

FREEMAN REPORT



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QUOTE OF THE MONTH

“China’s defense development is not aimed to challenge or threaten anyone, but to ensure its security and promote international and regional peace and stability... Security of a country relies not only on self-defense capabilities, but also on mutual trust with others.”

~ Chinese Defense Minister, **Liang Guanglie**, speaking at the first ASEAN Defense Ministers’ Meeting-Plus (ADMM-Plus) held in Hanoi on October 12. Minister Liang also commented that strengthening non-traditional security cooperation was the starting point, as well as a focus on future closer security cooperation for the ADMM-Plus. U.S. Defense Secretary Robert Gates met with Minister Liang on the sidelines of the inaugural meeting, which ended a year-long pause in military talks between the United States and China since the U.S. arms sale to Taiwan.

Source: *Washington Post*, October 12, 2010

The *Freeman Report* provides an open forum for individual opinions and commentaries on China. All opinions expressed in the feature essay of the report are those of the author.

Feature Article

SMOKING TIGER, INJECTING DRAGON: THE ILLEGAL TRADE IN NARCOTICS IN CHINA

By Niklas Swanström

The narcotics trade has a long history in China, most notoriously during the end of the 19th Century and beginning of the 20th when foreign, primarily British, exports of opium had such a devastating impact. It is estimated that by 1931, 20 percent of the Chinese population was hooked on opiates, with 90 percent of such addicts (72 million) using opium and the rest (10 million) using morphine or heroin. While during the early decades since the 1949 establishment of the People’s Republic of China, abuse of narcotics was largely eradicated, it has increased significantly since the opening up of China and with the increased wealth of the Chinese citizenry. Chinese official figures showed 1,335,920 registered narcotics abusers by the end of 2009, but unofficial estimates run much higher and could be as high as 30 million (approximately 2.2 percent of China’s population). Though this is still much lower than the international average of 3.5 to 5.7 percent of the world population estimated by the UN Office on Drugs and Crime (UNODC), the number of users is steadily growing and could easily become a problem of greater magnitude, especially in key areas where the trade and its related problems – such as prostitution, HIV/AIDS, Hepatitis C, and petty crime – have grown rampant.

The pattern of abuse has also changed significantly since the years before revolution: heroin is officially the preferred drug, with a consumption of some 45 metric tonnes, while opium (a much less potent product) consumption stands at only 12 metric tonnes. However, the figures are, by most credible accounts, gross underestimates. Today China is one of the main opiate consumer markets in the world, consuming 12 percent of world output, according to UNODC, but still below the markets of Europe (19 percent), Russia (15 percent), and Iran (15 percent). According to the Chinese government, 77.5 percent of all abusers use heroin, a trend that has decreased from well over 80 percent since the first figures came out, even if the reality is that a much larger proportion of the population has used other kinds of drugs and that methamphetamine and “party-drugs” most

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likely constitute the majority of consumption today. UNODC notably has no figures on Chinese non-opiate consumption.

Much of Chinese heroin and opiate imports originate from Afghanistan and are increasingly transported through Central Asia via Xinjiang to the major markets in Central and Eastern China, as the direct link between China and Afghanistan is essentially closed for large parts of the year due to climate conditions. Afghanistan has become the primary source of heroin in China. UN statistics suggest Afghanistan provides 94 percent of the world's opium. But much of the other narcotic-like psycho-stimulants outside the heroin trade, such as methamphetamine and a wide array of "party drugs" are produced within China or its other neighbours. Apart from Afghanistan, North Korea, Russia, and Myanmar are also significant sources of narcotic supplies.

The impact of the narcotics trade in China on the Chinese government and the overall security situation has been devastating. Corruption and the spread of disease related to the narcotics trade are widespread throughout China, but the border areas and along trafficking routes have been most seriously affected. There are positive signs. China is resisting the rise of organised crime, due to broader economic opportunities than in neighbouring states. The central government also has resisted being co-opted by the trade, the case in several neighbouring economies. Organised crime, particularly narco-trafficking, has taken over parts of many of its regional neighbours, and increased criminality and militarization has followed in its footsteps. Increasingly, militant groups around China and globally have engaged in the narco-trade, as it generates great resources. China is, and should, be very concerned about this development.

