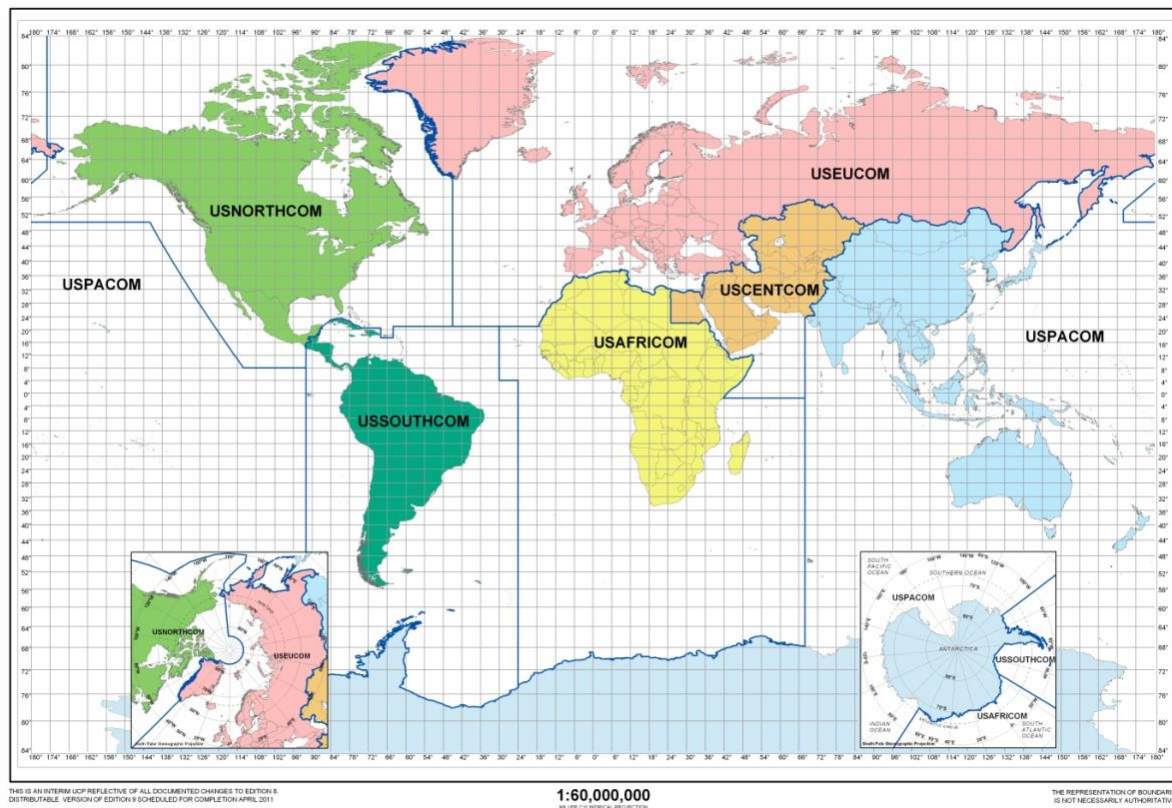


THE WORLD WITH COMMANDERS' AREAS OF RESPONSIBILITY



CAPSTONE 19-4 Indo-Pacific Field Study

<u>Subject</u>	<u>Page</u>
Combatant Command	3
New Zealand	53
India	123
China.....	189
National Security Strategy	267
National Defense Strategy	319
Charting a Course, Chapter 9 (Asia Pacific)	333

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U.S. INDO-PACIFIC Command

<u>Subject</u>	<u>Page</u>
Admiral Philip S. Davidson	4
USINDOPACOM History	7
USINDOPACOM AOR	9
2019 Posture Statement	11

Commander, U.S. Indo-Pacific Command

Admiral Philip S. Davidson, U.S. Navy

Photos



Admiral Philip S. Davidson (Photo by File Photo)

Adm. Phil Davidson is the 25th Commander of United States Indo-Pacific Command (USINDOPACOM), America's oldest and largest military combatant command, based in Hawai'i.

USINDOPACOM includes 380,000 Soldiers, Sailors, Marines, Airmen, Coast Guardsmen and Department of Defense civilians and is responsible for all U.S. military activities in the Indo-Pacific, covering 36 nations, 14 time zones, and more than 50 percent of the world's population.

Prior to becoming CDRUSINDOPACOM on May 30, 2018, he served as the commander of U.S. Fleet Forces Command/Naval Forces U.S. Northern Command. He previously served as the commander, U.S. 6th Fleet, and the commander, Naval Striking and Support Forces NATO, while simultaneously serving as the deputy commander, U.S. Naval Forces Europe and U.S. Naval Forces Africa.

A native of St. Louis, Missouri, Davidson is a 1982 graduate of the United States Naval Academy. He is a surface warfare officer who has deployed across the globe in frigates, destroyers, cruisers, and aircraft carriers.

His earlier sea commands included Carrier Strike Group 8/Eisenhower Carrier Strike Group, USS Gettysburg (CG 64), and USS Taylor (FFG 50).

Ashore, Davidson has served in fleet, interagency, and joint tours as a flag officer; he was previously the director, Maritime Operations, U. S. Fleet Forces Command, the senior military advisor to the Special Representative for Afghanistan and Pakistan (SRAP) at the State Department, and the deputy director for Strategy and Policy in the Joint Staff/J-5.

He served earlier in his career in policy, strategy, and operations billets on multiple tours with the U.S. Pacific Fleet staff, the Navy staff and the Joint Staff, and as the Navy's military aide to the vice president of the United States.

He is a distinguished graduate of the U.S. Naval War College. He has a Master of Arts in National Security and Strategic Studies, and a Bachelor of Science in Physics.

His decorations include the Distinguished Service Medal, the Navy and Marine Corps Commendation Medal with Combat "V," a Superior Honor Award from the U.S. Department of State, and other personal, service, unit, and campaign awards.

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USINDOPACOM HISTORY



History of United States Indo-Pacific Command

The U.S. Indo-Pacific Command was established as a unified command on January 1, 1947, and it is the oldest and largest of the United States' unified commands.

The present U.S. Indo-Pacific Command (USINDOPACOM) includes areas originally assigned to two other unified commanders. The Far East Command, which had been established on January 1, 1947, was disestablished on July 1, 1957, and all its responsibilities were assumed by the Pacific Command. That same day the command assumed some of the responsibilities of the Alaskan Command and individual Army and Air Force component commands for the Pacific also were established in Hawaii.

In October 1957, the then Commander in Chief, Pacific Command (CINCPAC) headquarters moved from Makalapa to Camp H.M. Smith, which is also the headquarters of Commander, Marine Forces Pacific. CINCPAC also served concurrently as Commander in Chief, U.S. Pacific Fleet until January 1958, when the U.S. Pacific Fleet became a separate component with its own commander.

Added responsibilities were assigned to CINCPAC on January 1, 1972, for military forces and elements in the Indian Ocean, Southern Asia, and the Arctic. Alaskan Command, one of the original unified commands established on January 1, 1947, was disestablished in 1975 and its responsibilities were transferred to the Pacific Command. The Pacific Command's area of responsibility was further expanded on May 1, 1976, to the east coast of Africa. This enlarged the Pacific Command to more than 50 percent of the earth's surface, an area of over 100 million square miles.

Another enlargement of the USPACOM area took place in October 1983, when CINCPAC was assigned responsibility for the People's Republic of China, the Democratic People's Republic of Korea, Mongolia, and the Republic of Madagascar. CINCPAC was also redesignated Commander in Chief, U.S. Pacific Command (USCINCPAC).

In 1986, the Goldwater-Nichols Reorganization Act expanded, as well as codified, the authority of the commanders of the unified commands to carry out their assigned missions and to employ combatant forces provided by the individual Services.

A new Alaskan Command (ALCOM) was established on July 7, 1989, at Elmendorf Air Force Base, Alaska, as a subordinate unified command responsible to USCINCPAC. (There is no relationship to the original ALCOM, a unified command disestablished in 1975.) This placed the defense of Alaska and its surrounding waters under the leadership of one commander, providing a unity of command absent from the state since the early 1970s.

From 1989 through 2000, three Unified Command Plans slightly reduced USPACOM's area of responsibility. With the focus of attention shifting to the Middle East, the August 16, 1989, plan assigned responsibility for the Gulf of Oman and Gulf of Aden to Commander, U.S. Central Command (USCENTCOM). The January 1, 1996 plan transferred the Seychelles and adjacent waters to USCENTCOM. On October 1, 2000, responsibility for Indian Ocean waters off Tanzania, Mozambique, and South Africa was transferred from USPACOM to U.S. European Command (USEUCOM).

The Unified Command Plan changed as a result of the events of September 11, 2001, and the ensuing war on terrorism, as well as the new defense strategy articulated in the 2001 Quadrennial Defense Review. For the first time the entire surface of the earth was divided among the various unified commands. A new Northern Command (USNORTHCOM) was created for homeland security and other changes in the various commands' responsibilities resulted in significant changes for USPACOM. The West Coast of North America was reassigned from USPACOM to USNORTHCOM. While Alaska was included in the reassignment to USNORTHCOM, Alaskan Command forces remained assigned to USPACOM in the "Forces for Unified Commands Memorandum." Antarctica was also added to USPACOM's area of responsibility. Approved in April 2002, the new Unified Command Plan became effective October 1, 2002.

Effective October 24, 2002, by direction of the Secretary of Defense, the title "Commander in Chief, U.S. Pacific Command" (USCINCPAC) was changed to "Commander, U.S. Pacific Command" (CDRUSPACOM). As stated by Secretary of Defense Donald Rumsfeld, there is only one Commander in Chief and that is the President of the United States.

The 2008 Unified Command Plan, signed on December 17, 2008, documented the transfer of all areas of the Indian Ocean previously assigned to USPACOM west of 68 degrees east to the newly established U.S. Africa Command (USAFRICOM). As a result, four island countries off the east coast of Africa that were formerly assigned to PACOM were reassigned to AFRICOM: Comoros, Madagascar, Mauritius, and Reunion.

USPACOM is the recipient of six Joint Meritorious Unit Awards.

History of Camp H.M. Smith

Camp H.M. Smith, home of the headquarters of Commander, U.S. Indo-Pacific Command and the Commanding General of Marine Forces Pacific, is located on Oahu's Halawa Heights at an elevation of about 600 feet above Pearl Harbor near the community of Aiea. Once covered with sugar cane fields, Camp Smith's location was approved by an Act of Congress on March 17, 1941 to be the site of a new Navy hospital. Initial investment for the 220.5 acres of land was \$912,000; improvements cost an additional \$14 million. Hospital construction began in July 1941. Following the Japanese attack on Pearl Harbor on December 7, 1941, construction of the planned 1,650-bed facility was rushed to completion. When Admiral Chester W. Nimitz attended the commissioning ceremony for the "Aiea Naval Hospital" on November 11, 1942, expansion was already necessary.

Throughout World War II, the Aiea Naval Hospital served as an interim treatment stop for thousands of wounded Sailors and Marines on their way home from the war in the Pacific. Following the battle for Iwo Jima in February - March 1945, the hospital was filled to overflowing with 5,676 in-patients, the highest number at any given time in its history.

On June 1, 1949, the hospital was deactivated when Army and Navy medical facilities were consolidated at the new Tripler Army Medical Center. Vacant and being considered for sale, the Marine Corps selected the site as the "Home of the Fleet Marine Force Pacific" in 1955. The installation was renamed on June 8, 1955, in honor of the first commanding general of Fleet Marine Forces, Pacific and a highly regarded Marine leader during World War II, General Holland McTyeire Smith. The Marines took up residence in October 1955 and Camp H.M. Smith was in full operation two weeks before its dedication on January 31, 1956.

In October 1957, Camp Smith also became the headquarters for USINDOPACOM where they, too, were located in the old Aiea Naval Hospital. In February 2001, ground was broken for a new USINDOPACOM headquarters building. Construction was completed and people began moving into the new Building 700 during the period February-April 2004. Although neither man had commanded the Pacific Command, the building was named in honor of two great leaders of World War II in the Pacific: Fleet Admiral Chester W. Nimitz, USN, and General of the Army Douglas MacArthur, USA. The Nimitz-MacArthur Pacific Command Center was formally dedicated on April 14, 2004.



USINDOPACOM AREA OF RESPONSIBILITY



United States Indo-Pacific Command (USINDOPACOM) is one of six geographic combatant commands defined by the Department of Defense's Unified Command Plan (UCP). As a geographic combatant command, USINDOPACOM is in charge of using and integrating United States Army, Navy, Air Force and Marine Corps forces within the USINDOPACOM area of responsibility (AOR) to achieve U.S. national security objectives while protecting national interests. The USINDOPACOM AOR covers more of the globe of any of the other geographic combatant commands and shares borders with all of the other five geographic combatant commands. The commander of US Indo-Pacific Command reports to the President of the United States through the Secretary of Defense and is supported by multiple component and sub-unified commands including: U.S. Forces Korea, US Forces Japan, U.S. Special Operations Command Pacific, U.S. Pacific Fleet, U.S. Marine Forces Pacific, U.S. Pacific Air Forces and U.S. Army Pacific.

There are few regions as culturally, socially, economically, and geopolitically diverse as the Asia-Pacific. The 36 nations comprising the Asia-Pacific region are home to more than 50% of the world's population, 3,000 different languages, several of the world's largest militaries, and five nations allied with the U.S. through mutual defense treaties. Two of the three largest economies are located in the Asia-Pacific, along with ten of the fourteen smallest. The AOR includes

the most populous nation in the world, the largest democracy, and the largest Muslim-majority nation. More than one third of Asia-Pacific nations are smaller, island nations, including the smallest republic in the world and the smallest nation in Asia.

The region is a vital driver of the global economy and includes the world's busiest international sea lanes and nine of the ten largest ports. The Asia-Pacific is also a heavily militarized region, with seven of the world's ten largest standing militaries and five of the world's declared nuclear nations. Given these conditions, the strategic complexity facing the region is unique.

In concert with other U.S. government agencies, USINDOPACOM protects and defends the territory of the United States, its people, and its interests. With allies and partners, USINDOPACOM is committed to enhancing stability in the Asia-Pacific region by promoting security cooperation, encouraging peaceful development, responding to contingencies, deterring aggression, and, when necessary, fighting to win. This approach is based on partnership, presence, and military readiness.

STATEMENT OF
ADMIRAL PHILIP S. DAVIDSON, U.S. NAVY
COMMANDER, U.S. INDO-PACIFIC COMMAND
BEFORE THE SENATE ARMED SERVICES COMMITTEE
ON U.S. INDO-PACIFIC COMMAND POSTURE
12 FEBRUARY 2019

Chairman Inhofe, Ranking Member Reed, and distinguished members of the committee, thank you for the opportunity to appear before you today to discuss the Indo-Pacific region. First, let me say thank you for the significant support we have received from Congress over the last two years. The temporary relief from the Budget Control Act and an on-time FY19 budget helped to restore the military readiness and lethality necessary to safeguard U.S. vital national interests in the Indo-Pacific.

