterns as mentioned earlier. At present, they can transport roughly 22,000 troops to Taiwan or the South China Sea. There are six ways of attacking and subduing Taiwan – missile bombardment, C4ISR paralysis, amphibious operations, air strikes, sea blockades and airborne forces.



From the Indian point of view, the strategic environment consists of two coasts both with several thousand square miles of open sea, island territories half way through and access to unlimited waters down south. However, if one is in Beijing the strategic view reveals only one coastline: one-third of which is effectively blocked by a South Korea, Japan and US military alliance. The southern third is blocked by Southeast Asia while the middle is dominated by Taiwan. Therefore, the geographical reality is that Chinese access to the sea is much more restricted and it is in this context that the PLA Navy's development must be examined.

Until 1980, Chinese land power and large numbers of personnel were considered the key to Chinese military power, as demonstrated in the 1962 Sino-Indian conflict. However, it was realized that to become a regional power China had to be able to project soft power economically and socially and which was backed up by a military component – namely the PLA Navy.

Estimates indicate that by 2010 the PLA Navy will have about 25 modern submarines and about 25 modern destroyers, some with an American Aegis equivalent capability, some equipped with 200km-range torpedos from Russia and some equipped with long-range cruise missiles.

Therefore, by 2010 the second island chain capability, to allow power projection seawards, would be a reality for the PLA.

By 2010, there is no doubt that the Chinese will be able to deploy in the Indian Ocean more easily than at present. However, at the moment they do not have the capacity to maintain a presence there without comprehensive facilities such as logistic chains and base facilities.

Some analysts believe that Chinese commercial ventures in Sittwe in Myanmar, Hambantota in Sri Lanka, Gwadar in Pakistan, and the Maldives, threaten Indian security. However, such threats can be overstated because India, Japan and the United States also exercise strong influence in all these areas. The other limitation for the Chinese in the Indian Ocean is that they cannot deploy their airpower while India has no such limitations.

The one weak element of the Chinese security equation is energy because the Chinese can easily be throttled in the Malacca Straits. The Gwadar and Sittwe pipelines are two attempts to overcome this by going overland, while the other plan is increased naval power. If India recognizes these strategies, it should not be difficult to prepare for any eventuality.

III. China's nuclear strategy: India's response and China's response to India's response

A Sino-Indian correlation in the sphere of nuclear strategy is one that is extremely contentious. India has much admired the Chinese ability to deter the United States with a small arsenal and to a certain degree this Chinese policy is now reflected in India's own advocacy of a credible minimum deterrence.

Chinese nuclear strategy has since come a long way and China today has DF-31s and its modified versions and is also experimenting with a new train mobile ballistic missile. While China is upgrading its military hardware to support its regional and global aspirations, India is targeted by a Pakistani missile of Chinese origin with a Chinese-designed warhead. It is important to understand that China has been instrumental in the development of Pakistan's missile and nuclear capabilities. Pakistan's capabilities and potential therefore have become the focus of the Sino-Indian nuclear strategy matrix.

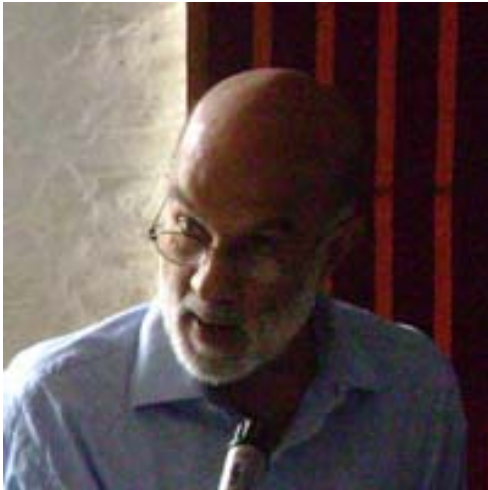
THE PAKISTAN FACTOR

A study of the bilateral relations of China and India on the one hand and the development of Pakistan's missile programme aided by China makes clear that these are closely connected. In 1981, the Chinese Foreign Minister visited India followed in 1988 by Rajiv Gandhi's path-breaking visit to China. Li Peng's 1991 visit to India led to a further thaw in relations but in 1993, during Indian President R Venkataraman's, visit the Chinese tested a nuclear weapon. Military delegations followed and the ground-breaking Sixth JWG met. However, during this period of cordial bilateral relations, China was continuously aiding Pakistan's missile programme. Meanwhile, it was in 1981-83 when China's began transferring its designs for uranium bombs to Pakistan. In 1987, the Chinese signed a major agreement to supply missiles to Pakistan and by 1992 M-11 missiles were being shipped to Pakistan.

In 1993, Narasimha Rao visited China while Jiang Zemin visited India in 1996. The Indian nuclear test took place in 1998 and in 2000 and 2002 Li Peng and Zhu Rongji visit and the trade target set for US\$10 billion. Meanwhile as regards Pakistan and its missile programme, in 1993 the second tranche of M-11 missiles is sent to Pakistan and under the

pretense of M-11 missiles, an M-9 was factory was shipped to Pakistan. It was during 1997-99, that the North Korean Nodong's transit from China to Pakistan took place. In 2001, the Karmapa fled to India and the Holum delegation flew to Beijing to discuss continuing Chinese proliferation to Pakistan. In 2003, the Chinese operationalize the DF-31. In 2004, during the run-up to the Indian elections, Pakistan test-fired the Shaheen-II, which is a two-stage missile that has a range of 2,500kms and is speculated to be a version of the M-18. The Shaheen-II is completely different from Shaheen-I in design and it is largely believed that Pakistan's current understanding of missile design would preclude the indigenous creation of Shaheen-II. While there is a view in India that Pakistan may not be able to make the missile nuclear-capable, this is not a certainty.

In August 2005, during Wen Jiabao's visit, Pakistan test fired the 500km range Babur, which is 0.53 metres in diameter. This last detail is significant because that is the diameter of a torpedo tube. The Babur has an accuracy of within 10 meters and the reason why it is certainly not of



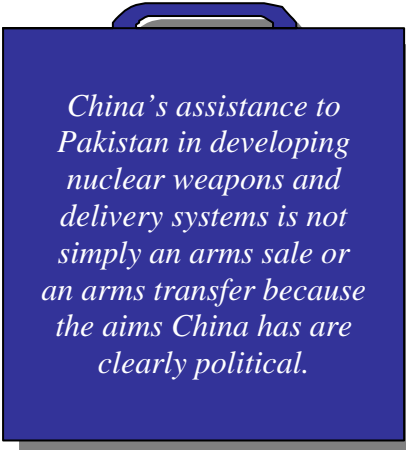
Pakistani origin is because it has a turbine engine which is similar to an aviation turbine. Pakistan does not make aviation turbines and given that the one used in Babur is to be fitted into a diameter of 0.53 metres, it is obvious that this is well beyond Pakistan's capability. The Babur is particularly important because it signifies the beginning of counter-force; it is a first-strike weapon.

China's assistance to Pakistan in developing nuclear weapons and delivery systems is not simply an arms sale or an arms transfer because the aims China has are clearly political. In 1983, when Chinese assistance to Pakistan began it was a clear commitment of 20 to 30 years for it involved not the sale of hardware such as a tank whose shelf life was about 10 years but investment in an entire research and development programme which reveals a long-term view. This investment in Pakistan could well have been to fortify an anti-Soviet loci in the dynamics of the Cold War and may not necessarily have been anti-India but aimed at breaking the perceived encirclement of China by the Soviets with their presence in Afghanistan and their ties with India. Another possibility, for the same reasons that China was anti-Soviet, is that it could have viewed India as a threat and this was an anti-India move. The Chinese fear of "splittism" would also account for a threat perception vis-à-vis India. While the exact rationale behind Chinese support to Pakistan may not be clear, what was a direct consequence, and quite possibly, an intended one, was the confinement of India south of the Himalayas.