China was initially slow to respond to the threat of narcotics in and around China; in part because of the government's prior refusal to admit that there was a problem but also due to the fact that Chinese companies (illegally) provided many of the precursors to the refinement of opium to heroin. The effect of this trade on China was seen as largely positive until its impact on the population at large was noticed. This has resulted in a rather strong reaction to the illicit trade in narcotics. The first step was the establishment of the Drug Control Bureau, which also serves as an operational agency of the NNCC, in 1988. In June 2008, the Chinese government further established the Drug Intel-

IN THE NEWS

SHANGHAI --- Following confrontations over a detained Chinese trawler captain, the South China Sea disputes, and China's decision to limit rare earth minerals, Chinese and Japanese citizens displayed discontent toward each other through protests. In mid-October, thousands of Chinese gathered in Chengdu, Xi'an, Zhengzhou, Wuhan, Chongqing, and Lanzhou, calling for Beijing to claim China's rights to the Diaoyu/Senkaku Islands and encouraging boycotting Japanese goods. Chinese Ministry of Foreign Affairs released a statement approving only of "rational" patriotism. In Aoyama Park, Japanese protesters shouted for Tokyo to defend the Senkaku Islands as its domain in the second anti-China rally in October. Leaderships in both countries are receiving harsh public criticism over the territorial disputes. Prime Minister Kan and Premier Wen Jiabao have been hesitant to announce any formal meeting between Asia's most powerful economies.

BEIJING --- On October 15-18, the 17th Central Committee of the CPC held its fifth plenary session to discuss the foundation of China's 12th five-year program (2011-2015) on national economic and social development. One of the highlights of the session was the appointment of Vice President Xi Jinping as Vice Chairman of the Central Military Commission, underscoring his status as President Hu's replacement in 2012. A range of inevitable difficulties will likely to arise from balancing urban and rural society growth, greater consumption, and cross-Strait relations. The published communiqué expressed the critical stage China is approaching with increasing demands for higher living standards, requiring the accelerated transformation of economic policies.

ligence and Forensic Center in Beijing to take stronger action against the illegal trade. This was followed by an increase in the Central Government's subsidy to local governments' drug control funds to RMB 500 million in 2008 from 330 million the year before. A number of other initiatives have been taken and there is no doubt that the Chinese government is taking strong action against the threat. However, there are several drawbacks that need to be considered.

First, China will have to reconsider its "hands off" policy in Afghanistan. Stronger action against both traders and producers is needed if China wants to seriously control opiate imports from the country. Similarly, China will

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have to take strong action against some of its other neighbours such as Myanmar, North Korea and Russia, where the governments are not necessarily involved, but will have to take strong action on their side to prevent further expansion of the narco-trade. Even with these actions, methamphetamine production, largely a local phenomenon, will not be easily suppressed.

If China is genuine in its efforts to reduce national security risks from the narco-trade, it will have to step up its inter-regional and global cooperation in drug enforcement. This will have a direct impact on China's approach to sovereignty, as it would force all states to share information about the political and economic aspects of the trade and also engage military, legal, and police entities in close cooperation, something that few are interested in providing. Non-traditional security threats, more so than traditional threats, are increasingly of a transboundary nature both in the challenges they pose and in their solutions. China and its neighbours, for whom sovereignty is a third rail, will need to work together in ways that may share or pool the tools of sovereignty. There is simply no way of controlling the narco-trade bilaterally or unilaterally: the trade is fluid and will move where governments are weak and transaction costs are low.

There has been some movement in both financial and anti-narcotics cooperation among regional states, but it is still far from the levels needed. Much of the inter-state cooperation is dependent upon overly complex procedures, something from which criminal networks do not suffer. The reality is that the financial gains available from the trade is so great that some of China's neighbours, such as Afghanistan, are economically reliant on the drug trade and will not accept effective external intervention. Therefore China will also have to strengthen its own border controls and combat corruption and co-option of its own regional institutions.

Sadly, the narcotics trade in China is here to stay, especially in poor provinces. The only thing the Chinese government can do is to increase transaction costs for the illicit trade (i.e. decrease profits) and decrease its effects nationally by intra-regional cooperation and strong national counter-measures. Since this latter emphasis goes against nearly every Chinese policy instinct, we will likely see narcotics trade as a significant factor in China's internal debates about its external affairs policies.