Overview

For more than 70 years the Indo-Pacific has been largely peaceful. This was made possible by three things: the willingness and commitment of free nations to work together for a Free and Open Indo-Pacific; the credibility of the combat power of U.S. Indo-Pacific Command; and a robust and modern U.S. nuclear deterrent. This commitment, and this credibility, have worked to liberate hundreds of millions of people, as well as lift billions out of poverty, all to a level of prosperity previously unseen in human history. It has also ensured that tensions, regardless of how or where they arise, do not escalate into large-scale war.

Our nation's vision for a Free and Open Indo-Pacific, announced in 2017 at the Asia Pacific Economic Council (APEC) summit in Vietnam, demonstrates our commitment to a safe, secure, and prosperous region that benefits all nations, large and small. The concept of a Free and Open Indo-Pacific resonates with our allies and partners across the region and includes economic, governance, and security dimensions. The vast majority of nations across the region share similar values, including the core beliefs that governments should be accountable to their people. We must stand together in support of our shared values and be unambiguous in condemning those who attempt to undermine those values.

USINDOPACOM is the primary military component of our government's efforts to ensure a Free and Open Indo-Pacific. Every day we work with a constellation of like-minded allies and partners and the rest of the U.S. government to advance our shared vision for a Free and Open Indo-Pacific.

When we say Free we mean Free both in terms of security—free from coercion by other nations—and in terms of values and political systems. Free to choose trading partners. Free to exercise sovereignty.

An Open Indo-Pacific means we believe all nations should enjoy unfettered access to the seas and airways upon which all nations' economies depend. Open includes open investment environments, transparent agreements between nations, protection of intellectual property rights, and fair and reciprocal trade—all of which are essential for people, goods, and capital to move across borders for the benefit of all.

While the term "Free and Open Indo-Pacific" is new, the underlying values and principles to which the vision speaks are not. In fact, this is how the United States has approached the region throughout our 240-plus year history. We are now seeing a general convergence around the importance of a free and open Indo-Pacific across the region—as Japan, Australia, France, New Zealand, and India have all put forth similar concepts or visions.

The United States is an enduring Pacific power. Our historical, structural, economic, and institutional ties to the Indo-Pacific are indelible.

U.S. power underpins the post-WWII international system that helps strengthen the essential foundation of a rules-based international order for economic growth and prosperity in the region for everyone. Furthermore, USINDOPACOM's role as a guarantor of security in the region has enabled our economic power and allowed our partners and allies to focus on their economic development, which in turn has increased opportunities for U.S. economic engagement and prevented costly conflict. A peaceful, free, and open Indo-Pacific is especially vital to our economy in the 21st century when you consider the following:

- The United States conducted more than \$1.8 trillion in two-way goods trade with Indo-Pacific nations in 2017, and more than \$1.3 trillion by the third quarter of 2018.
- In 2017, U.S. foreign direct investment in the region reached \$940 billion – more than doubling since 2007.

- The Indo-Pacific is home to half of the 20 fastest growing economies.
- The Indo-Pacific currently contains over a third of global GDP and 60% of the global GDP growth.
- By 2030, 65% of the world’s middle class will reside in the Indo-Pacific, representing an unrivaled amount of purchasing power.

As the above statistics portend, this dynamic and economically robust region will continue to play a vital role in our economic future throughout the 21st century.

Five Key Challenges

In my view, five key challenges threaten our vital national interest in ensuring a Free and Open Indo-Pacific. While we have made significant progress over the last year, North Korea will remain the most immediate challenge until we achieve the final, fully verifiable denuclearization as committed to by Chairman Kim Jong Un at the summit in June 2018. China, however, represents the greatest long-term strategic threat to a Free and Open Indo-Pacific and to the United States. Through fear and economic pressure, Beijing is working to expand its form of Communist-Socialist ideology in order to bend, break, and replace the existing rules-based international order. In its place, Beijing seeks to create a new international order led by China and with “Chinese characteristics”—an outcome that displaces the stability and peace of the Indo-Pacific that has endured for over 70 years. Russia is also active throughout the region. Moscow regularly plays the role of a spoiler, seeking to undermine U.S. interests and impose additional costs on the United States and our allies whenever and wherever possible. I am also concerned about the threat posed by non-state actors. Violent Extremist Organizations (VEOs) seek to impose their views and radicalize people across the region, as evidenced by the capture of Marawi City in the southern Philippines in 2017—a city of over 200,000 people—by ISIS extremists. Lastly, natural and manmade disasters are an ever present danger in the region. Let me describe these five key challenges in more detail.

North Korea:

Denuclearization. USINDOPACOM’s assessment on North Korean denuclearization is consistent with the Intelligence Community position. That is, we think it is unlikely that North

Korea will give up all of its nuclear weapons or production capabilities, but seeks to negotiate partial denuclearization in exchange for U.S. and international concessions.

Following a rapid series of nuclear and missile tests into 2017, tensions declined; North Korea halted nuclear testing in September 2017 and ICBM testing in November 2017. President Trump's meeting with Chairman Kim in Singapore in June 2018 was a significant milestone, and I am optimistic about another U.S.-North Korea summit. North Korea has taken some steps in the direction of denuclearization, most notably the reversible dismantlement of tunnels at the Punggye nuclear test site, yet much needs to be done to make meaningful progress.

In early 2018, the two Koreas initiated a season of rapprochement, beginning with the Winter Olympics in February 2018, and continuing through three subsequent Korean summits between President Moon and Chairman Kim and multiple lower-level meetings. More recently, North Korea has undertaken measures in accordance with the Comprehensive Military Agreement it signed with South Korea in September 2018, to include dismantling guard posts within the demilitarized zone and removing land mines near Panmunjom. North Korea also returned remains of U.S. service members from the Korean War, which provided great comfort to mourning families.

I welcome these steps, but we must remain vigilant to the threat North Korea still poses to the United States and the international community. North Korea has demanded "corresponding measures" from the United States in return for these above actions. Kim warned in his 2019 New Year's speech of a potential "new path," which could indicate an eventual return to missile and weapons of mass destruction (WMD) testing if he is not satisfied with the pace of negotiations and potential benefits. Our military combat readiness and combined lethality remain the best deterrent and the best leverage against any threat from North Korea.

Sanctions. North Korea is continuing efforts to mitigate the effects of international sanctions and the U.S.-led pressure campaign through diplomatic engagement, counter pressure against the sanctions regime, and direct sanctions evasion. USINDOPACOM will continue to support the President's pressure campaign by ensuring the military readiness of the combined force and

supporting sanctions enforcement as directed by United Nations Security Council Resolutions (UNSCR). UNSCR sanctions resulted in a decline in North Korea's export earnings and cut off key cash flow sources. However, recent calls from Russia and China to change the sanctions against North Korea threaten to undo these positive developments.

Additionally, North Korea has a long history of flouting international sanctions, and Pyongyang regularly attempts to circumvent them. Early in 2018, North Korea exceeded its sanctioned limit on refined petroleum imports through illicit ship-to-ship transfers. USINDOPACOM is working with partners and allies to disrupt illicit ship-to-ship transfers that occur primarily in the East China Sea, often near or in Chinese territorial waters, and in the Yellow Sea. North Korea is also engaged in cross-border smuggling operations and cyber-enabled theft to generate revenue, while simultaneously circumventing United Nations Security Council prohibitions on coal exports.

China:

Military Modernization. Over the last 20 years, Beijing has undertaken a massive effort to grow and modernize the People's Liberation Army (PLA). The PLA is the principal threat to U.S. interests, U.S. citizens, and our allies inside the First Island Chain—a term that refers to the islands that run from northern Japan through Taiwan, the Philippines, and Indonesia—and the PLA is quickly increasing its ability to project power and influence beyond the First Island Chain. Beijing pursues both qualitative and quantitative efforts to transform its military, modernizing its military platforms while simultaneously increasing the number of platforms in service. Newly-fielded systems include:

- Beijing's first aircraft carrier group, centered around its refurbished Soviet-built carrier, reached initial operational capability in mid-2018.
- Beijing's first domestically-built aircraft carrier, has completed four sets of sea trials since May 2018 and will likely join the PLA Navy (PLAN) fleet in 2019.
- The RENHAI-class guided missile cruiser, was launched in 2017; three additional vessels were added to the PLA Navy's inventory in 2018. This class of vessels will be a key component of PLA Navy carrier strike groups.
- The FUYU-class fast combat support ship, developed specifically to support aircraft carrier task group operations, was commissioned less than a year ago.

- The J-20, the PLA's first 5th-generation stealth fighter, entered service in February 2018; plans are underway to research a sixth-generation fighter.
- The Y-20, a domestically-produced heavy-lift aircraft, entered military service in 2016; the Y-20 has a significantly larger payload capacity and range than the PLA's previous heavy and medium-lift aircraft, which advances Beijing's strategic airlift capability.
- The S-400 advanced surface-to-air missile system, received from Russia in April, 2018; the S-400 has a 250-mile range, which could expand the PLA's air coverage over the Taiwan Strait and other high priority facilities.

The PLA maintains a high operations tempo, primarily in and near China, but is quickly expanding its operating areas beyond the region. The PLA's Naval Escort Task Force (NETF)—now in its 31st iteration—follows its anti-piracy missions off the Horn of Africa by conducting naval diplomacy deployments to Europe, Africa, and the South Pacific. From May-July 2018, the 28th NETF completed a three-month naval diplomacy tour conducting port visits and bilateral exercises in Spain, Nigeria, Ghana, Cameroon, Gabon, South Africa, and Indonesia before returning to China. Beijing regularly conducts joint military exercises across its ground, sea, air, and space forces, including amphibious assault training that is designed and specifically timed to intimidate Taiwan. This spring, approximately 10,000 PLA Marines traveled more than 1,200 miles as part of a large-scale exercise designed to improve long-range maneuverability. In April, Beijing conducted a live-fire exercise into the Taiwan Strait with coastal artillery, and PLA Air Force (PLAAF) bombers regularly circumnavigate Taiwan.

Beijing continues pursuing next-generation technologies and advanced weapons systems, including hypersonic glide vehicles, directed energy weapons, electromagnetic railguns, counter-space weapons, and unmanned and artificial intelligence-equipped weapons. The PLA has also made significant technological, game-changing developments in its ability to defeat, or drastically reduce, the effectiveness of U.S. sensors and defensive weapons. The PLA has tested hypersonic missiles since 2014, including the WU-14, with speeds approaching Mach 10. In August 2018, Beijing claimed to have successfully tested its first hypersonic aircraft.

Beijing is also modernizing and adding new capabilities across its nuclear forces. China's third generation Type 096 nuclear-powered Ballistic Missile Submarine (SSBN) will be armed with JL-3 sea-launched ballistic missiles and will likely begin construction in the early-2020s. In April, Beijing confirmed the DF-26 entered service—a road-mobile, nuclear, and conventional capable Intermediate-Range Ballistic Missile (IRBM), expanding Beijing's near-precision strike capability as far as the Second Island Chain (a term that refers to the southern part of the Aleutian Islands, the Commonwealth of Northern Mariana Islands, Guam, the Republic of Palau, and northern Papua New Guinea). Beijing continues testing its DF-41 road-mobile Intercontinental Ballistic Missile (ICBM), which carries multiple independently targetable re-entry vehicles and has a range of up to 9,300 miles.

South China Sea. Beijing maintains maritime claims in the South China Sea that are contrary to international law and pose a substantial long-term threat to the rules-based international order. Beijing ignored the 2016 ruling of an Arbitral Tribunal established under Annex VII of the Law of the Sea Convention, which concluded that China's claims to historic rights, or other sovereign rights or jurisdiction, with respect to the maritime areas of the South China Sea encompassed by the "nine-dash line" are contrary to UNCLOS and without legal effect. In April 2018, Beijing continued militarizing outposts by deploying advanced military systems that further enhance the PLA's power projection capabilities, including missiles and electronic jammers. These actions run directly counter to President Xi's 2015 commitment not to militarize these features. On multiple occasions, Beijing has landed military transport aircraft on the Spratly Islands and long-range bombers on the Paracel Islands. Additionally, Chinese Coast Guard vessels now fall under the command of the Central Military Commission and regularly harass and intimidate fishing vessels from our treaty ally, the Philippines, operating near Scarborough Reef, as well as the fishing fleets of other regional nations.

East China Sea. Beijing continues using its military forces to advance its territorial claims in the East China Sea. Beijing maintains a high level of surface combat patrols in the East China Sea. Additionally, Chinese Coast Guard vessels frequently enter the territorial waters of the Senkaku Islands, which the United States recognizes as being under the administrative control of the Japanese. In 2017, these incursions occurred on an average of once every ten days, and

continued in 2018 at about two per month. Additionally, while Beijing mostly implements United Nations Security Council Resolutions against North Korea, in a number of cases, illicit ship to ship transfers continue to occur within Chinese territorial waters.

Economic Pressure. While the United States strives to promote a Free and Open Indo-Pacific, Beijing is leveraging its economic instrument of power in ways that can undermine the autonomy of countries across the region. Beijing offers easy money in the short term, but these funds come with strings attached: unsustainable debt, decreased transparency, restrictions on market economies, and the potential loss of control of natural resources. Beijing's actions in this regard have potential military ramifications as well. Beijing touts its need to safeguard its citizens abroad and defend its expanding global interests in order to justify increased permanent PLA overseas basing and presence. Beijing is also exploiting growing debt burdens to access strategic infrastructure in the region. In December 2017, Sri Lanka handed over control of the newly-built Hambantota seaport to Beijing with a 99-year lease because Sri Lanka could no longer afford its debt payments to China.

Over the last year, we have seen that countries across the region are becoming more aware of the threat Beijing's economic policies pose. Malaysia announced the cancellation of three projects worth \$22 billion in August 2018, declaring that it could not afford Beijing's projects, decrying the corrupt practices associated with the projects, and criticizing the loans as a "new version of colonialism." The Maldives' former president described Beijing's investments as a "land grab" under the guise of development. In contrast, the United States' vision for a Free and Open Indo-Pacific strives to preserve the autonomy of independent nations in the Indo-Pacific region. We must continue to support countries that stand up to Beijing's coercive economic policies whenever possible and help those countries offset any economic blowback from Beijing. Our engagement in the Indo-Pacific must truly be a whole-of-government undertaking, in partnership with the private sector and civil society, to counter China's economic coercion.

Arctic and Antarctic. Beijing recognizes the growing strategic significance of the Arctic and Antarctic and has signaled its plans to assert a greater role in these regions. Despite not being an Arctic nation, Beijing published its first Arctic policy paper in 2018, which defends Beijing's

role in the region and outlines Beijing's vision of a "Polar Silk Road" to complement its other economic initiatives. Beijing launched its first domestically built icebreaking research vessel in September 2018, and Beijing plans to launch its second in 2019. Beijing also opened bidding for construction of its first nuclear-powered icebreaker. Beijing wants to boost its polar research and expedition capabilities and recently announced plans to double the frequency of its Arctic expeditions to once a year. Beijing has also expressed increasing interest in Antarctic operations and establishing logistics stations to supply them. This is of increasing concern to our ally Australia, as well as New Zealand, as Beijing seeks positional advantage and control of territory and natural resources in these vital regions.