Despite steadily improving bilateral relations with India, Chinese assistance to Pakistan has not come to an end as expected by India. In the current phase, Chinese aid could well be intensified as a consequence of the Indo-US nuclear deal. The Chinese reaction to the contentious border

issue on the eve of Hu Jintao's India visit could well be an indication of this. China may view Sino-India relations as not a purely bilateral relationship but as a tool that can be leveraged with the United States.

In the future, with NATO and US withdrawal from Afghanistan, Pakistan would have reduced utility for China. Pakistani interest in China could be an attempt to hedge against the United States in the event that China emerges as the foremost cash-rich nation in the world. The interests of Pakistan could coincide with that of China as the latter seeks entry into Africa via Gwadar. However, pursuing strategic and energy interests in Africa through Pakistan does not necessitate the transfer of nuclear technology. To think that this is indicative of the manner in which the Chinese hope to run their foreign policy is a sobering thought. With the rise of radical Islam and China's fears of its spreading in its own periphery, as also the loss of political stability in Pakistan, China does perhaps regret supporting Pakistan. It may in fact begin to realize that a stable South Asia is ensured by a strong India.



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The fact that India and China do have a steadily improving economic relationship does not mean that differences in the strategic realm will be resolved easily. Differences between China and the United States have not been resolved despite the US\$200 billion trade deficit with the United States. The trade volume between India and China is only US\$20 billion. It hardly seems plausible that economic relations will thus necessarily take precedence. The strength and maturity

of a country is often seen in the seemingly contradictory policies it is able to follow simultaneously.

The questions that emerge time and again on Chinese nuclear strategy are manifold. First, what is the size of the Chinese nuclear deterrent and is the sea based deterrent actually deployable in the near future. There is no reliable way of answering this question and this problem eventually is linked to the demand for greater transparency in Chinese military expenditure. Second, China's policy of 'no first use' (NFU) is not quite satisfactorily articulated. It could either represent a policy to accept the first blow or an inability to deter a nuclear first strike. If China develops space-based missiles or launch detection mechanisms then this policy of NFU could come to an end. Third, as demonstrated by the ASAT test, there is little civilian control over China's military. The important question then, is how to factor this into an assessment of strategy in times of crisis. China is in the process of overhauling its central military command system and this will play an important role in strategy formulation and implementation in the future.

IV. Chinese and Indian approaches to regional organizations

China's approach to regional organizations is one that is not static but has been shaped by the imperatives of a dynamic world order. What is important to keep in mind is that China's approach to regional organizations varies significantly between different organizations depending on its specific objectives. China's approach to various regional organizations has therefore been shaped by its domestic imperatives and also the transformation of the Southeast Asian region as a whole.

CHANGES IN CHINA'S APPROACH

Prior to 2001, China followed a three pronged approach in foreign relations. One, it did not engage with regional organizations but preferred bilateral negotiations primarily in order to leverage China's size and might against smaller states; two, it remained extremely uncompromising on issues of national sovereignty and territorial integrity as a matter of principle; and finally, China viewed international relations as a zero-sum game.

With the regional economic crisis in 1997-98 China's views on the matter underwent a substantive change. First, China realized that it could not artificially isolate itself because it was very much part of the world economy and was thus vulnerable to outside changes. Second, the power that China held in the international order was emphasized. This was different from traditional military or political power and was economic in nature. Third, due to the process of development and reform, China had been integrated into the international system and its well-being was closely related to that of the existing international system. These three lessons led to a reevaluation of



Chinese views on national sovereignty and territorial integrity have also undergone a change and these are now viewed as relative concepts. China is now adopting a more pragmatic approach on this issue and tried to ensure that China's development is constructive and positive in the region.

China's position in international affairs and the Chinese leadership encouraged debate on the future role it was expected to play.

There are three fundamental questions that arose as a consequence of this internal debate within China. The first is related to security. The major challenge to China's security comes not from outside China but from within it. The CCP is threatened from within China. The power exercised by China is different from that of other countries because it is not predicated on global military reach. Second, China's rise is achieved through its integration into the international system, a system which is based on the market economy and led by the markets. Third, as China develops, it is inevitable that China will have more conflicts over limited resources with all major powers. However, given that China does not have global military reach, it has to depend on the international system. Avoiding confrontation with the United States and its allies is a problem that China needs to address.



Given these three fundamental problems, China has devised fairly successful strategies to readjust its position through the new changes. The new diplomacy developed since 2001 has emphasized improved relations with neighbours in order to promote a peaceful external environment, which is necessary for China's economic development. Thus, Chinese leaders are able to concentrate on domestic problems as China's attitudes to regional organizations change. As China sought to improve bilateral relations with the multilateral approach, regional organizations proved to be the most ideal vehicle.

Chinese views on national sovereignty and territorial integrity have also undergone a change and these are now viewed as relative concepts. China is now adopting a more pragmatic approach on this issue and tried to ensure that China's development is constructive and positive in the region. As these ideas materialized between 1998 and 2001, China also developed a new concept of collective security that would use the economic interdependence in the region to its advantage. China has come to realize that conflict with United States in economic, political and strategic areas may be inevitable. China's leaders have realized that attempts to counter-balance the United States are counterproductive. They have learned to engage with the United States in such a way as to ensure that any action taken by the United States against China would invariably hurt US interests as well. For China, participation in regional organizations provides an opportunity to not only maximize common interest with the United States in international affairs but also to leverage it.

Despite the success with which recent policies have met, China continues to grapple with serious problems to which solutions have not yet been found. The first among these is the declining capacity of the central government. As the market economy has grown, Beijing's capacity to control China has declined rapidly. The second problem is related to this.

As central power has declined so too has policy coordination. Different policy agencies and departments often follow policies that prove to be counter effective. This leads to avoidable wastage of resources, time and opportunities. An improvement in horizontal communication within departments is desperately required. A third problem is related to China's participation in regional organizations and the subsequent conflict of interests with major players. Mechanisms need to be put in place in order to resolve conflicts that may rise between China and other actors within a regional organization. This is also related to American participation in regional organizations and the complex relations China has with the United States, which has elements of both cooperation and intense competition.

Further, it is important to remember that however successful China's approach has been with regard to regional organizations in the recent past, these strategies remain essentially ad-hoc and not long term. China is yet to evolve clear principles of participation in most regional organizations.

V. Challenges to China's economic growth, and China's overseas economic outreach and regional integration

According to Goldman Sachs, while China's GDP is only US\$1.9 trillion as compared with the United States which is six times larger, by 2040 China would equal the United States in absolute size. India continues to lag behind but by 2050, it would match the size of the G7 minus the United States. This reflects a shift in the center of gravity of the global economy.

CHALLENGES TO CHINA'S CONTINUED GROWTH

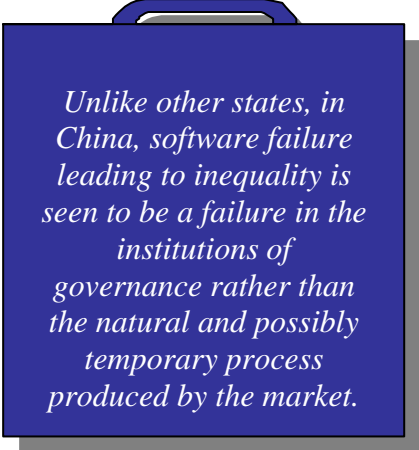
The question that emerges is whether China will actually achieve these dimensions in the future? There are certain 'failures' that could hamper China's economic growth. The first is one of 'hardware,' Many economists refer to the impact of the weak banking system on the fiscal position of the state and its ability to invest in infrastructure and deal with social expenditures. However, this is unlikely, for Chinese economic growth has taken place despite this. China's policy has been to adopt from the rest of the world.