Dr. Niklas Swanström is director of the Institute for Security and Development Policy in Sweden.

PUBLICATIONS

- "Obama in Asia: Trade and Economic Priorities," *CSIS Commentary*, October 28, 2010

By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

The president's upcoming trip to Asia will take place against a backdrop of rising concerns in the region about the frailty of the U.S. and global economic recovery and U.S. policy objectives and limitations to manage any new crisis. The administration's message to Asian partners in the run-up to the president's trip has been focused on its commitment to trade and economic engagement—a welcome sign amidst fears of rising U.S. protectionism as embodied by campaign rhetoric in a wide variety of congressional races. Chinese analysts are hard-pressed not to read the president's circuitous amble through Asia's biggest democracies through a prism of worry about American encirclement intentions. Despite these fears, the United States and China are actively pursuing policies designed to ratchet down bilateral tensions that increasingly alarm the region.

- "U.S.-China Relations: Tensions Rise and Fall, Once Again," *Comparative Connections*, Vol. 12, No.3, CSIS Pacific Forum, October 2010

By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS, and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

Diplomatic confrontations over the Yellow Sea and the South China Sea were the source of new bilateral tensions this quarter. Beijing objected to the dispatch of a U.S. aircraft carrier to the Yellow Sea, even before Washington had made a decision to deploy it and Secretary Clinton delivered a clear statement of U.S. interests in the South China Sea at the ASEAN Regional Forum meeting that irritated Beijing. U.S. frustration mounted over China's unwillingness to allow its currency to appreciate faster as the House of Representatives passed legislation that would allow the United States to impose import duties on countries that have undervalued currencies. The Pentagon submitted its annual report assessing Chinese military capabilities to Congress and President Obama met Premier Wen Jiabao on the margins of the UN General Assembly.

- "China's Interest Rate Regime: Paying a High Price for Cheap Credit", *China Knowledge@Wharton*, September 1, 2010 By **Wen Jin Yuan**, Research Intern, Freeman Chair in China Studies, CSIS

China's interest rate regime is paying a high price for cheap credit offered to Chinese state-owned enterprises. While Chinese state-owned banks are using the government's subsidized lending rates to prop up their balance sheets as they buckle under the weight of their record lending during the economic downturn, China's individual savers suffer low deposit rates and escalating inflation rates. The PBoC faces a dilemma of surging interest rates attracting speculative foreign investors, which could lead to a significant increase in the net indebtedness.

Publications from the Freeman Chair 2010*

*Please visit our Web site to access archived publications dating back to 2002.

2010

October

- “Obama in Asia: Trade and Economic Priorities”, *CSIS Commentary*, October 28, 2010 By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS
- “U.S.-China Relations: Tensions Rise and Fall, Once Again,” *Comparative Connections*, Vol. 12, No.3, CSIS Pacific Forum, October, 2010 By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS, and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

September

- “China’s Interest Rate Regime: Paying a High Price for Cheap Credit”, *China Knowledge@Wharton*, September, 1, 2010 By **Wen Jin Yuan**, Research Intern, Freeman Chair in China Studies, CSIS

August

- “Singapore’s Tightrope Walk on Taiwan,” *CSIS Southeast Asia from the Corner of 18th & K*, Vol. 1, No.26, CSIS, August 17, 2010 By **Ernest Z. Bower**, Senior Advisor and Director of Southeast Asia Program, CSIS, and **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

July

- “Managing Expectations,” *China Economic Review*, July, 2010 By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS, and **Jeffrey Bean**, Research Assistant, Freeman Chair in China Studies, CSIS
- “Asia’s Response to Climate Change and Natural Disasters: Implications for an Evolving Regional Architecture,” CSIS, July 16, 2010 Project Directors: **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS, and **Michael J. Green**, Senior Advisor and Japan Chair, CSIS. Editors and Coordinators: **Robert S. Wang**, Visiting Fellow, Freeman Chair in China Studies, CSIS, and **Jeffrey Bean**, Research Assistant, Freeman Chair in China Studies, CSIS
- “U.S.-China Relations: Cooperation Faces Challenges,” *Comparative Connections*, Vol. 12, No.2, CSIS Pacific Forum, July 15, 2010 By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