Fentanyl and Pre-Cursors Chemicals. Another challenge that affects the security environment indirectly is the continuing fentanyl and opioid crisis in the United States. Illicit fentanyl, as well as legal pre-cursor chemicals used in the production of illegal drugs primarily originate from China. Moreover, technological advancements in e-commerce and commercial shipping present a different business model from the traditional methods used by transnational criminal organizations for drug trafficking. These innovations represent a new level of complexity for U.S. law enforcement agencies and policymakers alike. I welcome the PRC's decision to designate and regulate fentanyl as a controlled substance after President Xi's meeting with President Trump in Argentina in December of last year, and we look forward to seeing tangible progress.

Russia:

Military modernization. Moscow continues to modernize its military forces, viewing military power as critical to achieving key strategic objectives and global influence. Nuclear weapons remain an important component of Russia's power projection and deterrence capabilities, and the Russian military conducts regular nuclear-capable Tu-95 Bear bomber long-range aviation flights off the coasts of Japan, Korea, Canada, and Alaska. For the past decade Russian military planning has emphasized the development of modernized platforms and weapons systems, and Moscow is pushing these platforms to the Indo-Pacific region. In recent years, the Eastern Military District has become increasingly important for Russian security interests. Russia has invested in military infrastructure, improved its command-and-control capabilities, deployed

anti-ship missile systems, and modernized its anti-air capabilities in the region. For example, Russian units in the Eastern Military District expect to take delivery of thirty-seven new vessels by 2024, which is a major increase compared to the twenty-eight new units received in the region over the last decade. Moscow recently announced plans to expand its combat forces in the Eastern Military District and to substantially reinforce the Pacific Fleet. Despite the threat of U.S. sanctions through the 2017 Countering America's Adversaries Through Sanctions Act (CAATSA), Russia continues to export weapons to the Indo-Pacific region.

Furthermore, Russia hosted its largest military exercise since 1981, Exercise VOSTOK 2018, simulating land, sea, and air operations in the Eastern Military District and mobilizing forces from across Russia to engage in multiple live-fire missile launches. Of note, Chinese forces participated in Exercise VOSTOK for the first time. While Beijing's military cooperation was largely symbolic, because the forces remained segregated with separate command posts, Vostok 2018 was still a significant first step in forging a closer military partnership.

Japan-Russia Relations. Japan and Russia have a long-standing territorial dispute since the Second World War over the Northern Territories/Kuril Islands, which are strategically important for Russia's access to the Pacific Ocean. Russia has further entrenched itself in this contested territory by reestablishing an airfield on Matua Island, located in what it calls the central Kuril Islands, to accommodate light military transport aircraft and helicopters. Russia has also deployed coastal defense cruise missile systems and SU-35 multirole fighters to the islands and also announced plans to build a naval base. This more assertive approach to its eastern front reflects growing focus in Moscow of the vital importance of the broader Indo-Pacific for Russia's long-term security. Although Prime Minister Abe and President Putin have met on several occasions to negotiate a peace treaty that could, in part, resolve this territorial dispute, they have not reached an agreement. Russia remains concerned that the United States could establish military facilities under Article VI of the Treaty of Mutual Cooperation and Security in the Northern Territories if they are returned to Japan

Violent Extremist Organizations (VEOs):

In the wake of the 2017 siege of the southern Philippine city of Marawi, Philippine security forces have maintained consistent pressure on Islamic State of Iraq and Syria (ISIS) networks in the Philippines, conducting a number of arrests in 2018. Additionally, counterterrorism operations on the Philippine island of Jolo against ISIS-supporting elements of the Abu Sayyaf Group succeeded in disrupting kidnap-for-ransom operations. ISIS claimed credit for multiple small-scale attacks in the Philippines, including a mid-2018 vehicle-borne improvised explosive device attack at a military checkpoint in the southern Philippines. Outside of the Philippines, we saw a number of small-scale attacks in 2018, and I remain concerned about the growth of ISIS in the region. Over 1,000 foreign terrorist fighters have traveled to Iraq and Syria from the Indo-Pacific region, and at least 170 have returned. We expect the number of returnees to increase with the persistent loss of ISIS-held territory. ISIS' Amaq News claimed responsibility for a series of mid-May 2018 bombings against churches and a police headquarters in Surabaya, Indonesia. Other countries across the region remain concerned about the potential for disenfranchised and vulnerable populations to become recruitment targets. Self-radicalized violent extremists who are influenced or inspired by ISIS or other extremists are another cause for concern. The recent attack on a local Catholic parish in Jolo in the Sulu Archipelago is evidence of continued concern.

Natural and Man-made Disasters:

The Indo-Pacific remains the most disaster-prone region in the world. It contains 75% of the earth's volcanoes and 90% of earthquakes occur in the "Ring of Fire" surrounding the Pacific Basin. Since 2008 the Indo-Pacific has lost half a million lives and suffered over \$500 million in damages, with over one and a half billion people affected by natural and manmade disasters overall. The UN estimates that economic losses in the region due to disasters could exceed \$160 billion annually by 2030. Many countries across the region lack sufficient capability and capacity to manage natural and man-made disasters.

A key element of USINDOPACOM's engagement strategy in the region is building capacity with our allies, partners, and friends to improve their resilience and capability to conduct their own humanitarian assistance and disaster relief (HA/DR).

USINDOPACOM directly supports HA/DR efforts across the region, as well. In July 2018, we sent special operations forces to help the international effort to rescue twelve Thai boys and their coach from a flooded cave. USINDOPACOM also assisted relief efforts in Sulawesi, Indonesia last year with sixty-four personnel and three C-130 aircraft after an earthquake and tsunami hit the country. Another recent example of USINDOPACOM's support continues today after the Super Typhoon Yutu hit Tinian and Saipan. USINDOPACOM responded quickly by providing joint forces, equipment, and fresh drinking water, and by building temporary shelters and assisting with clearing debris from roads and homes.

USINDOPACOM's Security Role in the Indo-Pacific

The most important security development in the Indo-Pacific has been the rapid modernization of the PLA. The scope and scale of that modernization has caused USINDOPACOM's relative competitive military advantage to erode in recent years. With the 2018 National Defense Strategy as a guide, USINDOPACOM is focused on regaining our competitive military advantage and ensuring a Free and Open Indo-Pacific over the short- and long-term.

My strategy centers around fielding and sustaining a force capable of combat-credible deterrence that is postured for two distinct security roles: to win before fighting and, if necessary, be ready to fight and win.

Ready to Fight and Win. USINDOPACOM's ability to prevail in armed conflict is the foundation of combat credible deterrence. By fielding and maintaining a joint force ready to fight and win, USINDOPACOM reduces the likelihood that any adversary will resort to military aggression to challenge or undermine the rules-based international order.

Win Before Fighting. Deterrence is necessary to prevent conflict, but deterrence alone cannot ensure a Free and Open Indo-Pacific. Our adversaries are pursuing their objectives in the space between peace and war, using fear and coercive actions across the instruments of national power to revise the rules-based international order and without resorting to armed conflict. Alongside like-minded allies and partners, USINDOPACOM must compete in the "gray zone" between

peace and war. These deliberate actions will ensure a Free and Open Indo-Pacific against those malign actors that seek to accomplish their political objectives short of armed conflict.

USINDOPACOM Focus Areas

Given the challenges in the region, ensuring a Free and Open Indo-Pacific requires that USINDOPACOM remain ready to execute high-end/high-tech wartime missions on short notice. USINDOPACOM must be postured to achieve a more advantageous security environment without the lethal use of military force. The following four focus areas guide the command's efforts toward meeting both of the aforementioned security roles:

- **Focus Area 1. Increase joint force lethality.** We must continue to develop and field capabilities necessary to deter aggression and prevail in armed conflict should deterrence fail.
- **Focus Area 2. Enhance our design and posture.** We will adapt from our historic service-centric focus on Northeast Asia only to a more integrated joint force blueprint that is informed by the changing threat environment and challenges of the 21st century across the entire Indo-Pacific region.
- **Focus Area 3. Exercise, experiment, innovate.** Targeted innovation and experimentation will evolve the joint force while developing asymmetric capability to counter adversary capabilities.
- **Focus Area 4. Strengthen our allies and partners.** Through increased interoperability, information-sharing, and expanded access across the region, we will present a compatible and interoperable coalition to our adversaries in crisis and armed conflict.

Focus Area 1: Increase Joint Force Lethality

Over the last two decades, adversaries have rapidly closed the gap in many of the areas that used to be clear asymmetric advantages for the United States, encroaching upon USINDOPACOM's ability to deter conflict or prevail in armed conflict should deterrence fail. Our adversaries are fielding advanced Anti-Access Area Denial (A2AD) systems, advanced aircraft, ships, space, and cyber capabilities that threaten the U.S. ability to project power and influence into the region. Increasing joint force lethality means developing and fielding systems and capabilities to

preserve our key asymmetric advantages in order to prevent any potential adversary from thinking it can achieve its political or military objectives through armed conflict. Increasing our joint force lethality means joint and combined interoperability, an integrated fires network that enables long-range strike, and advanced missile defense systems capable of detecting, tracking, and engaging advanced air, cruise, ballistic, and hypersonic threats from all azimuths. In short, we must be able to defend our forces and project power so that no adversary can achieve sustained dominance in the Indo-Pacific and threaten our key allies and partners.

Air Superiority. The United States cannot assume that it will have air superiority in the Indo-Pacific. For over fifteen years, the predominant employment of United States armed forces has been in the ongoing fight against terrorism in Syria, Iraq, and Afghanistan where our ability to dominate in the air domain was unchallenged. In contrast, the U.S. faces peer competitors in the Indo-Pacific. Beijing has invested heavily in systems that challenge the United States' ability to achieve air superiority. The U.S. government must continue to pursue multi-domain capabilities to counter anti-air capabilities and we continue to prioritize 5th generation fighter capabilities to the Indo-Pacific.

Undersea Warfare. The United States must maintain its advantage in undersea warfare—an asymmetric advantage that our adversaries are focused on eroding. There are four-hundred foreign submarines in the world, of which roughly 75% reside in the Indo-Pacific region. One-hundred and sixty of these submarines belong to China, Russia, and North Korea. While these three countries increase their capacity, the United States retires attack submarines (SSNs) faster than they are replaced. USINDOPACOM must maintain its asymmetric advantage in undersea warfare capability, which includes not just attack submarines, but also munitions and other anti-submarine warfare systems such as the P-8 Poseidon and ship-borne anti-submarine systems. Potential adversary submarine activity has tripled from 2008 levels, which requires at least a corresponding increase on the part of the United States to maintain superiority.

Intelligence, Surveillance, and Reconnaissance. The Indo-Pacific's dynamic security environment requires persistent and intrusive Intelligence, Surveillance, and Reconnaissance (ISR) to provide indications, warning, and situational awareness across over half the world.

USINDOPACOM supports a re-allocation of DoD ISR assets to better satisfy intelligence needs in line with National Defense Strategy-priorities. USINDOPACOM relies on a mix of Airborne ISR (AISR) assets to provide a dedicated and flexible ISR capability across the entire region.

USINDOPACOM supports efforts to re-capitalize critical AISR capabilities and the continued development of future ISR platforms, such as the MQ-4C Triton, as well as our interoperable Processing, Exploitation, and Dissemination architectures.

Space. Space is a vital strategic domain. U.S. adversaries are militarizing space; USINDOPACOM must have access to resilient and defensible space systems that can operate in a contested environment. USINDOPACOM relies on space-based assets for satellite communications (SATCOM), ISR, missile warning, and Positioning, Navigation, Timing (PNT) capabilities, which support missions across the range of military operations. The command's vast geographic expanse increases the strain on USINDOPACOM's requirements and our reliance on low-density space-based assets that are in high-demand.

As Beijing's and Moscow's military modernization continues, they are pursuing broad and robust counter-space capabilities. While not as advanced, North Korea remains a threat through its employment of SATCOM and PNT jammers. The threat to the electromagnetic spectrum continues as our adversaries develop means to deny our space-enabled capabilities. As Space Command (SPACECOM) transitions responsibilities from United States Strategic Command (STRATCOM) into the future Space Force, USINDOPACOM looks forward to continued collaboration in this critical domain as we work to further integrate space-based capabilities into our daily operations and contingency planning.

Cyber. USINDOPACOM is heavily reliant on cyber capabilities and faces increasing threats in the cyber domain from both state and non-state actors, such as Beijing, Moscow, Pyongyang, and criminal actors. The United States must ensure it has a robust and capable cyber force with all required equipment and a common network operational structure necessary to ensure command and control. Moreover, USINDOPACOM requires an agile and defensible mission command network infrastructure to ensure adequate command and control, and enable interoperability with

our allies and partners to fully leverage our combined capacities. Furthermore, the DoD must prevent and, if necessary, respond to cyber-attacks against non-military critical infrastructure in both homeland defense and in support of civil authorities.

The U.S. military's offensive cyber capabilities provide additional tools to leverage as part of multi-domain operations to compete and win, but these tools must become more responsive to the operational requirements of the combatant commands. The growth in these offensive capabilities is not limited to equipment – we need talent and innovation. The development and retention of personnel with subject-matter expertise is a critical component for our nation's success.

My staff coordinates extensively with USCYBERCOM to integrate effective offensive, defensive, and network operations into my multi-domain plans and operations. Our staffs collaborate daily on current operations through our respective operations centers, at least weekly on future operations planning, and at least quarterly on future capability requirements.

Multi-Domain and Distributed Operations. As adversary military forces grow in both quantity and quality, USINDOPACOM must integrate operations in all domains to be successful in the 21st century. The Multi-Domain and Distributed Operations concepts of the services incorporate the capabilities of the physical domains and place greater emphasis on space, cyberspace, and other contested areas including the electromagnetic spectrum, the information environment, and the cognitive dimension of warfare. Multi-Domain and Distributed Operations allow U.S. forces to outmaneuver adversaries physically and cognitively, advancing the 20th century concept of combined arms into the 21st century's requirement to operate across all domains, at all times.

I fully support all services and functional commands efforts to operationalize Multi-Domain and Distributed Operations concepts. In 2018, USINDOPACOM successfully demonstrated Multi-Domain and Distributed Operations capabilities in major exercises while also integrating new technologies and approaches across the joint force. In the years ahead, USINDOPACOM will

progress from experimentation to validation of concepts, culminating in an overall increase in the lethality of the joint force.

Advanced Munitions. Developing and fielding advanced munitions is a critical component to increasing joint force lethality. The following are some of the more pressing munitions upgrades based on the challenges we face in the region:

- Improvements to Missile Defense – Patriot Missile Segment Enhanced (MSE), Terminal High Altitude Area Defense (THAAD) upgrades, and other capabilities to defend against maneuvering and hypersonic missiles.
- Innovations in heavy weight torpedo technology provide force-multiplying effects that currently do not exist, including long range in-port or at-sea attack and shallow water covert mine laying.
- The immediate resourcing and integration of ATACMS system and/or the Kongsberg Naval Strike Missile with HIMARS/MLRS to support Army and United States Marine Corps (USMC) units conducting Multi-Domain Operations and sea control missions.
- Continued investments in Hard Target Munitions (HTM). There is a significant increase in the number of hard and deeply buried targets in the theater requiring HTM.
- Hypersonic long-range strike (H-LRS) – these emerging weapons dramatically improve probability of engaging time sensitive targets and have increased survivability and thus higher probability of success.
- Effective counters to the expanding asymmetric unmanned aerial system (UAS) threat including potential for multiple swarms of small UAS.