The real probability of failure lies in 'software' and in power supply. The greatest risk in China is the risk of inequality stemming from official corruption leading to the looting of state assets and official corruption. Unlike other states, in China, software failure leading to inequality is seen to be a failure in the institutions of governance rather than the natural and possibly temporary process produced by the market. The second 'software' failure would be the inflexibility of the state in changing its role to meet the rising social expectations of the population.



The year 1991 marked a real turning point for China. In the later half of 1991, India deregulated in response to the balance of payment crisis; in August 1991, the coup against Gorbachev took place and the Soviet Union moved towards capitalism; and the Solidarity government took power in Poland. This was also when China really began to engage with the world, as is evident from the flows of FDI. Although FDI had been coming in to China from around 1978, from 1992 the volume of FDI witnessed a remarkable increase. A collapse of the free trade institutions that facilitated China's economic development could be the third major challenge.

Standard economic theory tells us that wages in developing countries cannot rise unless there is a corresponding rise in productivity. As developing countries gain greater productivity, the wages in the rich countries begin to fall. It is perhaps no accident that real wages in the United States have stagnated since 1992 when China's economic boom began. There are a number of reasons for the rising protectionist tendency in the developed countries that followed China's emergence. The first is that the size of the economic shock that came in the wake of China's rise is much bigger than the Japan, Korea, Taiwan and ASEAN shock in earlier years. Second, the time to accommodate this shock has been shortened. The speed with which China is climbing up the value-added ladder is, much faster than South Korea. Developments in politics are not particularly conducive to the continuation of the multilateral trading system. The United States encouraged imports from Japan and Korea because these were frontline states in the Cold War, but this rationale is wholly missing in its relationship with China.



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The political tolerance towards trade adjustment has decreased and this has come along with changes in technology that have worsened income distribution and broadened the impact of trade on US and European societies to a greater extent than before, affecting specifically middle-class income in the services. People's jobs are no longer safe from foreign competition, despite limited immigration. The internet is impacting trade in areas that were earlier considered 'safe' from encroachment by foreign competition. Medical reports can be assessed and financial accounts settled by qualified persons in a different country who charge less for their services via the internet. Technological progress has allowed the most high-skilled people to work more. The capacity to work and the substitution of high-skill for low-skill labor with rising efficiency has worsened the income distribution. That comes along with the negative impact on income distribution from the opening of trade.

Economists are the biggest defenders of free trade in the world. They are heavily influenced by the Heckscher-Olin Model of free trade. Five years ago Paul Samuelson brought a little twist to the model and found that free trade was good if you are a developing country and bad if you were a developed country largely because the developing country got smarter

over time learning how to produce knowledge-intensive goods that the rich countries exported. So over time the poor countries bought less knowledge-intensive and technology-intensive goods. The lower demand for these goods leads to lowered prices and eventually, losses for the developed countries.

Equally important is the post-9/11 syndrome in the United States. The country is feeling vulnerable which would explain why it is tilting towards protectionism more than it has before. In other words, insecure people do not necessarily make the most rational economic decisions. The atmosphere is right for protectionism.

The biggest challenge to the rise of China is undoubtedly climate change. The average temperature has risen drastically in Beijing over the last 20 years. Climate change has resulted in a redistribution of the rainfall pattern in China – the rains have moved from the north to the south – thereby affecting cropping patterns and agricultural output. China intends to build three canals ten times larger than the second largest water diversion project in the world to bring water from the south to the north in order to ameliorate the hardships caused. For India, the building of the third canal could imply a diversion of waters from the Brahmaputra to the northwest. These problems related to water are not unique to China. For instance, If India continues its trajectory of pumping water out from the ground, its ground water resources could be completely depleted in a few years time.


PROSPECTS FOR ASIAN ECONOMIC INTEGRATION

Most economic integration are failures be it MERCOSUR, ASEAN on its own, or South Asian economic integration. There are only two that have made big progress, one is the EU and the other is the North America Free Trade Area (NAFTA), and there are proposals to convert the latter into a FTA, spanning the area from Alaska to Argentina. Unlike the success stories, Asian integration does not anticipate culmination in political union. There is thus no institutional reason for common currency. The question that emerges as central to a discussion on Asian economic integration is whether there is an economic rationale for common currency.

In NAFTA, the United States dominates it now and will continue to dominate it in the future. Big countries like Brazil and Mexico will continue to be around five times smaller than the United States in economic terms. In the case of EU, the countries are equally matched in size, some are bigger but not overwhelmingly so. In the case of Asia, China would be much bigger than Japan, Korea and Indonesia, and remain substantially larger than India even in 2050. In such a situation if there is to be a common currency it would logically have to be yuan-based. This may be unacceptable to many countries in Asia. The dilemma that emerges is over trade integration on one hand and monetary cooperation on the other.

The integration of East Asia will get bigger just like the way that ASEAN+3 turned into ASEAN+6. India's participation in the EAS was good because greater participation ensures greater diversity, implying greater specialization, and leading to greater wealth generation. However, differences between nations and markets also imply greater adjustment. That why it is easy for the Western European countries to integrate. They are very similar and the adjustment pains are very low whereas for India and China to integrate with Japan, the adjustment pains will be very hard on the Japanese.

The rise of new powers does generate insecurity, similar to the pessimism surrounding the rise of Germany, Japan and the Soviet Union in the early 20th century. This pessimism, however, is often overdone as evident from the stable rise of the United States as the biggest power in the 20th century. Similarly, China and India can assume a stabilizing role. However, there has to be greater shared world governance, and mutual adjustments to the rise of these countries. In the case of the developed countries, this requires taking the effort of structural adjustment seriously, for example, setting up social safety nets that are effective. Further, international institutions, specifically the WTO process, need to be strengthened. They also need to take care of the global environment where the big clash is going to be. The big optimism about the rise of India and China is the fact that the most valuable resource for this place, for the world is the human resource. However, this human resource needs to be trained and harnessed for which infrastructure needs to be put into place.



China and India can assume a stabilizing role. However, there has to be greater shared world governance, and mutual adjustments to the rise of these countries.

CHINA AND ECONOMIC INTEGRATION – CHALLENGES AND OPPORTUNITIES

Most annual statistical reviews of China's indicators of growth, suggest that China's growth depends on factors that lie in the realm of challenges as well as opportunities. The statistical review of China that came out in early 2007 gives a snapshot of what has happened in China over the last year and is fairly representative of what is happening in China over the last 30 years. Firstly, the GDP was up by 10 points, and since the estimated GDP growth was 9 per cent, it is actually 1.7 per cent over the estimation for the last year. Employment rose by 5.7 million from December 2005. However, 25 million people were unemployed and China needed to create 11 million jobs for the new entrants. Hence, employment is lagging behind and more needs to be done.

Many people from the rural areas moved to urban areas and urban residents increased by about 7 million in China. This increase in urban settlers puts enormous pressures on urban resources and urban services.

On the positive side, farm income has been on the rise for the last three years. It rose because agricultural production went up and farm income rose by 7.4 per cent. This was the first major increase since 1985 that marked the emergence of China's agricultural development after the liberalization and open door policies. As a result, agriculture is looking up in China which means that in the last few years of investment in the rural areas has actually worked for China. However, income disparity remains a major problem. The urban resident's net disposable income rose by 10.4 per cent and the gap between rural and urban was not decreasing that rapidly. Despite the numbers in poverty falling by 2.17 million, China has about 25 million to 30 million people below the poverty line. Yet, this is much less than in India.

The central-local relations seem to have developed better coordination because deficits fell and national revenue rose. As a result, the state now has much more to spend on public goods in China and consequently much of the social dissent and rural-urban divides have lessened.

There has been substantive growth both in the external and domestic sectors. Total export trade and FDI have increased and foreign exchange reserves topped US\$1 trillion. These developments have produced a China that is rich and is growing, but is still not very strong internally or in terms of its institutional structures.