June

- “Rising Wages in China: A New Shift Begins at the World’s Low-Cost Factory,” *China Knowledge@Wharton*, June 23, 2010 By **Wen Jin Yuan**, Research Intern, Freeman Chair in China Studies, CSIS, and **Autumn Zhu**, Managing Editor, China Knowledge@Wharton
- “China’s Burgeoning Foreign Reserves: Too Much of a Good Thing,” *China Knowledge@Wharton*, June 23, 2010 By **Wen Jin Yuan**, Research Intern, Freeman Chair in China Studies, CSIS
- “China’s Cheonan Problem,” *PacNet #31*, CSIS, June 18, 2010 By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS, and **Brad Glosserman**, Executive Director, Pacific Forum, CSIS

April

- “U.S.-China Relations: The Honeymoon Ends,” *Comparative Connections*, Vol. 12, No.1, CSIS Pacific Forum, April 14, 2010. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS, and **David Szerlip**, George Washington University

CONFERENCES AND EVENTS

• October 8 *New Actors in Chinese Foreign Policy*

Expanding pluralism within Chinese society and China's growing interdependence with the international community have led to the emergence of new foreign policy actors. **Linda Jakobson**, Director of the China and Global Security Programme at SIPRI, explained roles and influence of the new actors and assessed the implications of new foreign policy trends in China. **Erica Downs**, Fellow at the Brookings Institution, discussed the evolving role and influence of Chinese energy companies. **David Finkelstein**, Vice President and Director of China Studies at the CNA Corporation, addressed the changing role and impact of the PLA on Chinese foreign policy. **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies, moderated the discussion. [Click here for a link to the audio of this event.](#)

• September 20-21 *U.S.-China-Russia Trilateral Conference*

CSIS hosted the first in a series of three trilateral talks with the Chinese Academy of Social Sciences and the Russian State Institute of International Relations, seeking to explore areas of shared interest for further cooperation. In his keynote speech, **Ambassador Alexander Vershbow**, Assistant Secretary of Defense for International Security Affairs, spoke on Afghanistan, the evolving modern role of NATO, and issues of concern on which the United States, China, and Russia may work together. **Zbigniew Brzezinski**, CSIS Counselor and Trustee, also delivered a keynote speech on U.S.-China-Russia relations.

• September 16 *Congressional Briefing: China's Trade and Industrial Policies*

Charles W. Freeman III, Chairholder, CSIS Freeman Chair in China Studies, testified before the Senate Banking Committee on the Treasury Department's "Report on International Economic and Exchange Rate Policies." [Click here to read his full testimony.](#)

• September 7 *Gaps in Global Security Architecture: Climate Change and Aviation Security*

Bonnie S. Glaser, Senior Fellow, Freeman Chair in China Studies, gave a keynote speech in the conference in New York hosted by the Taipei Economic and Cultural Representative Office. The speech focused on the possibility of Taiwan's representation in the UN Framework Convention on the Climate Change and the International Civil Aviation Organization.

• August 1-7 *Conference on Cross-Strait Confidence Building Measures*

A delegation led by **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies, and composed of prominent American scholars, retired military personnel, and government officials, participated in the 3rd Cross-Strait Confidence Building Measures conference. The delegation, headed by former US PACOM Commander **Admiral Timothy Keating** (Ret.), met with scholars from think tanks and universities, military personnel, and political leaders in Beijing on August 1-3, and in Taipei on August 3-6. The issues of cross-strait CBMs and broader Taiwan-China relations, U.S.-China relations, Taiwan arms sales, and ECFA all figured prominently in discussion.

FREEMAN FACTS

Real Estate Pricing in China

1. Property prices in 70 largest Chinese cities rose 9.1% in September from a year ago and 0.5% from August.
2. Overall floor space transactions in the property market rose 52.4% from a month-on-month basis and 16.6% from last October.
3. Real estate attracted \$511.4 billion in investments in the first three quarters of 2010 in China, 36.4% up from the same period in 2009.
4. The People's Bank of China raised the interest rate on one-year loan and one-year rate paid on deposits to 5.56% and 2.5% respectively, effective October 20.
5. China's Public Housing Fund mortgage rates for loans with a maturity of 5 years or less are now up from 3.33% to 3.5%, and for loans with 5 years or more from 3.87% to 4.05%.

Sources: *Associated Press, Beijing Review, Ministry of Housing and Urban-Rural Development, Wall Street Journal, Xinhua*

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