Focus Area 2: Enhance Design and Posture

To effectively defend U.S. interests, USINDOPACOM must update its existing design and posture to compete with our adversaries across the entire Indo-Pacific. At present, USINDOPACOM forces west of the International Date Line are focused in Northeast Asia – an historical legacy of the Second World War and Korean War. We must update our design and posture to preserve strength in this key region, but also ensure that the United States is ready to compete and win before fighting across all of the Indo-Pacific. By recalibrating theater posture

to balance capabilities across South Asia, Southeast Asia, and Oceania, USINDOPACOM will be able to respond to aggression more effectively throughout the Indo-Pacific.

Similarly, the USINDOPACOM Joint Logistics Enterprise must be capable of supporting joint warfighting requirements across the entire theater in a more dynamic and distributed posture. Posture and pre-positioning are essential to overcome the region's tyranny of distance. Ship sailing times are upwards of ten days from the U.S. west coast, and it takes significant lead-time to reposition strategic airlift and tanker support to enable major force flow.

The speed of war has changed, and the nature of these changes makes the global security environment even more unpredictable. It's dangerous and unforgiving. Time and decision space have collapsed, so our approach to warfare must adapt to keep pace; with the speed and multiple avenues that our adversaries are able to pursue. We require a force posture that enables the United States to undertake a spectrum of missions. These missions include: capacity building for partners that face internal and external vulnerabilities, cooperation on transnational threats, and joint and combined training. Our enhancements to interoperability make for more effective coalitions in crisis.

USINDOPACOM will "regain the advantage" by positioning theater infrastructure that supports:

- Expeditionary capability that is agile and resilient.
- Dynamic basing for our maritime and air forces.
- Special operations forces capable of irregular and unconventional warfare.
- Anti-submarine warfare capabilities unmatched by any adversary.
- Land forces equipped with weapons systems that hold an adversary's air, sea, and land forces at risk.
- Cyber and space teams integrated into Multi-Domain and Distributed Operations.
- Unique intelligence, surveillance, and reconnaissance capabilities.

Global Force Management (GFM) and Posture. The Indo-Pacific is a theater that requires short response timelines across a vast region. Regional threats require U.S. forces to maintain a high level of readiness to respond rapidly to crises. USINDOPACOM's readiness is evaluated

against its ability to execute operational and contingency plans. The plans place a premium on ready and immediately responsive forces that can exercise, train, and operate with our partner nations' militaries. Forward-stationed forces west of the International Date Line decrease response times, bolster the confidence of allies and partners, and reduce the chance of miscalculation by potential adversaries. Contingency response times require that I have the essential conventional and strategic forces assigned to USINDOPACOM.

In line with the National Defense Strategy, USINDOPACOM prioritizes stationing and deployment of 5th generation aircraft in the Indo-Pacific. Additionally, the United States has deployed some of our newest and most advanced aviation platforms to the region, such as the P-8 Poseidon, RQ-4 Global Hawk, MV-22 Osprey, EA-18G Growler, E-2D Hawkeye, and C-130J Super Hercules.

In addition to forward stationed forces, the ability of the United States to surge, rotate, and globally maneuver ready forces is an asymmetric advantage that must be maintained. The high operational demands, delayed maintenance, training pipeline shortfalls, and shortage of ready surge forces limit USINDOPACOM's responsiveness to emergent contingencies and greatly increases risk. The challenges grow each year as our forces continue to deploy at unprecedented rates while the DoD grapples with fiscal uncertainty.

Integrated Air and Missile Defense. USINDOPACOM faces unique Integrated Air and Missile Defense (IAMD) challenges in the Indo-Pacific to protect our forces and allies. Hawaii, Guam, and our Pacific Territories are part of our homeland and must be defended. Hawaii is currently protected from North Korean Intercontinental Ballistic Missiles (ICBMs) by the Ground-Based Midcourse Defense System. This system includes Ground-Based Interceptors in Alaska and California; ground, sea, and space-based sensors; and redundant command, control, and communications systems.

For the defense of Hawaii, the planned Homeland Defense Radar Hawaii (HDRH) will improve U.S. capabilities. A Notice of Intent to Prepare an Environmental Impact Statement was released in June 2018, and the radar is projected to be operational by late 2023. The HDRH will

provide an enhanced ballistic missile sensing and discrimination capability in the Indo-Pacific, and it increases the capability of the Ground-Based Midcourse Defense System to defend Hawaii.

Meanwhile, our adversaries continue to improve their capabilities in ways that challenge the United States' strategic, operational, and tactical freedom of movement and maneuver. Beijing and Moscow continue to develop and field advanced counter-intervention technologies, which include highly maneuverable reentry vehicle and warheads (hypersonic weapons). Beijing and Russia possess cruise missiles and small-unmanned aerial systems (sUAS) that fly different trajectories, making them hard to detect, acquire, track, and intercept due to unpredictable low-flight profiles and sophisticated countermeasures. North Korea retains its nuclear and ICBM capabilities.

USINDOPACOM's IAMD priority is to establish a persistent, credible, and sustainable ballistic missile defense by forward deploying the latest missile defense technologies to the Indo-Pacific. Through forward and persistent presence, these active missile defense capabilities would help mitigate the risk to missile threats faced in the region and to the homeland. USINDOPACOM addresses this IAMD priority in the following ways:

- USINDOPACOM works with the DoD, Missile Defense Agency, the services, academic institutions, and industry to deploy capabilities that counter the advanced missile threats in the region.
- USINDOPACOM maintains an active Terminal High Altitude Area Defense (THAAD) battery on Guam to protect U.S. citizens and strategic military capabilities from North Korean intermediate-range ballistic missiles (KN-17 and MUSUDAN).
- USINDOPACOM employs additional radars across the theater supporting homeland and regional missile defense, as well as continued testing of the Ballistic Missile Defense System (BMDS).
- In 2017, USINDOPACOM and USFK, with support from the MDA and the DoD, deployed a THAAD battery to the Korean Peninsula that is fully operational. The MDA and the services deliver improved BMDS capability to the Korean Peninsula, including

integration of existing Ballistic Missile Defense (BMD) assets to improve engagement options and coverage area.

- The U.S. Navy completed its forward deployment of the USS MILIUS from San Diego, CA to Yokosuka, Japan in Spring 2018. This port shift provides the U.S. Seventh Fleet improved capability to support the U.S.-Japan Alliance.
- USINDOPACOM continues working with Japan, South Korea, and Australia toward creating a fully-integrated BMD architecture that addresses the increasing cruise missile threat.
- USINDOPACOM supports MDA and the services to develop and test emerging missile and counter-small UAS defense capabilities through modeling and simulation, as well as live-fire testing conducted at the Pacific Missile Range Facility, the Ronald Reagan Test Center at Kwajalein Island, Point Mugu, and other testing ranges located in the continental United States and Alaska.

I support all efforts that improve the capability and capacity of ballistic missile, cruise missile, and UAS defense technologies to further enhance homeland defense capabilities and protect key regional locations. The development of a credible and effective defense against advanced and future missile and UAS threats remains vital to our operational plans and critical to the continued defense of the United States.

Logistics and Supply. Driven by budgetary pressure, our logistics system has become a more efficient business process, and a less effective warfighting function over the last 20 years. Efficiency has come at the cost of increased vulnerability and decreased redundancy. While this arrangement is sufficient for peacetime operations, it is insufficient for combat. Congress' Indo-Pacific Stability Initiative could significantly help reverse the current trend toward a less resilient Joint Logistics Enterprise in the Pacific.

As adversary capabilities improve, joint operations will increasingly rely on distributed supply chains in order to fight and win against a peer adversary. The joint logistics enterprise must be postured with the right capability and capacity at the right locations in order to effectively support multi-domain and distributed operations. This means developing infrastructure at both

enduring and contingency operating locations; identifying and sourcing transportation, distribution, and maintenance requirements; and developing the processes to enable logistics decisions at the speed of war. USINDOPACOM is critically dependent on tactical airlift and sea lift capacity, which expands options for force design and maneuver. Increased tactical airlift and sealift capacity further increase survivability as it becomes more difficult for an adversary to counter a highly maneuverable joint force. These tactical lift assets play just as important a role as strategic lift assets in ensuring our ability to create a resilient and agile logistics network. Significant and sustained investment in munitions is needed to reduce risk to current and future strategic readiness. Services must fund and continue investment in munitions research and development, while setting relatively steady requirements to maintain a healthy production capability for current and new munitions. I appreciate Congress' action to enhance munitions funding in FY2018 and FY2019, but shortfalls remain. USINDOPACOM's top priorities for increased procurement are Long Range Anti-Ship Missiles, SM-6, MK-48 torpedoes, AIM-9X, BGM-109 Block IV (Maritime Strike Tomahawk), and AIM-120D. The Services must also upgrade storage facilities and reassess prepositioning based on the new security environment.

Fuel supply agility and resilience are central to our success in being competitive, responsive, and lethal. The changing threat environment, energy security risks, and adversarial geopolitical and economic influences are driving longer supply lines, necessitating a flexible resupply chain and more resilient, agile, and interoperable petroleum distribution capabilities. Continued investment in next generation petroleum distribution systems is required to mitigate sustainment risk in austere, contested, and denied environments. Access and positioning of fuel remains a key pillar of our logistics posture and is vital to USINDOPACOM's ability to ensure operational freedom of maneuver throughout the theater.

Focus Area 3: Exercise, Experimentation, and Innovation

Our exercise, experimentation and innovation program is key to maintaining readiness while also developing and integrating new capabilities and concepts. This program also highlights our capabilities and capacity to deter competitors while simultaneously reassuring allies, partners, and friends.

Pacific Multi-Domain Training and Experimentation Capability (PMTEC) Initiative.

USINDOPACOM's Joint Exercise Program has traditionally monitored the operational and warfighting readiness of assigned theater and partner nation forces for crises, contingency operations, and HA/DR. Exercises have advanced key objectives including strengthening regional alliances and partnerships, while deepening interoperability through combined training. The current Joint Exercise Program has been useful for enhancing the readiness of USINDOPACOM's assigned forward deployed forces; I am now looking to move to the next level of integration.

Scarce resources have reinforced the need to integrate all major test and training ranges in the Pacific region through a Pacific Multi-Domain Training and Experimentation Capability (PMTEC) initiative. This USINDOPACOM initiative combines the existing Air Force Joint Pacific Alaska Range Complex (JPARC), the Navy's Pacific Missile Range Facility (PMRF) and the Army's Pohakuloa Training Area (PTA) in Hawaii, the Delamere Air Weapons Range in Northern Australia, and the Marine Corps' future Commonwealth of Northern Mariana Islands (CNMI) Joint Military Training (CJMT) range into a fully networked and integrated training constellation that supports joint, combined, multi-domain training. PMTEC will also ensure USINDOPACOM has the ability to prioritize training, readiness, and experimentation to achieve a more integrated and lethal joint force that can both deter and when necessary, fight and win. As the next layer of integration, PMTEC will also link test-ranges (e.g., the Ronald Reagan Test Site at Kwajalein) to enable experimentation with developing technologies to create new, more effective, joint operating concepts that will ensure future warfighting success.

The PMTEC initiative also integrates cyber and space capabilities to enable joint and combined experimentation and testing that is truly multi-domain. Currently, many of these ranges restrict operations to just air and land capabilities or just air, land, and maritime capabilities. As a result, our forces often have to simulate or provide exercise injects that replicate space and cyber effects. We are working to fully incorporate space and cyber into our exercises.

Experimentation and Innovation. USINDOPACOM relies on innovation and experimentation, underpinned by strong partnerships, to address our capability gaps in the region. This includes

testing and integrating new technologies, developing new capabilities, and exploring new concepts of operation and employment. USINDOPACOM makes extensive use of OSD's Joint Capability Technology Demonstration, Coalition Warfare Program, and other rapid prototyping programs to focus cutting edge technology-based capabilities and innovation to enhance our readiness.

Innovation is crucial to increasing logistics agility and resilience. USINDOPACOM will continue utilizing the Joint Capability Technology Demonstration program to identify technological solutions to our critical logistics capability gaps. To facilitate greater resilience, USINDOPACOM will protect and harden our critical logistics infrastructure, information systems, and enablers. For example, USINDOPACOM is developing the capability to rapidly repair damage to critical seaports and airfields.

As part of our innovation and experimentation efforts, USINDOPACOM maintains robust engagement with a variety of partners to identify, promote, and incorporate research and development to address key capability gaps. USINDOPACOM has worked with some of the best DoD industry partners on advancing man and machine teaming, artificial intelligence, machine-learning, hypersonic technology, autonomy, command and control, and block chain technology. USINDOPACOM benefits from engineers, operations analysts, and theater-experienced operators from Federally Funded Research and Development Center (FFRDC) and University Affiliated Research Center (UARC) partners. These partners perform robust military utility assessments of emerging technology in the context of theater plans. The ability to harness the knowledge and experience of the individuals from these organizations is vital to advancing key capabilities for targeting, cyberspace operations, undersea warfare, electronic warfare, and ISR.

Focus Area 4: Strengthen Allies and Partners:

The United States' network of allies and partners is our principal advantage against any adversary. USINDOPACOM depends upon the collective capabilities of our allies and partners to address the challenges to a Free and Open Indo-Pacific. The most obvious point—one made abundantly clear in the National Security Strategy—is that whatever we do, we must do it with

our allies and partners. The keys to our bilateral and multilateral relationships are communication, information-sharing, and interoperability.

Agile Communications. Agile communications are crucial—not only for our readiness, but for our relationships in the region. USINDOPACOM works with allies and partners in order to enhance our interoperability throughout the Indo-Pacific region. Currently, USINDOPACOM is not fully postured with the latest technology to operate in cyberspace with dynamic multiple-partner combinations in all phases of military operations. Furthermore, our nation is still developing the communication capacity and sharable encryption capability necessary to support most modern warfighting platforms and weapon systems with our allies and partners. Although USINDOPACOM does not have formal agreements for exchanging information with many of the nations or organizations within the region, there is continued progress. The recently concluded Communications, Compatibility, and Security Agreement (COMCASA) with India is a step in the right direction. COMCASA is a bilateral agreement that allows the Indian military to procure U.S. cryptological equipment to enable secure voice and data exchange for enhanced interoperability. There will be similar efforts undertaken with others in the Indo-Pacific. As we continue to improve our agility in coalition information-sharing environments, our future capabilities will allow ally and partner forces alongside of our forces to adequately respond to natural disasters and contingencies. We will have agile, secure, dynamic information technology capabilities to support the full spectrum of military operations with our partners and allies in order to enhance interoperability.

Security Cooperation and Capacity Building. Security cooperation and capacity-building engagements in the region help build ally and partner capabilities, information-sharing, and interoperability. Addressing maritime security and maritime domain awareness challenges remains a key priority for nations across the region. The 2019 National Defense Authorization Act extended the FY16 NDAA Section 1263 “Southeast Asia Maritime Security Initiative (MSI)” for another five years (FY21 through FY25), and expanded MSI to encompass portions of South Asia. The MSI authority, along with other DoD authorities such as the Title 10 Section 333 Global Train and Equip, and Department of State authorities such as Foreign Military Financing (FMF) and International Military Education and Training (IMET), in addition to the

new Asia Reassurance Initiative Act, represent weighty tools available for building partner readiness, reducing capability gaps, and building capacity. The Department of State's one-time reprogramming of \$290.5 million of FMF to the Indo-Pacific in 2018 is a clear effort to assist our region, for which USINDOPACOM is grateful.