Problems seen in the snapshot are also issues that are taken up at great length in the National People's Congress (NPC) and at the top levels of the Chinese leadership, that is, Chinese planners and economic managers are aware of what is happening and what needs to be done.

This provides a clear definition of where the challenges actually lie and one of the major debates in China has been on whether China needs to look at the exports-driven model rather than pushing up domestic consumption, which according to the EU and the United States lies at the heart of the enormous trade surplus China has with the Western world. If the issue is examined, it uncovers the whole set of structural weaknesses that create a set of challenges to the Chinese economy and growth.

In the domestic context, the rural-urban and regional imbalances are the most glaring and troublesome for the Chinese policy makers and in the medium and the long run could put a stop to economic growth.

Environmental degradation and use of resources in China have been another cause of concern. Inefficient use of resources can be dated to Mao's era. The push for development essentially ignored environmental issues in China and a view of development and growth has emerged that ignores larger environmental issues. 40 per cent of land area is affected by various types of land degradation and that is enormous because

China has very little arable land. Over half the major cities failed to make the Grade 2 National Air Qualities Standard set out by the government and about one-third of the territory is affected by acid rain caused by CO₂ emissions.

Another problem is related to health issues. About two-thirds of urban residents live in a polluted environment and health risks are enormous. If China does not switch to more efficient forms of energy and continues to use enormous amounts of coal, pollution will remain unacceptably high as well.

Externally, a debate is on over whether consumption levels should be pushed up and whether the economy can go forward in terms of trade deficits and imbalances. The figure for domestic consumption as part of GDP in China was 60 per cent in the 1950s and that has decreased to 45 per cent in 2005. So the Chinese are buying less, they are using less and they are also importing less in certain sectors.

On the one hand, China is globalizing, it is integrating and is much more open to the world. On the other hand, it creates all kinds of dependencies, which may not be good for Chinese economy if the global trading slows down. The ratio of trade to GDP is approximately 40 per cent and that makes China hugely trade-dependent.

Finally, a huge challenge for China is related to its role on the world stage, on the regional stage and its 'stepping out' policy. Its investments are now being seen especially in Africa as being overly mercantilist and as a South African has said, it is neo-imperialist and the tone and voices that are coming from Africa are basically indicating that China is in Africa for China and not Africa. Essentially, integration of China's interest with the interests of other countries is not coming through in its more recent policies.


Where is China going with the challenges that its economy faces and is it going to be able to overcome these? It has to take certain corrective measures, in terms of institutional structures. It needs to sustain domestic economic growth which is at the heart of everything that China does today by bringing down the cost of that growth, both the environmental cost of growth as well as the geopolitical cost of that growth. This will prevent the formation of oppositional blocs to its political as well as economic policies and to its economic reach both globally and regionally. It needs to invest where it gets the highest returns. This does not happen often because of the fiscal system and the financial system within China wherein much of the money that goes into the economic investment goes through the banking system which then puts it into enterprises that are essentially just meeting targets and creating overcapacities. So, overcapacity is a huge issue in China especially in very significant sectors of its industrial economy such as mining, steel or iron ore. China should be able to addresses domestic problems such as unemployment, spend on public goods, invest in backward regions and prevent huge social dissension from breaking out in China.

Another significant issue for the world is that if the Chinese economy slows down then the East Asian economy and even the global economy is likely to follow suit. The Chinese have this remarkable ability to be able

to circumvent this slowdown and seek solutions by not addressing the issue but by actually opening out on other fronts. China's very aggressive energy policy investments initiated may actually create a backlash.

According to the 2007 statistical survey, imports and exports as a total, increased to 24.1 per cent year on year while the trade surplus, increased by 66.1 per cent. In terms of FDI, the total amount fell in 2005 and the number of approved projects decreased by 6.3 per cent. Chinese contractual investments abroad went up by 40.6 per cent. The fruits of this aggressive initiative on outward investment need to be explored. It is to be noted also that the numbers of Chinese who are going out on its overseas projects have increased by 11.9 per cent.

China's interests in Africa need careful analysis. First of all, China's oil interests in Africa are fairly extensive. The problematic part is that China has to deal with rogue countries such as Sudan in order to access it. China accounted for 40 per cent of total growth in global demand for oil in the last four years and that has actually spurred African growth enormously over these years as well. Sino-African trade grew by about 700 per cent in the 1990s. This is enormous for Africa though it may not



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be that large for China and not very large as a proportion of China's total trade. The China-Africa Forum in Beijing saw several trade investments agreements and cooperative frameworks with the targets of this trade also being increased.

How is China building this relationship with Africa? China's integrated packages for Africa, its infrastructure, its social spending, its business opportunities and the market share of Chinese companies have the Africans

concerned but they are also happy because Chinese trade and investment initiatives pushed Africa's growth up by 5.2 per cent.

Latin America is different in terms of economic development from Africa. The problem in Latin America is that countries actually protest that China promises but does not invest. Most Chinese companies that invest are state owned companies, and few private players are interested in this investment game as part of the stepping out strategy. There is a certain incompatibility in what China is promising to do and what it is actually doing in Latin America.

From the above observations, it can be concluded that China has a fair amount of global reach both in terms of investments and in terms of trade and in terms of FDIs into China. The next step in that global reach is the policy of integration, including regional integration and sub-regional integration and if multilateral frameworks do not work out, the Doha Round does not work out, then a diversion of interests from multilateral forums to regional ones.

The most important reason for this is because there is no evidence to indicate that the amount of trade intra-regionally is much more than that

inter-regionally. In the EU, the level of trade is 60 per cent within the region. Figures indicate that regionalization is good for regional trade and China fortunately is in a situation that allows it to be part of many regional processes, the SCO, the ASEAN, the East Asian Community, and SAARC. Hence, China's perspective or orientation is going to move from multilateral forums to regional forums. However, if India and China move out of multilateral forums and if the WTO talks do not succeed, chances for global economic agendas will lessen.

One of the big issues is global energy policy; and an anomaly here is that China is not part of any of the forums in which global energy policies are decided such as the International Energy Association, which is part of the OECD. Hence, to avoid a clash over energy resources, these institutions should be opened to China and to India as well.

VI. Changing political and economic tectonics between India and China

China's economic rise has been much feted. However, it remains to be seen whether it is real industrial growth or growth which is merely subsidized by the state. China sells all its goods at below market prices in the United States because there is no collective bargaining in China, there is no industrial democracy in China, there are no environmental



standards in China and there are no stringent labour laws. Exports may well be growing but it remains debatable whether this growth has led to economic prosperity or is premised on the exploitation of cheap labour.

China's potential vis-à-vis that of India's lies in its ability to raise more taxes that can be utilized for infrastructural development. In India however, income inequality is growing at a much smaller rate and its most important asset in the future will be its relatively

young population. As China's population grays, India will have a younger population that can fuel greater growth. This said, the big difference between India and China is that half of China's GDP comes from industry whereas half of India's GDP comes from services of which IT actually only forms a very small part. It is the public administration component that forms about 17 per cent of services in India. FDI of almost US\$600 billion has come into China while in India the figure stands at a mere US\$40 billion. In 2006, India received FDI of about US\$22 billion whereas the Chinese received US\$58 billion. FDI into India is therefore increasing but India is still debating whether foreign money is good or bad and frequently changes the terms of investment.

CHINA AND SOUTHEAST AND CENTRAL ASIA

The Chinese views of Central and Southeast Asia have been shaped in a historic context. Since many of China's historic tributary relations, central to the idea of a "middle kingdom," were first formed in Southeast Asia, China has historically considered the region as its area of influence. The

last 150-200 years have in this respect been an aberration where Western powers, especially the United States, have become increasingly entrenched. China is now perceived to be in a process of reclaiming its position as the dominant power in the region. As regards Central Asia, though it never formed part of the Chinese sphere of influence, it was a recurrent source of insecurity in China's periphery. Central Asia remains a concern for China.

In the 1990s, the Chinese learnt that their approach to Southeast Asia, of challenging the American presence there was not working, they initiated a new subtle policy of reassuring ASEAN that they had common aims and challenges. Therefore, China has begun emphasizing themes such as free trade agreements, confidence building measures, economic development and multilateralism.

CHINA, THE UNITED STATES AND SOUTHEAST ASIA

There are two views on China and Southeast Asia. One asserts that China's determined diplomacy in the region has led to a loss of American influence. Every Chinese gain is perceived as a loss for the United States and therefore, it is depicted as a zero-sum relationship.

The second view does not view the equation as zero-sum. It contends that US interests in Southeast Asia are not being damaged by Chinese influence in the region. In fact, American interests in terms of access, security of the straits, advancing democracy are not necessarily being



damaged by Chinese growth in the region. American interests are on the contrary, seen to be enhanced for the United States is increasingly viewed as the only alternative to China in the region which can be used to hedge the latter's growing might.

There is no single perception of China in Southeast Asia but there is one common assumption. China is expected to give more than it receives in Southeast Asia and prove its goodwill through greater benevolence. Southeast Asian countries continue to engage with China on their own terms. They have displayed no eagerness in forming a coalition to balance China nor in supporting China against a third country. There is much discussion on comprehensive security in Southeast Asia which takes into account the domestic political scenario as well. Southeast Asian elites possibly view China through the prism of China's contribution to their own economic interests. China is viewed as only one of the four major powers in the region, including the United States, Japan, and India, and does not necessarily compare favourably with the other three. The emphasis on sovereignty, territorial integrity, primacy of principle of influence, consensus building, peaceful resolution, are all factors that are utilized to constrain coercive power and characterize the Southeast Asian approach

to security. The Southeast Asian states encourage all four powers to remain engaged since this provides them with opportunities to hedge and leverage one against the other.

Compared to China and the United States, it is Taiwan and Japan that have lost the most. Taiwan has been unable to emphasize its ties with Southeast Asia while Japan's economic clout has not translated into political influence. The image of the United States and China in competition for Southeast Asia is misleading and simplistic. They are but two of the four leading players in the region and the Southeast Asian states continue to engage with each of the four on their own terms. What remains to be seen is how the balance between hard and soft power of the various players develop in the future.

VII. Energy security: are the United States, India and China all in the same boat or are they on a collision course?

Any discussion on energy security, energy access and energy availability requires a contextual overview of recent happenings. One notable development is that Russia is currently producing as much oil as Saudi Arabia, although with less long term sustainability. Meanwhile, important new sources of supply have emerged in Central Asia, Western Africa and Latin America. There has also been a noticeable increase in the salience of gas in the energy considerations of most countries. For example, in Europe gas usage is about 24 per cent, compared to India's 8 per cent and China's 3 per cent. Thus, there is a long way for China and India to go to catch up with the rest of the world, particularly in the post-Kyoto paradigm. In addition, liquefaction costs have been declining over the years, so LNG trade, merely 6 per cent of global gas trade only five years ago, has now grown to 30 per cent.

In the post 9/11 context, energy markets have tended to converge on a regional volume basis. For example, the United States is sourcing most of its oil and gas from Canada, Mexico, Venezuela, and some from West Africa and Europe is sourcing it from Russia, Norway and the North Sea.

This has been combined with the phenomenon of globalization. This process has introduced the previously unthinkable concept of a certain material standard of living to millions of citizens in developing countries, a way of life that demands substantial energy consumption. Moreover, this change in expectations is an irreversible phenomenon and thus both energy consumption and oil prices can be expected to rise. Therefore, besides availability and accessibility, affordability has become a central issue for countries like India and China.

THE ENERGY SCENARIO FOR THE UNITED STATES, CHINA AND INDIA

The United States is by far the largest energy consumer in the world, utilizing 22 million barrels a day out of the daily worldwide total of 82 million barrels - a little over a quarter of global consumption. Of this, 13.5

million barrels, or 63 per cent of the total are being imported. The United States has managed to diversify supplies somewhat. Only 12 per cent currently comes from the Persian Gulf and a lot of measures are being taken to combat energy vulnerability. The recent Gulf of Mexico Energy Security Act will enable companies to do offshore drilling and there have been efforts to diversify into ethanol.

By comparison, China has recorded 9 per cent growth this decade, a good deal of it hydrocarbon led. China is the world's second largest oil consumer and the third largest oil importer. Oil consumption in 2006 is estimated to have been around 7 million barrels daily – less than one-third of US consumption. According to four separate estimates by the International Energy Agency, the United States Department of Energy, the Institute of Energy Economics, Japan (IEEJ) and Merrill Lynch, maximum Chinese usage may top 9.2 million barrels in 2010 and 12.3 million barrels daily by 2020. However, even if these top-end estimates are accurate, 12 million barrels would still be only half of American oil consumption today. Moreover, as US oil consumption would also have grown by 2020, Chinese usage will still represent a fraction of the United States in terms of oil consumption. Currently, 58 per cent of China's oil imports come from the Gulf, which could rise to 70 per cent by 2015. Thus, the security of stocks and the share of natural gas can be expected to be major issues in the future.



In India, there is an energy intensive growth paradigm but it trails GDP growth marginally. Most incremental growth is coming from hydrocarbons which represent 40 per cent of total commercial energy consumption. Coal increasingly fuels power generation, but transportation in India will continue to depend on oil which must be imported. India's energy paradigm is import intensive because production has been only 640,000 barrels daily for the last five years. Geologists believe that there is little scope for finding new oil on the mainland or off-shore. Consumption at present is 2.4 million barrels per day, that is, indigenous production is only about one quarter of the total requirement. Consumption is projected to increase to 3.4 million barrels a day by 2010, which is actually very modest growth, largely due to the low base from which the country is starting. Nevertheless, these imports, 68 per cent of which come from the Persian Gulf region, cost India US\$45 billion in 2006 – an incredible 40 per cent of total export earnings.

A straight comparison in terms of per capita energy consumption is instructive. It reveals that 25 barrels per capita are consumed in the United States compared to only 1.3 barrels per citizen per year in China, while the average Indian uses only 25kg per person annually – a fraction of a barrel. Meanwhile, in the United States, energy imports as a percentage of consumption, stands at 63 per cent, whereas the

equivalent figures for China and India are 47 per cent and 75 per cent respectively.

THREE CRITICISMS OF THE CHINESE ENERGY POLICY

There are three main criticisms that Chinese energy policy has faced especially from US think tanks, which relate to the burgeoning Chinese oil demand, the alleged 'mercantilist approach' of Chinese energy policy, and the adoption of non-market measures to acquire overseas assets. However, all these accusations are generally overstated and inaccurate.

First, the assertion that burgeoning Chinese oil demand is leading to tight markets and is therefore, rendering oil prices volatile and expensive needs to be examined. In 2003 and 2004, China's oil consumption did grow, probably due to a fear of disruptions owing to the Iraq war. It rose by almost 17 per cent, but since 2005 it has declined and now measures in single digits. Therefore, Chinese consumption has slowed down considerably in the last two years while US consumption or import growth in absolute quantities is much bigger than China's. From 1995-2004, US daily oil demand grew by 3.9 million barrels, compared to China's growth of only 2.8 million barrels. Thus, in absolute terms the United States is actually more of a culprit in driving up prices and creating the tight market situation.



China and India can only invest in areas where there is availability: namely in Africa, Latin America and, to some extent, Central Asia.