Addressing the Indo-Pacific Together: Enhancing Partnerships with our Allies and Partners

The Indo-Pacific is one of the largest and most diverse regions on earth. These differences are our strength, and the thousands of miles of ocean and sky between us do not divide us, they are the connective elements that bind us together. As I look at the depth and breadth of the Indo-Pacific, I see opportunities in each of the regions to advance our shared values in ensuring a Free and Open Indo-Pacific. Throughout the Indo-Pacific, the most effective way to address the challenges I have described is through collective action of multiple nations.

The security landscape mirrors the diversity of the Indo-Pacific. In Northeast Asia, the security environment where our strong alliances with Japan and South Korea dominate, I am focused on the immediate threat presented by North Korea and the long-term threat posed by Beijing's and Moscow's aggressive policies. In Southeast Asia, I am focused on working with our allies, Thailand and the Philippines, and our strong partners, Singapore and Vietnam, to strengthen ASEAN, expand multilateralism, and improve their combined capacity to stand up to the malign influence of state and non-state actors, especially in the South China Sea. In South Asia, I am focused on expanding cooperation with the world's largest democracy, India, and working with all South Asia countries to increase air and maritime domain awareness across the Indian Ocean. Finally, in Oceania, I am encouraged by the opportunities to partner with our strong allies, Australia and France, and strong friend, New Zealand, to improve information sharing and maritime cooperation as the Pacific Island Countries address the challenges associated with Illegal, Unreported, and Unregulated (IUU) fishing, natural disasters, narcotics trafficking, and economic coercion from Beijing.

Northeast Asia. The command's goal is to stabilize Northeast Asia and leverage our strong alliances with Japan and South Korea to improve stability across the broader Indo-Pacific. In order to achieve this, USINDOPACOM needs a security environment that is secure from coercion from Pyongyang, Beijing, and Moscow. As the region becomes more stable, we will encourage Japan and South Korea to take a greater role in the alliances related to their own security and contribute to security in the broader Indo-Pacific region.

Japan. The U.S.-Japan alliance is the cornerstone of our efforts to ensure a Free and Open Indo-Pacific. The Government of Japan released its own Free and Open Indo-Pacific Strategy in 2017, and Japan is looking to become more involved across the broader Indo-Pacific region. Additionally, Japan is a key supporter of UNSCR enforcement operations and hosts the Enforcement Coordination Cell (ECC) in Yokosuka, Japan. Tokyo intends to procure high-tech U.S. platforms that will increase interoperability, including F-35A, E-2D Hawkeye, Global Hawk UAS, MV-22, and Advanced Electronic Guides Interceptor System (AEGIS) Ashore. Furthermore, Japan's 2018 National Defense Program Guidelines (NDPG) call for strengthening the U.S.-Japan alliance, and expanding their international security cooperation with like-minded partners in the region. They also prioritize advancements in Japan's space, cyberspace, and electro-magnetic capabilities.

USINDOPACOM and Japan's Self Defense Force have transformed the way military alliances plan and campaign together. Our approaches for a Free and Open Indo-Pacific are synchronized in our national policies and defense strategies, and communication mechanisms exist at every level of our governments to ensure we are synchronized on key issues. The U.S.-Japan alliance is committed to supporting countries that respect and adhere to the rule-of-law, and our alliance seeks to enable opportunities for economic prosperity throughout the region.

South Korea. The U.S.-South Korea alliance remains ironclad, and we are both committed to the final, fully verified denuclearization of North Korea. South Korea is also a key supporter of UNSCR Enforcement activities against North Korea. USINDOPACOM works closely with Seoul in obtaining capabilities required under the Conditions-based Operational Control Transition Plan (COTP) – the ongoing plan to transfer Combined Forces Command (CFC) to

South Korean leadership. Seoul has future procurement plans for the P-8, advanced munitions, upgrades to PAC-3 missiles, and F-16 fighters. All these assets will increase interoperability with the United States.

Taiwan. In accordance with our One China Policy, based on the Taiwan Relations Act and three U.S.-China Joint Communiques, the United States and Taipei maintain a substantive and robust unofficial relationship with Taiwan based on the Taiwan Relations Act (TRA). Taiwan's values reflect our own—it features an open economy with a free and democratic society that respects human rights and the rule of law. The United States opposes any unilateral change to the status quo in the Taiwan Strait. The United States continues to support the peaceful resolution of cross-Strait issues in a manner, scope, and pace acceptable to the people on both sides. USINDOPACOM's engagement focuses on improving joint interoperability within Taiwan's military, improving Taiwan training and readiness, and supporting Taiwan's military and professional development.

Beijing is pushing across the globe to diplomatically isolate and economically constrain Taiwan. Taiwan has only seventeen diplomatic partners left after losing El Salvador, Burkina Faso, and the Dominican Republic as diplomatic partners in 2018. Beijing continues to press the international community and private businesses to remove or modify any references to Taiwan on websites and publications and is attempting to deny Taiwan's participation in international fora.

As evidenced in President Xi Jinping's New Year's speech, China is focused on achieving reunification as a part of the PRC's national plan of rejuvenation by "reserving the option of taking all necessary measures and not renouncing the use of force." We continue to be concerned with China's military buildup across the Strait, Beijing's opaqueness about its military capability and capacity, and its unwillingness to preclude the use of force to resolve the cross-strait issue. The United States has a deep and abiding interest in peace and stability in the Taiwan Strait and welcomes steps by both sides to reduce tensions and improve cross-Strait relations. President Xi's solution of a one country, two systems approach to reunification does not reflect the wishes of both sides. We hope that there will be continued high-level

communications and interactions going forward through which both sides can continue their constructive dialogue on the basis of dignity and respect. Although President Tsai and her party, the Democratic Progressive Party (DPP), have committed to “avoid confrontation and prevent surprises” with China, the cross-Strait situation is of increasing concern given the harsh rhetoric from Beijing toward the leadership in Taipei.

Taiwan recently passed its 2019 defense budget, which will fund foreign and indigenous acquisition programs as well as near-term training and readiness. Consistent with the TRA, USINDOPACOM engages with the Taiwan military to enable Taiwan to maintain a sufficient self-defense capability that is credible, resilient, and cost-effective.

Mongolia. Mongolia is a strong partner and contributor to the United States’ regional and global policy objectives. Mongolia supports missions in Afghanistan and United Nations Peace Keeping Operations, making Mongolia a model for emerging democratic countries that want to be more active globally. Ulaanbaatar’s “Third Neighbor Policy” intends to balance Russian and Chinese influence by developing relationships with the United States and other like-minded countries. USINDOPACOM and Mongolia have had inaugural land forces talks, developed a five-year security cooperation plan, and laid the groundwork for Airman-to-Airman Talks. The United States is helping Mongolia improve their special operations forces, peacekeeping operations, and Air Forces.

Southeast Asia. USINDOPACOM’s objective in Southeast Asia is to strengthen the sub-region’s ability to deny adversaries’ attempts to dominate or disrupt the gateway between the Pacific and Indian Oceans, while enabling the region to promote their sovereign interests, resist economic pressure from others, and preserve conditions for continued economic growth. USINDOPACOM is setting conditions in the security environment that support this goal, which ensures that all nations can freely access shared domains. Adversary militaries will be unable to dominate the global commons that enable trade and the global economy. The command’s efforts will improve the region’s awareness and capability to enforce their borders, territorial waters, and exclusive economic zones. USINDOPACOM will advocate for multilateral venues like the Association of Southeast Asian Nations (ASEAN) to advance collaboration, settle disputes

equitably, and strengthen resolve against the malign influence of state and non-state actors. We are very grateful to Congress for its continued support for the \$425 million Maritime Security Initiative for Southeast Asia which enables Thailand, Philippines, Vietnam, Malaysia, and India to increase their capability and capacity in continued maritime domain awareness over the next five years.

ASEAN. The United States and ASEAN share the common principles of a rules-based international order, respect for international law, and the peaceful resolution of disputes. The ten ASEAN member states, under the chairmanship of Singapore in 2018 and Thailand in 2019, continue to seek ways to improve multilateral security engagements and advance stability in the Indo-Pacific. USINDOPACOM is committed to strengthening regional institutions such as ASEAN, the ASEAN Defense Ministers' Meeting-Plus, and the ASEAN Regional Forum. USINDOPACOM participates in ASEAN exercises, key leader engagements, and multilateral cooperation on a number of shared transnational challenges, and will host an ASEAN-U.S. Maritime Exercise in 2019. USINDOPACOM co-chairs the ASEAN Defense Ministers' Meeting-Plus Experts' Working Group on Humanitarian Assistance and Disaster Relief with Malaysia through the end of 2019. USINDOPACOM's engagements with ASEAN, and with the respective ASEAN member states, build and strengthen relationships, and convey the United States' steadfast commitment to the region.

Cambodia. USINDOPACOM reduced the number of engagements with Cambodia. During these limited engagements the command reaffirms the importance of strengthening democratic institutions and maintaining an independent foreign policy. The United States and other countries in the region are concerned about the possible construction by a Chinese state-owned enterprise of a facility in Cambodia. USINDOPACOM appreciates the statements by the Prime Minister noting that foreign military facilities are prohibited under their constitution. However, the command remains concerned about the possible militarization of Cambodia's coast including the prepositioning of military equipment, the stationing of military units on long term rotations, and the construction of dual use facilities.

Indonesia. This year, the United States and Indonesia celebrate our 70th anniversary of bilateral relations, which provides an opportunity to highlight our growing strategic relationship. USINDOPACOM is committed to a strategic partnership with Indonesia. Indonesia's strategic location, its status as the third largest democracy, fourth most populous country, and its expanding economy all underscore its essential role in the regional security architecture. Indonesia is the largest recipient of U.S. training and education programs in the region. We continue to support the Indonesian military's focus on external threats and national defense, particularly maritime domain awareness and maritime security.

Laos. After decades of stagnation in the U.S.-Lao relationship following the Vietnam War, we have seen some significant advancements over the last two years. In 2016, the United States and the Lao People's Democratic Republic signed a Comprehensive Partnership that resulted in a surge of bilateral military engagements. The command's engagement goals are to partner and assist Laos in becoming a stable, prosperous, and independent member of ASEAN that is willing and able to promote its sovereign interests and respect international law. These engagements focus around unexploded ordnance (UXO) clearance, POW/MIA recovery, and military medicine. Laos actively supports the Defense Personnel Accounting Agency (DPAA) in the search for 290 missing U.S. service members with an aim to honorably conclude war legacy issues (UXO and POW/MIA recovery missions) by 2030. USINDOPACOM is expanding engagements with the Lao military.

Malaysia. Malaysia remains a critical partner of increasing importance in the region ever since the United States elevated the relationship to a Comprehensive Partnership in 2014. USINDOPACOM is exploring expanded collaboration in the areas of maritime security, counterterrorism, information-sharing, and defense institutional reform. Malaysian Armed Forces have demonstrated the professionalism, capacity, and resolve to contribute to regional security, and we continue to evolve our defense relationship on mutual areas of interest.

Philippines. The Philippines is a treaty ally and a partner in preserving a Free and Open Indo-Pacific and our military-to-military relationship has never been stronger. USINDOAPCOM has increased the number and scope of exercises in recent years, to include the resumption of live-

fire exercises. Terrorism continues to pose a security challenge in the Philippines, and USINDOPACOM is committed to helping the Philippines ensure that the southern Philippines does not become a safe-haven for terrorists that would threaten the entire region. I am also focused on helping to develop the territorial defense capability of the Armed Forces Philippines (AFP) and look forward to re-engaging with the Philippines National Police Maritime Group to continue improving their ability to protect their sovereign interests.

Singapore. Singapore remains a steadfast security cooperation partner in Southeast Asia with a strong commitment to promoting a Free and Open Indo-Pacific. Though not a formal ally, Singapore provides valuable access to the strategically-located entrance of the Malacca Straits and South China Sea. Singapore supports a strong U.S. presence in the region as well as a deep and broad defense relationship between our two countries. Singapore supports our objectives on North Korea, and in 2018, Singapore hosted the historic U.S.-North Korea summit between President Trump and Chairman Kim Jong Un. Singapore also hosted the transit and rotational deployment of more than 1,500 U.S. military aircraft and vessels (2015-2018), making the United States the heaviest foreign user of Singapore's facilities at Sembawang Port, Paya Lebar Air Base, and Changi Naval Base. Singapore maintains training facilities at Luke Air Force Base (AFB), Arizona (F-16); Mountain Home AFB, Idaho (F-15SG); Marana, Arizona (Apache AH-64D); and Fort Sill, Oklahoma (High Mobility Artillery Rocket System (HIMARS)). Moreover, USINDOPACOM and Singapore steadily increased interoperability through increasingly complex exercises, and we continue to strengthen cooperation in counterterrorism and maritime security. Singapore annually sends 1000 students to training and education courses in the United States, representing the largest training presence in the United States from any foreign military.

Thailand. Last year marked 200 years of friendly U.S.-Thai relations, and Thailand remains a key ally and security partner. In 2019, I am focused on advancing our alliance and restoring elements of our military-to-military relationship following the restoration of a democratic government after elections in March. Thai facilities provide vital training opportunities for USINDOPACOM personnel, and logistical nodes that are essential to operate throughout the

Indo-Pacific region. Thailand assumed the chairmanship of ASEAN in 2019 and continues to play a vital leadership role in the Indo-Pacific region.

Vietnam. Vietnam has emerged as a key partner in promoting a secure and rules-based international order in the Indo-Pacific region. USINDOPACOM's defense partnership with the Vietnamese military is among the strongest aspects of our growing bilateral relationship. As a symbol of closer ties between the United States and Vietnam, the aircraft carrier USS CARL VINSON made a port call in March 2018 to Vietnam, the first of its kind since the end of the war in 1975. Vietnam shares many of the United States' principles on issues such as international rule of law and freedom of navigation, and Vietnam is one of the loudest voices on South China Sea disputes. USINDOPACOM's and the Vietnamese military's military-to-military engagements prioritize enhancing Vietnam's maritime capacity, which will be bolstered by Vietnam's acquisition of Scan Eagle UAVs, T-6 trainer aircraft, and a second U.S. Coast Guard cutter. I look forward to Vietnam assuming the ASEAN Chairmanship in 2020 and increasing its leadership across the region.

Burma (Myanmar). Ongoing human rights abuses, including growing restrictions on freedom of expression, including for members of the press, and atrocities [including ethnic cleansing], and instability in some ethnic minority areas comprise threats to Burma's democratic transition. Due to credible information of serious human rights violations and abuses, especially in relation to Rohingya, as well as restrictions that remain in place based on decades of military rule, U.S.-Burma security cooperation is minimal. The U.S.-Burma security relationship is limited to lower-level engagements at select regional security events and conferences, and participation in multilateral exercises focused on HA/DR. Burma military personnel are not attending academic exchanges, including at the region's DoD academic institute, despite the importance of engaging the next generation of officers.