In addition, there are many other factors which are driving up global prices. For example, it is estimated that US\$10-US\$15 of the cost of each barrel represents a terror premium. In the worst case scenario, if the Ras de Nura terminal in Saudi Arabia gets attacked it could drive 8-9 million barrels of oil out of the market, so this threat is represented by a premium that boosts prices. Moreover, there is no spare production capacity. Saudi Arabia used to be the swing producer and previously used to maintain 2 million barrels of spare capacity. However, this has been eroded by growing global oil demand and there now exists a very tight demand-supply situation so that any spurt in oil demand will drive up prices. There is also a tight refinery capacity, particularly for light sweet crude, exacerbated by the effects of Hurricane Katrina. This has had a spill-over effect on all crudes. Market speculators and political disruptions in Nigeria, Venezuela and Iraq have also contributed substantially to market volatility. Thus, there are a lot of factors responsible for driving up oil prices and China's culpability has not been unequivocally established.

The second main criticism of Chinese energy policy has been directed against the country's purported 'mercantilist approach,' China currently has oil assets in 27 countries and its share of production from overseas oil assets could soon reach 15 per cent of consumption, in line with the hopes of the Chinese leadership. Nevertheless, physical supplies from

overseas oil assets in 2006 were negligible. For example, from Sudan, China was importing substantial quantities in 2004 and 2005 but this has subsequently tapered off to only a few thousand barrels daily. In fact, overseas oil production to China totals only 372,370 barrels, a relatively small figure considering the consumption level of 6 million barrels a day. The prevailing view among energy professionals now is that this is not adding substantially to China's energy security. Most of the oil assets that China has are in exploration rather than in producing assets and, China will have to invest still more money and technology before it can actually reap the benefits of these investments. Thus, without physical accessibility, Chinese oil assets in West Africa or Latin America will not contribute greatly to energy security.

In India's case, the stake in Sakhalin-1 has not yielded more than a token amount of oil and gas, such as the 30,000 barrels recently received at the Mangalore port. Sakhalin is not going to be feasible because it has to come through the Straits of Malacca in the opposite direction. So the acquisition of a stake in Sakhalin has effectively aggravated the stocks problem. It is not beneficial for India to get into this game. Similarly, for China, unless they are physically accessible, overseas oil assets should not be viewed as energy security measures but rather as investment measures. At a time of rising oil prices it makes eminent sense to invest in oilfields purely for profit. This contention is supported by the fact that 93 per cent of oil produced by Chinese oil companies overseas is sold to the local market and the international market instead of being shipped back to China.

Additionally, although there are general policy directions by the Chinese leadership to acquire oil assets, it is not a coordinated strategy. Companies such as the China National Petroleum Corporation (CNPC) and Sinopec (China Petroleum and Chemical Corporation) have a personality and identity of their own, whereas the government in China is an uncoordinated multiplicity of institutions. In fact, these companies are identifying assets and the political leadership, embodied by institutions like the Chinese Ministry of Foreign Affairs, uses diplomatic devices or incentives such as weapon sales to enable companies to clinch these oil assets.

Third, China is accused of adopting non-market measures to acquire overseas oil assets. This involves offering financial concessions, aid packages, and Chinese-aided development of infrastructure, in order to persuade countries like Angola and Sudan to part with their oil assets. Yet, if it is infrastructure, schools or refineries that are being built and China is engaging in the development of Africa and Latin America, this can be a positive force.

A more general criticism is China's business engagement with oppressive regimes, or those hostile to the United States, like Sudan, Iran, Myanmar, Uzbekistan, Syria, Venezuela and Cuba. However, this is mainly a function of China's status as a latecomer to the global oil game. It is important to recognize that of the global oil assets available for acquisition, 77 per cent are controlled by governments and national oil companies. The entire Middle East is unavailable, the Russian government has wrested control from the private sector, and Kazakhstan has put in place a very restrictive production sharing and royalty regime. So wherever there is oil there is a

tendency for states to dominate these assets. This means states like China and India can only invest in areas where there is availability: namely in Africa, Latin America and, to some extent, Central Asia.

CONCERNS FOR THE UNITED STATES

China's expansion into Central Asia, as demonstrated by the Atasu-Alashankou pipeline is a concern from the American point of view. With the Caspian believed to contain 40 billion barrels of oil, the Baku-Tbilisi-Ceyhan pipeline built by American companies is seeking to access this new source of petrochemicals. However, Chinese expansion of the Atasu-Alashankou pipeline threatens this project.



President Putin's Look West Policy had concentrated exports primarily to Europe which now depends on Russia for 50 per cent of its gas imports. However, as part of the political fallout from the Ukraine affair, the Russian President has subsequently announced that exports to Asia will increase from 5 per cent to 15 per cent of the total from Northeast Russia, Siberia and Sakhalin. Given their geographical proximity, China, South Korea and Japan are logical markets for new

production. However, the logical corollary is that European and American markets will have to reduce their reliance on Russian energy.

17 million barrels of oil pass through the Hormuz Straits daily headed towards many destinations besides the United States, India, China and Japan that are the major recipients. By comparison, the Malacca's see 11.7 million barrels pass through their waters daily; of which China, Japan and South Korea are the major buyers. China perceives the reliance on these two chokepoints to be a point of vulnerability and dependence, not least because it is dependent on American policing of these sea-lanes. This is one reason why it is engaged in massive diversification of its supplies, the building of alternative transit routes, and investment in pipelines.

PROJECTIONS

China is marching towards its manifest destiny of being a developed country and as such the pursuit of energy resources is a necessary part of meeting its development objectives. It is important to understand that growth and development, both heavily dependent on cheap oil and gas

availability, are imperative for regime stability in China. It is unlikely to engage in conflict unless provoked and there are many Sino-US synergies that could further reduce the likelihood of violence, such as possible Chinese entry into the IEA system. However, these will depend on a proactive approach and constructive engagement with China.

The United States should also assist China and India to improve energy efficiency. Coal will remain the mainstay of both the Chinese and Indian economies for the foreseeable future and so if the world is really serious about climate change, the technology to use this coal in a clean fashion needs to be developed and promulgated affordably. Presently certain WTO stipulations and the movement against climate change appear to be working at loggerheads. There exists a WTO regime where the



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patenting of intellectual property rights is stressed with very stringent laws put in place but at the same time, developing countries want access to clean technologies so they can realize a cleaner growth paradigm. Therefore, unless these technologies are made available in an inexpensive manner, dirty coal will remain the best option for developing countries. Thus, it is in the interest of the United States and the global community to tackle climate change through the transfer of such technology to India and China, perhaps through the establishment of a joint fund for clean energy.

There are also many areas of synergy between India and China. First, both countries do not have strategic petroleum reserves yet, whereas the United States has 700 million barrels of oil in reserves. OECD countries have their own stockpiles under the IEA. This means that there is a free rider problem because if stockpiles are released in times of high prices, everybody benefits from the moderation of prices. Therefore, it would be in the interest of IEA countries and of America to encourage India and China to build a strategic stockpile, particularly if these two countries coordinate their efforts in building and maintaining them.

Second, another useful action that can be taken would be the elimination of the US\$1-US\$1.5 premium that Asian countries pay for oil, over and above the market price paid by the United States. Japan has been making some diplomatic noise, but with the support of two big consumers like India and China, the abolition of this premium could be achieved.

Third, there needs to be an Asian market price for crude that truly reflects the quality of oil used in Asia. Currently, all crudes are priced with reference to Brent and Western Texas Intermediate which have no relevance to the heavy and medium grade crudes that are consumed in India and China. This reflects another opportunity where India and China can work together and potentially save up to US\$10 billion dollars every year.

Finally, one other important area where India and China can collaborate is to de-link gas prices from crude prices. With the global market value of oil rising, international gas prices are reaching levels that are unsustainable for Asian countries. In India, the price of gas is US\$1.83, the rate at which Indian power companies purchase this commodity. In China, too the cost is below US\$2. Indian power companies could possibly absorb prices of US\$3-US\$3.5 but could not cope with price rises above US\$4. Iran is currently demanding US\$4.5 at the wellhead, which, if added to the cost of the pipeline and transit fees to Pakistan, may well end up costing US\$6.5 by the time it enters India. If transportation within the country is factored in, then it is clear that gas at this price will not be affordable for India. LNG cannot be a solution because it usually costs at least 30 per cent more than the equivalent amount of gas piped from the neighbourhood. So for gas to play its rightful role and replace some of India's use of dirty coal, gas prices need to be de-linked from oil, especially as nuclear, hydro and renewables will continue to play only a marginal role in the country's energy security for the next 15-20 years.

WHY CHINA LACKS A COMPREHENSIVE ENERGY STRATEGY AND A CONSISTENT ENERGY POLICY

Energy security is composed of three basic considerations – adequate supply, affordable prices and safe delivery. From a Chinese point of view, the government really has little control over any of these factors. Therefore, China's effort to secure energy security mostly revolves around cooperation with both energy producing countries and competitors such as the United States, Japan and India.

First, there is an ongoing debate in China whether state-centric energy mercantilism or dependence on the international market is the best energy strategy. As mentioned above, 77 per cent of oil and gas is controlled by national governments rather than independent oil companies. Moreover, there has been a recent rise in 'energy nationalism' in most energy producing countries but especially those in the former Soviet Union, Central Asia, Latin America and Africa. This means that increasingly, those countries that produce energy will use it as a strategic asset and a political tool for strategic policy goals.

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Thus Chinese leaders have competing incentives – they produce energy and it is tempting to use it as a strategic asset for political rather than commercial deals. However, there is only one oil market and only one energy market. China cannot escape this fact and indeed the energy issue is a global one that affects all countries. Thus the only way to fundamentally solve this problem is to strengthen and improve the mechanism of the market.

Currently, the market-oriented argument appears to be winning in China. Not because the Chinese economy is very integrated in the international system, but because the Chinese Oil Company has become market-driven and is increasingly governed by market forces rather than government policy.

The second reason that China does not have a comprehensive energy strategy is that its policy coordination is very poor. China's decision-making system is very good at vertical control, but it has insufficient horizontal or simultaneous communications among policy players. In a command economy this can work effectively but in the reformed Chinese system it becomes a problem.



Only about 6 per cent of China's energy supply comes from the international market, but this 6 per cent is vital for the Chinese economy because the industries that depend on imported energy are the 'backbone industries' of China such as the automobile, transportation, and defence businesses. So as a result there are several players involved in the policymaking process including the Ministry of Foreign Affairs, the Ministry of National Security, the military, and the Ministry of International Trade and Commerce. They all have their vested interests and do not often communicate openly with each other.

The third reason is the increasing tension between Chinese oil companies and the Chinese Government, especially since 2004. Partly, this is a result of the initial reforms of the 1980s which removed responsibility from the Ministry of Energy and the Ministry of Chemical Industry and instead empowered two big companies, the CNPC and Sinopec. These reforms were expanded from 1996-1999 by Chinese Premier Zhu Rongji who attempted to make energy prices more market-related. These two changes combined with the government's desire to protect domestic constituencies in China from price fluctuations meant that the newly profit-oriented companies increasingly began to garner more business abroad. This drive for profitability has resulted in political problems for the Chinese leadership, one of the best known of which has been Chinese involvement in Sudan.

When the CNPC first went into Sudan, it needed the cooperation of the local government. So it cut deals, agreeing to build hospitals, schools and other buildings. For the companies this was simply a business necessity but it caused conflict with the Ministry of Foreign Affairs. Moreover, because Sudan is not a safe working environment, oil companies began to have security forces to protect them. The PLA saw an opportunity to get a cut and provided its services. Thus, there are currently 6000 Chinese troops employed by Chinese oil companies in African countries such as Sudan, Nigeria and Angola in order to protect their interests. This has caused conflict with the Ministry of National Security and the Ministry of

Foreign Affairs who are very reluctant to join peacekeeping activities in Africa.

Last year, when Hu Jintao was in Africa, he gave a very unusual one-hour lecture to all the Chinese companies who invest in Africa. He instructed them to practice corporate responsibility, adhere to human rights norms, and ensure that company interests do not interfere with national policy goals. Therefore, it can be said that the relationship between Chinese oil companies and the Chinese government is unique and is a major factor behind the seemingly unclear Chinese energy strategy. However, despite these points, there have recently been some signs that a more coherent policy may be emerging. For example, only three years ago, 80 per cent of Chinese imported oil still came from the Middle East, but it has managed to reduce dependence on the region to 65 per cent. Second, the Chinese government has conducted dialogues with Japan, the United States, and also with India – the latter resulting in a 50:50 deal with the Indian Oil Corporation (IOC). Third, the Chinese government has belatedly begun to listen to industry professionals. It now seeks advice from the oil companies more often and has established a leading group to focus on the energy issue. In this group, most of the experts are executives from oil companies and they play a very important role in shaping a more focused Chinese energy policy.

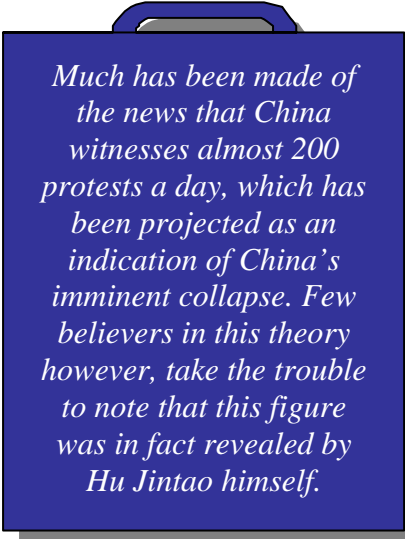
Finally, Chinese energy policy has developed a very important focus on gas and already has a significant and fast developing gas market. This is important not only because it is cleaner than other petrochemicals and coal, but because China has much more extensive gas reserves than it has oil reserves. Moreover, China could conceivably also source its gas requirement from Central Asia and Southeast Asia. Thus, from a Chinese point of view, diversification to gas would help address two aspects of energy security – safe delivery and adequate supply.

VIII. Chinese leadership and political evolution

The changing rules of Chinese elite politics or the changing nature of the Chinese political process can be assessed on the basis of important questions that are related to the upcoming 17th Party Congress, the defining characteristics of elite politics in China today, the fifth generation of Chinese leaders and how the collective characteristics of the new generation of leaders will shape China's trajectory.

A caveat is necessary to recognize that the recent explosion of analysis related to China has obscured the dearth of literature that existed before the turn of the century, particularly in the non-Asian academic community. Therefore, it should be understood that current assertions on diverse topics such as energy, the middle class, SARS and the impact of social protests are based on a relatively shallow base of previous analyses. Nevertheless, these developments do reveal important insights into the changing nature of elite politics.

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to note that this figure was in fact revealed by Hu Jintao himself. By releasing this data, Hu took a proactive role that underlined the need for policy change thereby consolidating his position. Such political manoeuvring increasingly characterizes Chinese politics.

The 17th Party Congress to be held later in 2007 is critically important for several reasons. First, the scale of leadership turnover is expected to be very large. Second, it is possibly at the 17th Party Congress that Hu's successor will become known. Third, the issue of Zeng Qinghong's retirement will be settled at the 17th Party Congress and this will help determine the emergence of the fifth generation of leadership.

First, the average age of the members of the top organs and institutions in China is 65 years. This includes the Politburo, the members of the Standing Committee, and the secretaries. Of the 356 members in the Central Committee, 241 or 88 per cent have reached the age of 60 years.

Those above the age of 63 are expected to step down. This will be a sizeable number. Similarly, of the seven secretaries, six are above the age of 60 and are expected to step down. The State Council will not change till 2008 but the leaders of the next council are expected to be chosen at the 17th Party Congress. Three of the four Vice Premiers will retire and



four of five State Councilors are also expected to retire. A major change in the state leadership is therefore on the anvil. On the financial economic policy front, four top leaders except Premier Wen Jiabao will probably stay on while of the four Deputies, three will retire due to the age factor. In the foreign policy team, the top three foreign policy formulators will step down. The military leadership is also expected to change with more than half of the CMC members expected to be replaced.