South Asia. USINDOPACOM's goal in South Asia is to create and seize opportunities to broaden critical partnerships to ensure shared domains remain open to all. In conjunction with India's contributions to regional security, these actions will prevent adversaries from establishing an effective military presence in the Indian Ocean that threaten the security of vital commerce

and continued economic growth and development. As a result, the regional states will be able to reduce internal conflicts, respond to regional security challenges, and resist adversaries' military and economic coercion.

India. The U.S.-India strategic partnership continues to advance at an historic pace as we continue to increase our interoperability and information-sharing capabilities. The inaugural 2+2 Ministerial and signing of the COMCASA in 2018 were pivotal moments in our relationship. USINDOPACOM expects this trajectory to continue and that 2019 will be a significant year in bilateral relations. The United States and India are natural partners on a range of political, economic, and security issues. With a mutual desire for global stability, support for the rules-based international order, and a Free-and-Open Indo-Pacific region, the United States and India have an increased agreement on interests, including maritime security and maritime domain awareness, counter-piracy, counterterrorism, humanitarian assistance, and coordinated responses to natural disasters and transnational threats. Over the past year, the United States and Indian militaries participated in five major exercises, executed more than fifty other military exchanges, and further operationalized the 2016 Logistics Exchange Memorandum of Agreement (LEMOA). The LEMOA enables the U.S. Navy to replenish supplies from Indian navy logistics platforms. USINDOPACOM is working with the Indian military to operationalize the COMCASA, which will boost interoperability between our militaries. Defense sales are at an all-time high, with India operating U.S. sourced platforms such as P-8s, C-130Js, C-17s, AH-64s, CH-47s, and M777 howitzers. Additionally, India recently agreed to a \$2.1-billion purchase of MH-60R multi-role sea-based helicopters and is considering a number of additional U.S. systems for purchase. USINDOPACOM fully supports the purchase of U.S. systems, F-16 and F/A-18E aircraft, a reorder of 12-15 P-8Is, and a potential purchase of Sea Guardian UASs.

Bangladesh. Bangladesh is an important security partner with strong potential to enhance regional stability and advance U.S. interests in South Asia on counter-terrorism, Muslim outreach, countering violent extremism, supporting humanitarian assistance and disaster relief, and supporting United Nations Peacekeeping Operations (UNPKO). The humanitarian crisis caused by the presence of more than 700,000 Rohingya refugees from Burma (Myanmar) in Bangladesh has strained the Government of Bangladesh. Bangladesh's December 30 elections

point to concerning trend of consolidation of power by the ruling Awami League and raise fears that PM Hasina is aiming to achieve a de facto one-party state. Military-to-military engagement with Bangladesh fits into a broader strategy and commitment to uphold an international, rules-based order in the vital Indo-Pacific region and contributes to building a regional security framework.

Sri Lanka. Sri Lanka remains a significant strategic opportunity in the Indian Ocean, and our military-to-military relationship continues to strengthen. However, political turmoil and ethnic tension between the Tamil and Sinhalese populations remain drivers of instability and potential obstacles to continued growth in our partnership. Moreover, Sri Lanka has handed over the deep water port of Hambantota to China on a 99-year lease due to its mounting debts to China, which has caused international concern. Despite the political upheaval, it is in our interests to continue military collaboration and cooperation with Sri Lankan Forces. USINDOPACOM cooperation with the Sri Lankan Military centers on building capacity in maritime security and maritime domain awareness, humanitarian assistance and disaster relief as well as humanitarian demining, medical assistance, and peacekeeping operations. Increasing navy-to-navy engagement with Sri Lanka will be a USINDOPACOM focus in 2019. The Sri Lankan Navy is a well-trained and professional force with the potential to contribute to multi-lateral maritime interoperability in the Indian Ocean. The recent transfer of an excess U.S. Coast Guard cutter to Sri Lanka in August 2018, along with additional platforms from Japan and India, provide the Sri Lankan Navy greater capabilities to contribute to regional maritime domain awareness initiatives. Going forward, it is necessary to sustain engagement with Sri Lanka, particularly the navy, and construct a multi-lateral approach to capacity building with like-minded partners to rapidly enhance the Sri Lankan Navy's capabilities.

Oceania. USINDOPACOM is deepening engagement with the Pacific Island Countries (PICs) of Oceania to preserve a Free and Open Indo-Pacific region, and we are committed to strengthening the region's future security and prosperity with our partners and allies. In close coordination with Australia, Japan, France, and New Zealand, USINDOPACOM is working to strengthen the resilience of the PICs by tackling common challenges: drug trafficking; Illegal,

Unreported, Unregulated (IUU) fishing; the existential threat of rising ocean levels; natural disasters; and the heavy debt burdens that threaten their sovereign interests.

Australia. Our alliance with Australia underpins our relations across Oceania, and Canberra plays a leading role in regional security and capacity-building efforts for a Free and Open Indo-Pacific. Australia is increasing its diplomatic presence, military and economic assistance, and infrastructure investments in Fiji, Papua New Guinea, and the other PICs to enhance security in the region. Australia is a key supporter of UNSCR enforcement operations against North Korea as well. The U.S. Marine Corps completed its sixth successful Marine Rotational Force-Darwin deployment, and we expect to reach the full authorized strength of 2,500 Marines later this year. These deployments maintain significant combat power west of the International Date Line with an ally. Moreover, Australia is procuring high-tech U.S. platforms, such as the F-35, that will increase interoperability.

Compact of Free Association (COFA) States. The Republic of Palau, Federated States of Micronesia (FSM), and the Republic of the Marshall Islands (RMI), collectively referred to as the “Compact” states, are threatened by external pressures including the pernicious use of Beijing’s economic leverage. The Republic of Palau, FSM, and RMI entered into a Compact of Free Association (COFA) with the United States more than 25 years ago, allowing the United States to foreclose access or use of those countries by third-country militaries. Under the COFAs, the Compact States receive economic assistance, including grants, access to various U.S. federal programs, and for many citizens of the Compact States, visa-free travel to the United States. U.S. contributions to the trust funds established by the COFA are scheduled to end after 2023. Moreover, these island nations are under increasing pressure from Beijing’s economic strategy. Additionally, the changing climate represents an existential threat to these nations as they urgently seek to mitigate damage from higher tides and rising sea levels, shifting patterns of fishing populations essential to economic livelihood, and greater intensity of natural disasters such as tropical storms and droughts. The continued support that the COFA has engendered also benefits the United States. We provide support to these countries and they support the United States. The patriotic citizens of these nations join the U.S. armed forces in larger numbers per capita than most U.S. states, and I value their service. The Compact states

rely on continued support from the United States to mitigate these threats and the United States would like to continue to benefit from the good will of these Pacific Island Countries to further our strategic interests in Indo-Pacific region.

Fiji. USINDOPACOM's relationship with the Republic of Fiji is thriving and robust, and we were pleased to see a credible election process there in 2018. Australia's decision to invest in the Black Rock International Peacekeeping Center was welcomed, and will ensure that Fiji continues to play an important role in peacekeeping missions around the world. USINDOPACOM is postured to provide engineering support for improvements and new construction to the Ground Forces Training Center and to assist Australian engineers with the Black Rock International Peacekeeping Center. In 2018, Fiji signed a U.S. ship-rider agreement, opening up new opportunities for maritime security cooperation between our two countries. Additionally, the establishment of Fiji as a partner in the National Guard's State Partnership Program opens up another door for our two militaries to train and work together. The \$5 million plus-up in foreign military sales (FMS) allows USINDOPACOM to deepen our military relationship with the Fijian military.

France. France, a NATO ally with significant territory in the Indo-Pacific, is increasing its operational activities in the region and is a key contributor to the multilateral efforts. The United States, Japan, Australia, New Zealand, and France coordinate operational support and capacity-building with the PICs. The primary operational engagement provides support to the Forum Fisheries Agency to address IUU fishing. France is also becoming increasingly active across the broader Indo-Pacific region, and I welcome both French support to UNSCR sanction enforcement activities against North Korea, and increased French activity in the South China Sea.

New Zealand. New Zealand remains a steadfast and key partner who, in 2018, increased investment, foreign assistance, and infrastructure support to the South Pacific. USINDOPACOM greatly appreciates this commitment of additional resources to the PICs. For the last six years, the United States and New Zealand, through bilateral defense dialogues, have increased interoperability collaboration headlined in 2018 by New Zealand's purchase of P-8

Poseidon maritime patrol aircraft to replace aging P-3 Orion aircraft. Additionally, New Zealand has provided key support to UNSCR sanctions enforcement against North Korea.

Papua New Guinea (PNG). USINDOPACOM's engagement with PNG improves regional posture and demonstrates the U.S. commitment to the region. With security support from Australia and the United States, PNG hosted the Asia Pacific Economic Cooperation (APEC) summit in 2018. During APEC, Vice President Pence announced that Australia and the United States would partner with Papua New Guinea to develop the Lombrum Naval Base on Manus Island in the northern part of PNG. USINDOPACOM looks forward to assisting Australia and PNG in developing options for this base.

Additional Allies

Canada. Like the United States, Canada is a member of NATO and a Pacific nation. Canadian policy in the Indo-Pacific focuses on cooperation and building partnerships as they increase operational activities in the region. By focusing on consistent engagement with all willing parties, Canada hopes to deepen its relationship with Australia, New Zealand, and the United States. Canada wants to provide a continued presence in the Pacific to enhance regional stability, specifically citing tensions on the Korean Peninsula in their National Defence Policy. Ottawa provides support to ongoing North Korea UNSCR sanctions enforcement as well.

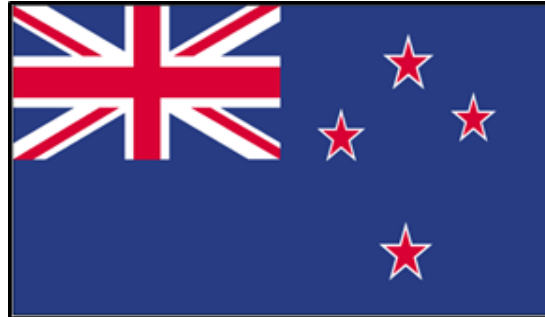
United Kingdom (UK). The UK, another NATO ally, remains one of the strongest defenders of a Free and Open Indo-Pacific, and sees prosperity and security in the Indo-Pacific as an essential driver of global economic growth. The UK recently established three new diplomatic posts in the Pacific and increased foreign aid to the Pacific by 6% in 2018. The recently concluded cooperative deployment with the HMS Argyll and USS McCampbell in the South China Sea highlights the value of multinational operations and, more importantly, the international message to those who seek to infringe on the ability to fly, sail, and operate wherever international law allows.

Conclusion

In the 21st century, U.S. security and prosperity will increasingly depend upon a peaceful and stable Indo-Pacific region—one that features respect for states’ sovereignty, freedom of the seas and skies, and adherence to international norms, rules, and behavior. In short, it is in our vital national interests to ensure a Free and Open Indo-Pacific over the short- and long-term. As the Commander of USINDOPACOM, my focus is first and foremost on preserving and advancing the security and stability of the region, over the short- and long-term.

I will ensure the 375,000 men and women of USINDOPACOM remain ready to fight and win, if necessary, while also focusing on competing and winning below the level of armed conflict. It is in this so-called “gray zone” between peace and war where many of our adversaries currently operate, and we must be equally prepared to compete with our adversaries before and after the initiation of hostilities. To do this, we need a comprehensive approach across multiple U.S. governmental departments, and partnerships with civil society and the private sector, to engage in areas that transcend traditional military core competencies. Our armed services must be manned, trained, and equipped to overcome the full spectrum of challenges presented by state and non-state actors. With the continued support of Congress, and together with our allies and partners, I believe we will be successful at this important mission.

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New Zealand

Subject	Page
Ambassador Scott Brown	55
US Relations with New Zealand	57
CultureGram 2019.....	61
BBC Country Profile	69
Economist Intelligence Unit Country Report.....	73
CRS: The Pacific Islands Policy Issues	97

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Ambassador Scott Brown



Scott Brown, U.S. Ambassador to New Zealand and the Independent State of Samoa. He was confirmed by the Senate as Ambassador to New Zealand on June 8, 2017, and arrived in New Zealand on June 25.

Scott P. Brown is a prominent political leader, attorney, and National Guardsman with a long history of public service.

In 2010, Ambassador Brown won a special election and served in the U.S. Senate for three years. During his time in the U.S. Senate, Ambassador Brown was known as the most bipartisan Senator and was the ranking member on the Armed Services Committee, as well as the Committee on Homeland

Security and Governmental Affairs, and was a member of the Veteran's Committee and the Committee on Small Business. As an elected official, he worked extensively on sex offender, child trafficking and other law enforcement issues to keep children and families safe. He began his public service career as an Assessor and Selectman for the Town of Wrentham, Massachusetts. He served as Massachusetts State Representative for the 9th Norfolk District for seven years and as State Senator for the Norfolk, Bristol, and Middlesex District for five.

Ambassador Brown served in the enlisted and officer ranks of the Massachusetts and Maryland National Guard. He retired as a Colonel after 35 years of service, the last four of which he served as the Deputy to the Chief Counsel to the Chief of the National Guard Bureau at the Pentagon. While maintaining his law practice he was also a contracted contributor and analyst for Fox National News.

Ambassador Brown worked as an attorney for Nixon Peabody, LLP, Boston, MA. He served on the Board of Directors and as an Advisor to Kadant, Inc., Westford, MA and

as an advisor to 1st Alliance Lending, LLP, East Hartford, CT, an organization aimed at helping low income citizens keep their homes. He was an Advisor to SkyBridge Capital, New York, NY and to Ron Terwilliger Housing Foundation, Vienna, VA, and served as a board member for the USA Triathlon Foundation introducing youth to the sport of triathlon. He traveled extensively speaking before colleges, businesses, trade associations, and financial and government advocacy groups globally.

Ambassador Brown is married to Gail Brown. They have two daughters: Ayla, a singer/songwriter in Nashville, Tennessee and Arianna, a veterinary who studied at Cornell University in New York. Ambassador Brown earned a B.A. from Tufts University and a J.D. from Boston College Law School. He has Honorary Doctorates from Lasell College (Humanitarian Letters) and Nichols College (Public Administration).



United States Department of State

U.S.-NEW ZEALAND RELATIONS

New Zealand is a strong partner and friend of the United States. The U.S. diplomatic presence in New Zealand dates back to the commissioning of the first U.S. Consul in 1838. Formal diplomatic relations were established in 1942, following the United Kingdom's recognition of New Zealand's domestic and external autonomy within the British Empire. During World War II, U.S. military personnel were stationed in New Zealand to prepare for battles such as Guadalcanal and Tarawa. The United States and New Zealand share common elements of history and culture and a commitment to democratic principles. New Zealand's relationship with the United States in the post-World War II period was closely associated with the 1951 Australia-New Zealand-United States (ANZUS) security treaty, under which signatories agreed to consult in case of an attack in the Pacific and to "act to meet the common danger." This changed in the 1980s, when New Zealand's implementation of a policy barring nuclear-armed and nuclear-powered warships from its ports effectively prevented practical alliance cooperation under ANZUS. In 1986, the United States suspended its ANZUS security obligations to New Zealand.