The high turnover rate of China's leadership is not a new phenomenon. From the 12th Central Committee in 1982 onwards, the turnover rate has been around 60 per cent and this has ensured a smoother and more regulated transition of leadership.

On the issue of Hu Jintao's successor, there are two models that can be applied. The first is the so called leader among equals, as Hu was designated fourteen years ago. The second model is to select two or four new leaders to compete with each other. It seems that the second model is the most likely scenario for China today since it is in line with the recent leadership rhetoric on collective security and party democracy. As regards Zeng Qinghong's retirement, he is the leader of the Shanghai gang and remains extremely powerful but his retirement will pave the way for the next generation of leaders and also an opportunity for his protégés.

There are three defining characteristics of elite politics in China today. First, the all-powerful 'strong-man in decision making' has given way to collective leadership, in which the top leader is no more than the first among equals. Consensus is required for decision making which can only be arrived at through negotiations, consensus and compromise. Second, the zero sum game in politics is being replaced by a pattern of power sharing among competing factions, regions and social groups. This power sharing is making the decision making process increasingly transparent. The third is that of factional politics in China. The two factions represent two different sociopolitical groups and geographical regions with differing policy initiatives and priorities but are complementary in terms of the leadership's skills and expertise.

The first difference between the factions lies in the composition and background of their members. The 'populist coalition' is led by President Hu and Premier Wen and includes leaders of the Chinese Communist Youth League, party functionaries and provincial leaders especially from the inland regions. The second faction is the 'elitist coalition,' They include the Shanghai clan, the 'princelings,' that is, the children of high-ranking officials, and who are entrepreneurs and particularly CEOs of

companies in important sectors such as oil, telecom and energy. This faction also includes the returnees – people who studied overseas and then returned to China, and leaders from the coastal provinces. The region of interest from where the factions garner support thus has a direct influence on the policies they promulgate. Checks and balances of power exist among these two factions and power in the highest echelons is usually divided equally between the two.

As regards policy, the 'populist coalition' emphasizes social issues, social justice, social fairness, and social cohesion, as described by the term 'social harmony.' Priority is given not to economic growth alone but to social issues such as rising inequalities. A balanced regional development is advocated by this faction and it has already brought to an end the developmental policy that favoured the coastal regions. People-centred rhetoric is also given importance; instead of a single-minded pursuit of economic growth, social and environmental costs are also brought to bear in policy decisions.

The 'elitist coalition' on the other hand puts priority on economic growth, economic efficiency, maintaining a certain percentage of growth and favours a coastal development strategy. It supports Deng's view that some people will get rich first and is less concerned about the environment. It believes that China should maintain high levels of growth to absorb surplus labour and prevent unrest. This group represents interest of the emerging middle class and entrepreneurs.

How would the new generation of leaders affect the trajectory of Chinese policy? An answer may be sought not only from an analysis of the relative power of the two factions in institutions of government, but also in the characteristics of the leaders themselves. We are probably witnessing the end of the technocracy that has ruled China after Mao. From 75 per cent of the leadership comprising of technocrats in 1980s, only 40 per cent will comprise of technocrats after the 17th Party Congress. Increasingly, China's leaders have been trained in the social sciences. Many of them are lawyers and economists. Perhaps this is a sign of things to come. It remains to be seen whether the new development strategy that seeks to develop the coast and the interior simultaneously, will work. Questions over the allocation of resources and the appeasement of local interests remain to be satisfactorily answered.

There are many important developments in Chinese elite politics that must not be forgotten. Elite politics is no longer a zero-sum game. The rise of the non-technocrats is a new phenomenon as is the coexistence of the populist and elitist approaches to development. The compromise negotiations that now take place are something new as also the peaceful shifts in policy. There are indicators that open political lobbying may well emerge from the factional politics of China. The knowledge of political deal-making and complications that was closely guarded previously is now in the public domain. This tacit public participation is a new emerging characteristic which accords with the dynamic nature of political processes in China.

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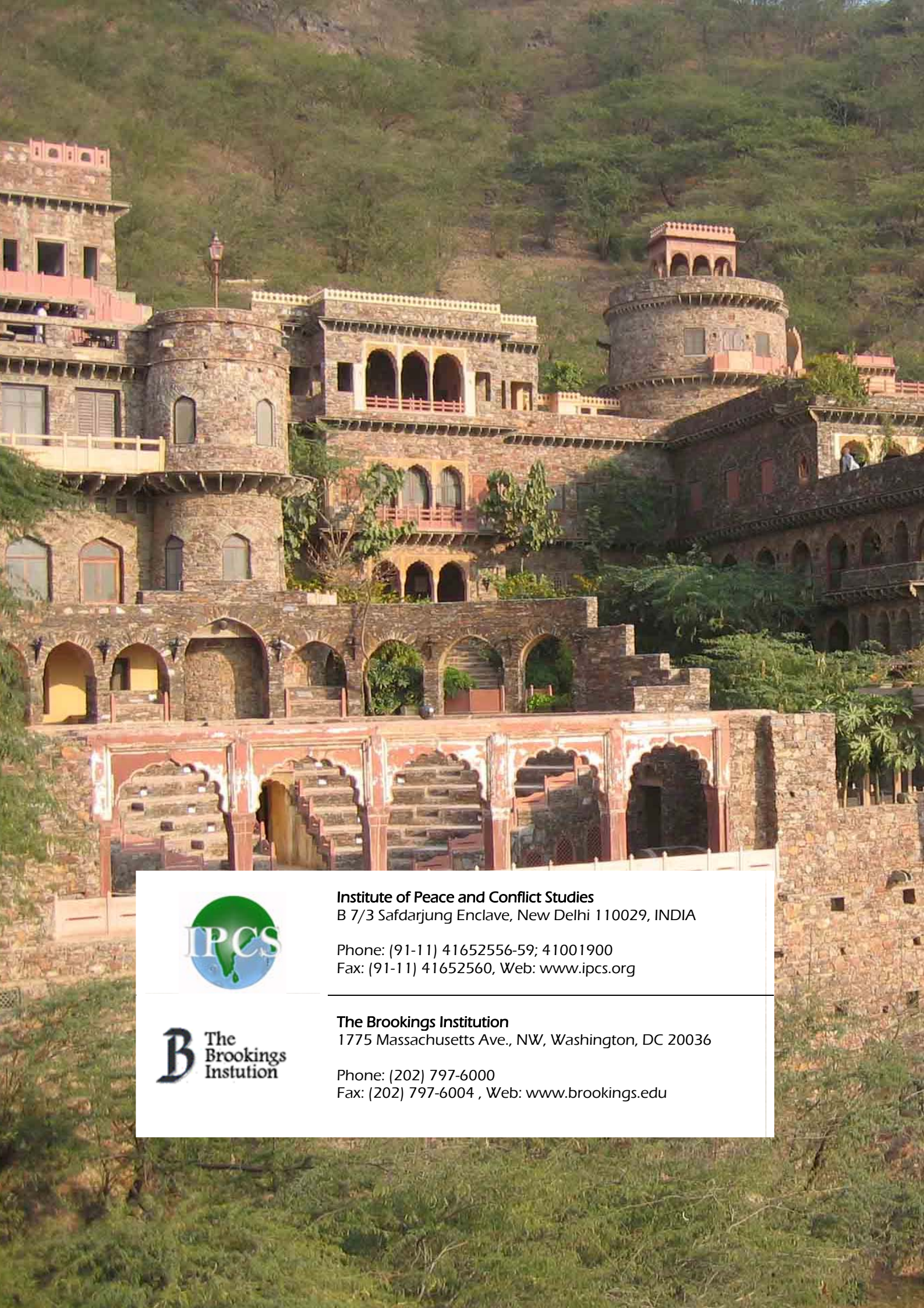
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