Bilateral ties have improved dramatically in the past several years. In 2010, the United States and New Zealand signed the Wellington Declaration, reaffirming close ties between the two countries and outlining future practical cooperation. This was enhanced in 2012 by the signing of the Washington Declaration, which strengthened the defense relationship by providing a framework and strategic guidance for security cooperation and defense dialogues. In November 2016, the destroyer USS Sampson visited New Zealand, the first bilateral ship visit in more than thirty years. The USS Sampson's visit took on additional

significance in the aftermath of the 7.8-magnitude Kaikoura earthquake. At the request of the New Zealand government, the USS Sampson diverted to the South Island and provided humanitarian assistance and disaster relief to affected communities.

The New Zealand government attaches significant importance to continued close political, economic, and social ties with the United States. New Zealand actively engages in peacekeeping and international security efforts around the world. The United States and New Zealand work together on a range of scientific areas, especially research in Antarctica. Christchurch is the staging area for joint logistical support operations serving U.S. permanent stations at McMurdo and the South Pole, as well as New Zealand's Scott Base. In late July 2018, the U.S. Congress passed the Knowledgeable Innovators and Worthy Investors (or KIWI) Act, which granted New Zealanders access to E1 and E2 entrepreneurship and investor visas. President Trump signed this act into law in early August 2018.

U.S. Assistance to New Zealand

The United States provides no development assistance to New Zealand.

Bilateral Economic Relations

Commercial ties between the United States and New Zealand are strong and growing. U.S. goods exports to New Zealand totaled \$3.92 billion in 2017, and the United States imported \$4.16 billion in goods from New Zealand. Bilateral trade in services stands at \$4.77 billion annually, yielding total annual bilateral trade of goods and services of approximately \$13 billion. U.S. exports to New Zealand include aircraft, machinery, agricultural products, vehicles, and optic and medical instruments. U.S. imports from New Zealand include frozen beef, caseins, milk protein concentrate, wine, and machinery. The United States and New Zealand have had a bilateral trade and investment agreement in place since 1992.

The United States is New Zealand's second most important investment partner, after Australia. The United States was the second largest source of foreign investment into New Zealand, accounting for almost \$5.5 billion in investment in 2017. The United States was the second most popular destination for New Zealand foreign investment, accounting for

15.4 percent of all investment in 2017 for a total of \$2.66 billion. U.S. direct investment in New Zealand is concentrated in the finance, insurance, and manufacturing sectors, but also includes the food/agriculture, mining, professional services, transportation, energy, and wholesale trade sectors. New Zealand foreign direct investment in the United States is led by the manufacturing and wholesale trade sectors. Over 300 U.S. companies have subsidiary branches in New Zealand. Many operate through local agents, and some are in association in joint ventures.

Approximately 330,000 U.S. travelers visited New Zealand in 2017 representing a 13.3 percent increase from the previous year, and more than 300,000 New Zealand visitors traveled to the United States – a doubling of visitors since 2008. New Zealand travelers spent nearly \$437 million while in the United States in 2017, representing a 16.5 percent increase in spending over the year prior.

New Zealand's Membership in International Organizations

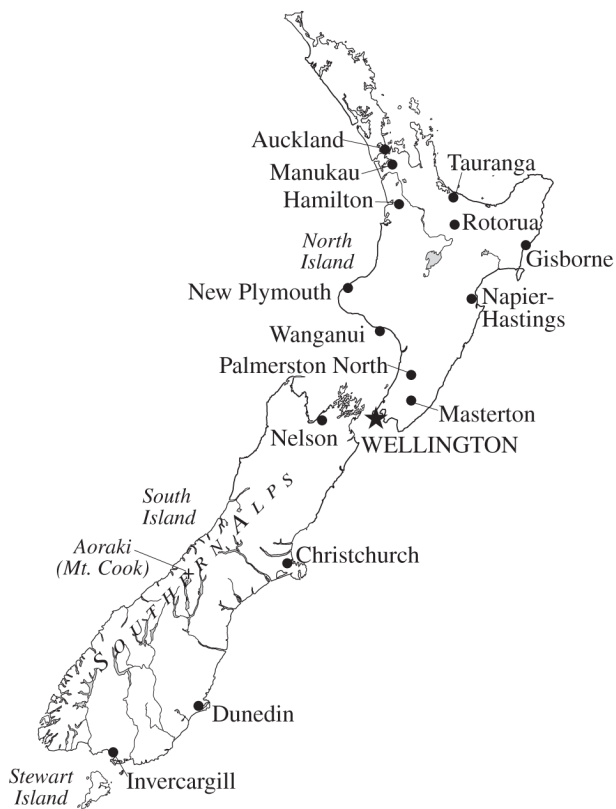
New Zealand and the United States belong to a number of the same international organizations, including the United Nations, Organization for Economic Cooperation and Development, Asia-Pacific Economic Cooperation forum, ASEAN Regional Forum, International Monetary Fund, World Bank, and World Trade Organization. New Zealand also belongs to the Pacific Islands Forum, of which the United States is a Dialogue Partner.

Bilateral Representation

Scott Brown is currently the U.S. Ambassador to New Zealand. Other principal embassy officials are listed in the Department's Key Officers List.

New Zealand maintains an **embassy** in the United States at 37 Observatory Circle NW, Washington, DC 20008 (tel. 202-328-4800).

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Boundary representations are not necessarily authoritative.

BACKGROUND

Land and Climate

New Zealand is slightly smaller than Italy, or about the same size as the U.S. state of Colorado. The country's indigenous name is Aotearoa (“Land of the Long White Cloud”). This mountainous island nation lies in the South Pacific about 1,000 miles (1,600 kilometers) southeast of Australia. Its two principal landforms are the North Island and the South Island.

The more populous North Island has fertile agricultural land and a few isolated snowcapped volcanoes. It also boasts hot springs and geysers in the thermal region of the Central Plateau. On the South Island, the Southern Alps provide magnificent scenery and opportunities for sports such as skiing. There are many glaciers, lakes, and rivers. Southwest coastal fjords characterize an area called Fiordland. Coastal lowlands are used for agriculture. Other islands include Stewart Island, south of South Island, and the Chatham Islands, about 500 miles (805 kilometers) to the east. Numerous other small islands are mostly uninhabited. About one-third of New Zealand's land is protected land used for national parks and reserves. Earthquakes are a continual threat.

The climate is temperate, with plenty of sunshine, adequate rainfall, and few extremes in weather. However, in winter (June–September), particularly in the south, high

humidity makes it seem colder, even though average winter temperatures rarely go below 40°F (4°C). Highs in summer (December–March) average about 73°F (23°C). Hot winds bring higher summer temperatures to the east coast.

History

Early Settlers

The first discovery of the islands is attributed to Kupe, a legendary Polynesian explorer. Maori migrations from Polynesian islands probably began before AD 900. These early Maori were warlike, highly organized, and skilled in many crafts. In 1642, Dutch explorer Abel Tasman sighted the islands and named them Staten Landt. After a skirmish with Maori off the coast of the South Island, Tasman chose not to go ashore, and the islands remained largely uncolonized until the early 1800s.

Dutch geographers changed the islands' name to Nieuw Zeeland—after the Dutch province of Zeeland—but the Dutch were not directly involved in colonizing the islands. Instead, Britain's Captain James Cook, who first visited the Maori in 1769, opened the door to European (chiefly British) settlement. Western contact led to a decline in the Maori population due to the introduction of diseases and of modern weapons in tribal warfare.

Treaty of Waitangi and British Colonization

In 1840, the Maori and British signed the Treaty of Waitangi,

which allowed *kawanatanga* (governance) by the British monarch but granted the Maori legal protection and rights to perpetual ownership of their lands and resources. Only the Crown was entitled to buy land from the Maori, but the law was not always observed, and improper purchases and illegal leases were made. Colonization and Western settlement proceeded rapidly after 1840. In 1852, Britain granted New Zealand internal self-government, and by 1907 the nation became an independent dominion within the British Empire (later, the Commonwealth). In the 20th century, the Maori population rebounded, and Maori people integrated with residents of European descent. However, Maori maintain many distinct aspects of their cultural heritage.

World Wars and Pacific Ties

New Zealand contributed heavily in terms of soldiers to both world wars. After World War II, New Zealand turned its focus from European ties to Pacific ties, developing trade links with growing Asian economies. Conversely, by the 1990s, Britain was focusing on European integration. This divergence has raised the question of whether New Zealand's status as a democratic monarchy, with the British queen as nominal head of state, reflects the country's independent outlook. Some New Zealanders favor a future (though not necessarily immediate) transition to a local head of state.

Recent Politics

For decades, New Zealand politics has been dominated by two major political parties: the center-left Labour Party and the center-right New Zealand National Party. In 1999, the Labour Party won elections and remained in power for the next nine years. During its rule, the Labour Party increased the minimum wage by 5 percent annually and strengthened social programs. When the economy entered a deep recession in 2008, New Zealanders voted for the New Zealand National Party, which campaigned on tax cuts and reduced spending on social programs. The New Zealand National Party also won elections in 2011 and 2014. Even though the economy has been growing since 2009, economic inequality and unaffordable housing prices have become some of the biggest challenges facing New Zealand today.

Recent Events and Trends

- **Free-trade agreement:** In June 2017, New Zealand, along with Australia and several Pacific island countries, signed the Pacific Agreement on Closer Economic Relations Plus (PACER Plus), an updated free-trade and economic-development agreement. PACER Plus aims to promote trade and economic development among member nations by reducing trade barriers, lowering tariffs, and encouraging worker mobility. New Zealand's once agrarian-dependent economy has diversified in recent decades and become an industrialized, free-market economy that competes globally.
- **New prime minister:** In October 2017, Jacinda Ardern, the leader of the Labour Party, became prime minister after forming a governing coalition in New Zealand's 120-seat parliament with the centrist New Zealand First party and the left-wing Green Party. The coalition ends nine years of rule by the center-right New Zealand National Party, which received the most votes in New Zealand's September 2017 general election but failed to capture a majority of seats in

parliament. During the campaign, Ardern and the Labour Party pledged to end child poverty, make higher education free, reduce immigration, and strengthen environmental protections.

- **Housing affordability:** In August 2018, New Zealand banned most foreigners without residency status from purchasing homes in the country, a move aimed at curbing the nation's rapidly rising housing prices, which have soared 60 percent in the last decade. New Zealand's overheated housing market has been fueled in part by low interest rates and a severe housing shortage. Housing has become unaffordable for many New Zealanders, forcing some into homelessness.

THE PEOPLE

Population

Most of New Zealand's population lives in urban areas. The principal metropolitan areas include Auckland, Christchurch, and Wellington (the capital). Auckland and its suburbs hold about one-third of the nation's people and constitute New Zealand's commercial and industrial center. Throughout the world, New Zealanders are commonly called "kiwis," a nickname derived from the country's indigenous national bird.

Over two-thirds of the population is of European descent, and 14 percent is Maori. Asians and Pacific Islanders from neighboring islands make up another 19 percent of the population. Intermarriage between groups is common, and the question of ethnic identity is largely a matter of self-identification. Some people indicate in census data that they identify with more than one ethnic group, and some identify themselves with designations that have no reference to ethnicity, such as "New Zealander." The term *Pakeha* generally refers to people of European descent.

Maori are Polynesians and the country's indigenous inhabitants. They live mainly on the North Island. Pacific Islanders (Tongans, Samoans, Cook Islanders, Fijians, and others) began migrating to New Zealand after 1946 and today comprise a significant minority. Immigration from China, India, and other Asian countries has increased in recent decades. Many Pacific Islanders and Asians live in Auckland, the nation's most multicultural city.

Language

English, Maori, and New Zealand Sign Language are official languages. English is the most common everyday language, while Maori is used in educational and cultural settings. Many Maori words are used in English conversations. Examples include the words *eg kiaora* (greetings), *tamariki* (children), *morena* (good morning), *kai* (food), and *ka kite ano* (see you later). Maori people also speak English, and some Pakeha speak a little Maori, which they may learn in school. Many New Zealand English words or phrases reflect British English. For example, a car's trunk is a *boot* and the hood is a *bonnet*. Others include *come around* (come over), *over the road* (across the street), and *go to the loo* (go to the bathroom). A *bathroom* is a place to take a bath or shower, a *lift* is an elevator, and *petrol* is gasoline.

Religion

About 44 percent of New Zealanders identify themselves as Christians, of which Roman Catholics, Anglicans, and Presbyterians are the largest denominations. The Ratana and Ringatu Christian churches have significant numbers of Maori adherents. Only a small minority of New Zealanders attend church on a regular basis; attendance is higher on religious holidays. The largest non-Christian religions are Hinduism (2.1 percent) and Buddhism (1.4 percent). About 39 percent of New Zealanders indicate in census data that they have no religious affiliation.

General Attitudes

New Zealanders tend to be open, friendly, and hospitable. Compared to that of U.S. Americans, their lifestyle is normally more relaxed and informal. For example, while a U.S. American might discuss occupations, incomes, and career objectives with colleagues, a New Zealander is more apt to discuss leisure activities and family interests.

New Zealanders are, on the whole, self-reliant, practical people. Many people enjoy working around their homes and gardens; they often prefer to make small repairs and complete projects themselves, rather than hiring someone to do work for them. People tend to believe their society should be caring and should help people through public programs. They are generally curious about the world around them: many people read a newspaper daily, and many travel overseas. Home ownership and a good education are valued by most. Maori heritage emphasizes the extended family (*whanau*), hospitality, friendship, and a strong sense of community.

In many parts of the country, especially the North Island, there is a multicultural society in which Pakeha, Maori, and others share many values and customs. Despite the general harmony between Pakeha and Maori, relations have been strained in recent years in disputes over land and resource rights. In a major settlement signed in 1997, the government apologized for past abuses, paid reparations, and returned large portions of land to a South Island Maori *iwi* (tribe). Many landmark names were changed, including New Zealand's highest peak, Mount Cook, which is now Aoraki. Other disputes are still being considered as the nation strives to achieve greater social justice.

Personal Appearance

Western-style clothing is standard. People typically wear casual clothing in public, although it is usually neat and clean. Business attire has become more casual, though some corporate settings continue to require business suits or a jacket and tie. At many companies, employees dress down on Fridays, wearing clothing like jeans. Employees of companies such as banks wear uniforms. European fashions are popular, but New Zealand also has its own fashion industry. Globally recognized designers such as Karen Walker are known for their informal but stylish looks. Because many New Zealanders love spending time outside, there is a thriving outdoor clothing industry in the country. The weather can change quickly, so layered clothing is a popular option. It is common for New Zealanders to wear shorts (weather

permitting) when playing sports, going shopping, and visiting friends.

Maori wear traditional clothing for ceremonies and cultural events. For men and women, this means a *piupiu* (woven flax skirt) over black shorts or a black skirt. Women pair this with a colorful woven top featuring a geometric pattern, usually in red, black, and white. A *korowai* (ornate cloak) is worn over the *piupiu*. It is made of flax and decorated with dog fur or feathers from native birds. A headband and feathers are worn in the hair. Carved jade pendants (*tiki*) are common accessories for women. Full-faced tattoos (*moko*) for men and chin tattoos for women were once common. In Maori culture, tattoos symbolized higher social rank. Today, similar designs are usually drawn on for performances and special events.

CUSTOMS AND COURTESIES

Greetings

New Zealanders generally greet with a handshake or, if they know each other well, a hug. In formal situations, men often wait for women to offer their hand before shaking. Pakeha greet formally with *Hello, how are you?* More informal greetings include *Hello* or *Hi*. Also common are *Gidday* (Good day); *Yeah, gidday*; or *Gidday, how's it going?* After an initial introduction, most people switch from addressing each other by title and surname to using first names.

Maori may greet with a hug or a traditional *hongi* (pressing noses together with eyes closed). The *hongi* is used with non-Maori on a *marae*, a sacred courtyard used for meetings that is located in front of a Maori *wharenui* (great house, and a place where guests stay). Maori greeting phrases include the ceremonial *Nau mai* (Welcome). *Tena koe*, *Tena korua*, and *Tena koutou* are polite ways to say "Hello" to one, two, or many people, respectively. *Kia ora* (Be well) is a more common and less formal hello in predominantly English-speaking environments; it can also mean "Thank you." Upon parting, Maori may say *Haere ra* (Farewell) and reply *E noho ra* (Stay well). An increasingly common and less formal good-bye is *Ka kite ano* (See you later).

Gestures

New Zealanders often supplement their conversation with hand gestures. If conversation is not possible or polite, a nod, wave, or raise of the eyebrows serves as a sign of recognition. Traditional social courtesy is valued but not necessarily practiced by all segments of the population. Most younger women do not expect traditional courtesies from men (and some may find them patronizing). However, it is still considered polite to give up bus seats or to open doors for the elderly. It is also considered polite to avoid chewing gum or using a toothpick in public and to cover yawns with the hand. Personal space usually is important during conversation; standing too close is uncomfortable for many people.

Visiting

New Zealanders entertain often in the home, no matter their social class. They like to have friends over for dinner. Garden

barbecues are especially popular on weekends. Guests are expected to feel at home. They might remove their shoes unless told otherwise by the hosts. Dinner guests almost always take a gift, usually a small contribution to the meal, chocolates, or good wine if the hosts enjoy it. Houseguests always leave a gift with their host family. When welcomed on a *marae* (a sacred open space used for religious and social gatherings), one leaves a *koha* (gift of money). The *koha* is a donation toward the cost of hospitality; the larger the gift, the more important the giver.

Dropping by a friend's home unannounced is quite common, although such visits after 8 p.m. are not usually appropriate. Guests may be invited to a formal dinner at which the host provides all of the food. Also common is a potluck dinner, to which guests are asked to bring food for everyone to share. Rather than prepare a meal, friends may simply enjoy chatting over cake and coffee or plan to meet at a café or coffee shop.

Even when not invited for a meal, guests are nearly always offered refreshments. It is considered rude not to at least offer a drink. Even a repairman who is staying only briefly would be offered a drink. Common refreshments include coffee, tea, soft drinks, finger sandwiches, cakes, and *biscuits* (cookies).

Eating

Most New Zealanders eat a light breakfast before work or school, typically by 8 a.m. Lunch is in the early afternoon, and dinner is around 6 or 7 p.m. The family generally eats dinner, the main meal, together. Dessert is often included, and coffee is nearly always served at the end, especially in restaurants. People eat in the continental style; the fork is in the left hand and the knife remains in the right. Hands and elbows are kept above the table. To indicate one is finished with a meal, one places the utensils parallel on the plate.

When people eat out, dinner is closer to 8 p.m. In a fine restaurant, staff members consider it their job to let diners take their time. They do not hurry with the check unless requested. At restaurants, people generally are quiet and do not speak too loudly. New Zealanders do not always practice tipping because wages are considered the duty of the employer, not the customers. However, tip jars are often found next to cash registers.

LIFESTYLE

Family

Structure

The average New Zealand family has two children. Single-parent households are fairly common due to divorce and out-of-wedlock births. The number of unmarried parents has risen, as cohabitation is now widespread and socially acceptable.

Among Polynesians, extended family connections are important. In some cases, several generations live together in one house. Polynesian women traditionally play strong roles in their communities. For Maori, the *marae* (a sacred open space used for religious and social gatherings) is important in binding families together. Important meetings (*hui*),

ceremonies, and recreational activities take place on the *marae* and in the *wharenui* (great house, and a place where guests stay).

Parents and Children

Around age seven or eight, children begin helping with chores such as setting and clearing the table, folding laundry, cleaning their rooms, and making their lunches for school. Most children receive a small allowance called “pocket money” in return for carrying out these tasks.

Family ties are looser than they once were, but people still believe in supporting one another. Parents often give financial help to their adult children until they finish their education (although it is becoming increasingly common for students to finance their own education through part-time work and interest-free government loans). It is fairly common for young people to move out of the parental home upon graduation from secondary school; university students commonly live on their own. Aging parents do not usually live with adult children; instead, most prefer to stay at home as long as possible and move into rest homes when necessary. They also receive support from New Zealand's comprehensive social welfare system.

Gender Roles

In the past, women carried out most household chores, while men were responsible for lawn, car, and house maintenance. Today, couples tend to divide such tasks more equitably, though women continue to do more cooking and cleaning than men. Affluent couples who work full-time may hire a part-time housekeeper.

Women account for a large part of the work force. Whereas women used to take an extended break from their careers in order to stay home with young children, today many employed mothers return to work immediately following their maternity leave, taking advantage of affordable daycare centers and government childcare subsidies. Since the 1990s, the number of women holding managerial and leadership positions in business and government has increased significantly. New Zealand has had several female prime ministers, and just under a third of parliament members are women.

Housing

Urban and Rural

As city life becomes more popular, semi-detached and apartment-style homes have become more common. Many city lots with old homes have been subdivided to accommodate an extra dwelling, and sometimes a single home is removed to make way for two or three new townhouses. All urban homes have access to plumbing and electricity, as do most rural houses. Many rural homes are equipped with septic tanks and get their water from an external storage tank that is filled with water from the roof.

Exteriors and Interiors

The typical family home is a detached single-storey home on a quarter-acre lot, with a yard in front and back of the house. Yards often contain vegetable and flower gardens. Most homes are either wooden or brick. A separate dining area and a living room are typical, though modern homes may offer an open-plan combination kitchen, dining, and living area. Many

New Zealanders like to restore colonial-era villas, which have large verandas and ornate lattice work.

Ownership

A majority of families own their own homes rather than rent. In recent years, however, New Zealand has been grappling with a severe housing shortage, especially in urban areas like Auckland. This crisis has raised housing prices and rental rates to unaffordable levels for many people. As a result, New Zealand has one of the highest rates of homelessness among the world's developed nations.

Dating and Marriage

Dating and Courtship

Although most New Zealand parents restrict exclusive dating until their children are 15 or 16, group social activities usually begin around age 12. Youth enjoy going to movies, dancing, and having parties. Older teens may go with a group of friends to the local club for dancing and drinking. People generally date only one person at a time.

Marriage in Society

Couples often live together for a few years prior to marriage. On average, women and men marry around age 30. Many couples live together instead of marrying; doing so is considered a socially acceptable arrangement except to older generations and the religiously conservative. The Civil Union Act of 2004 guarantees the rights and obligations of marriage to couples who have lived together for at least two years and legalized civil unions for same-sex couples. In 2013, New Zealand legalized same-sex marriage.

Divorce is common and does not usually carry with it a social stigma. Divorced individuals often get remarried, so many families are composed of step-parents and half-siblings.

Weddings

Weddings can be lavish. Tradition held that the bride's parents paid for weddings in the past, but today—since people generally marry at an older age—most couples take responsibility for the majority of costs themselves. Both sets of parents do, however, usually contribute to a portion of the expenses as a wedding gift. The details of a ceremony, the decorations, and the catering tend to reflect the individual tastes of each couple. Most ceremonies are held in the afternoon. Some couples get married in churches, but locations such as homes, gardens, wineries, beaches, and other outdoor locations are becoming increasingly common. Wedding parties generally consist of the bride and groom, their parents, bridesmaids, groomsmen, a flower girl, and a page boy.

A large celebration follows the wedding and may include speeches, a sit-down meal, and a dance. Since many couples already have established homes by the time they marry, some request gifts of cash rather than the household items traditionally given at weddings. Most couples take a 7- to 10-day honeymoon after their wedding. Popular destinations include nearby Pacific locations such as Fiji, New Caledonia, or the Cook Islands.

In Maori culture, the bride and groom receive a traditional welcome (*powhiri*) as soon as they enter the *marae* (a sacred courtyard). The *powhiri* consists of several steps, including songs, speeches, *koha* (gift of money), *hongiri* (pressing noses

together with eyes closed), and feasting. During the wedding ceremony, *pikorua* (pieces of jade or whale bone shaped like twisted infinity loops) are placed around the necks of the couple to symbolize eternal love. Jade or bone wedding rings may be exchanged in place of gold ones.

Life Cycle

Birth

Pregnant women have access to a range of healthcare providers, from midwives to general practitioners. The majority of maternity costs are covered by the government for New Zealand citizens and permanent residents. Many expectant parents take prenatal classes together. Family members and friends typically throw a pregnant woman a baby shower, where guests play games and give her useful items for the baby. Traditionally, babies born to Christian families were baptized soon after birth, but baptism is becoming less common. Many infants are named after a relative, such as a grandparent, uncle, or aunt.

Milestones

Several milestones occur during the teenage years of a young adult's life. New Zealanders may begin driving at age 16 and can buy alcohol and cigarettes and vote in elections at age 18. High school graduation at age 17 or 18 is another important event.

The age of 21 is considered the beginning of adulthood. A twenty-first birthday celebration is significant. It typically includes a large party attended by relatives and friends held in the family home or at an event center. The party usually involves large amounts of alcohol, and partygoers may give speeches about the young person, often trying to embarrass him or her in front of the guests with anecdotes from the past. The host may be given birthday cards featuring images of keys, which represent the key to the door of adulthood.

Death

Pakeha funerals follow Western traditions, with a wake, memorial service, and burial in a cemetery or cremation. At a wake, friends and family share memories of the deceased and consume light refreshments.

Maori funerals (*tangis*) are held at a *marae* (a sacred open space used for religious and social gatherings) and often last several days, with guests staying for the duration, usually at the *wharenui* (great house near the *marae*). Maori believe that the spirit of the deceased remains nearby until burial, so they hold a vigil until then.

Diet

The New Zealand diet has become lighter and more diverse in recent years, with influences from the country's many ethnic groups. *Kaimoana* (seafood) and fresh vegetables play a greater role than in the past. Red meat is eaten less often and portions are smaller. Beef, pork, and roast lamb are still common, as is fish, but poultry is gaining popularity. Meat pies and *sausage rolls* (sausage wrapped in pastry) were popular, but now more people prefer hamburgers, pizza, fish and chips, and international cuisine. *Vegemite* (yeast extract), peanut butter, honey, and jam are used as bread spreads. Fruits are abundant and include apples, kiwis, bananas, apricots, peaches, nectarines, plums, cherries, strawberries,

and tomatoes. New Zealanders regard their cheeses and ice cream as among the best in the world.

European and Asian foods are popular, especially in larger cities. A *hangi* is a traditional Maori meal, prepared by placing meat, seafood, potatoes, *kumara* (sweet potatoes), and vegetables together in wire racks lined with cabbage leaves. The wire racks are then steamed for hours in an *umu*, or underground oven.

Recreation

Sports

Many New Zealanders love sports. Rugby is the national sport. The national rugby union team, the All Blacks (so named because of their uniform color), has achieved success in world competition. Soccer is popular in winter, while cricket is the favorite for summer. Field hockey and softball are popular with both men and women. Girls and women often play netball, a game similar to basketball. Tennis, *bowls* (lawn bowling), and *athletics* (track-and-field) are also enjoyed in the summer.

Nearly a quarter of the population are members of sporting clubs. These clubs offer coaching and competitions in a variety of sports, from rugby to *bowls*. On Saturdays, club teams often compete with each other and afterward enjoy a *barbie* (barbecue). Members range in age from senior citizens to primary school students. Some children also belong to dance groups. Most secondary schools close early one day a week to allow students to take part in inter-school sport competitions.

Since no area is far from the mountains, sea, or rivers, there are many opportunities for mountaineering, *tramping* (hiking), fishing (both deep-sea and freshwater), hunting (on a limited basis), swimming, walking, jogging, and sailing. Adventure sports are also popular, including bungee jumping—which was invented in New Zealand—whitewater rafting, caving, and rappelling. Various endurance events attract global competitors to the country; one example is the Coast to Coast, which features running, cycling, and kayaking across New Zealand's South Island.

Recreation

New Zealanders spend considerable time outdoors. In addition to playing sports, they garden and fix up their homes. Gardening is one of the most common leisure activities, and people take pride in growing produce to share at weekend *barbies*, which are typically potlucks.

Another popular pastime is cooking, with an emphasis on fresh, healthy food made from scratch using local produce. Throughout the year, people attend various wine and food festivals that showcase local products. Spending time at cafés and restaurants is a favorite way to relax. Many adults enjoy taking continuing education classes at local community centers or high schools. These classes teach a variety of subjects, such as foreign languages, yoga, woodworking, and art appreciation.

Vacation

Traveling is common. After graduating from high school or college, many young people go on an Overseas Experience (OE), during which they work abroad for a year or two; London is a popular destination. Many New Zealanders make

a visit abroad each year, often to places such as Australia and the Pacific Islands.

The Arts

Maori performing arts, or *kapa haka*, include songs, chants, and dances. These art forms may convey legends, love poems, tributes to ancestors, oral histories, and political statements. Performers often use face paint as an alternative to traditional *moko* (facial tattoos), which feature elaborate designs. A popular form of the *haka* (traditional dance) is a war dance performed by men, who make powerful moves, shout fierce chants, and display aggressive facial gestures, such as widening the eyes and sticking out the tongue. This type of *haka* has become an internationally-recognized symbol of New Zealand, due in part to the All Blacks's tradition of performing the dance prior to competition. A common dance performed by women includes the swinging of *poi* (percussive balls on the end of a string).

Maori folk arts include wood and bone carvings, which record traditional beliefs and tribal affiliation, and *taaniko* weaving (plaiting flax to produce clothing with colorful geometric patterns).

Classical orchestras and theater and dance companies all enjoy success, and contemporary painters and sculptors exhibit in galleries throughout the country. New Zealand's domestic film industry has enjoyed significant growth in recent years, and New Zealand's pristine natural environment and topographical variation have made the nation a favorite location for filmmakers from around the globe.

Holidays

Public holidays include New Year's (1–2 January), Waitangi Day (6 February), Easter (including Good Friday and Easter Monday), Anzac Day (25 April), Queen Elizabeth II's Birthday (first Monday in June), Labour Day (fourth Monday in October), Christmas (25 December), and Boxing Day (26 December). Each province celebrates an Anniversary Day, which marks the day colonists first landed in the area.

Anzac Day

Anzac Day commemorates the service and sacrifice of the armed forces of New Zealand and Australia (ANZAC stands for Australian and New Zealand Army Corps). It began by marking the day that these forces landed at Gallipoli during World War I. Today, Anzac Day honors all members of the armed forces, and the holiday has become increasingly popular. Dawn services are held at war memorials throughout the country. Former and current members of the armed forces march in organized parades to these memorials, while members of the public line the streets to show their support. Wreaths are placed at the base of the memorial by service members, local dignitaries, and school children. Speeches, hymns, a minute of silence, and a trumpet rendition of the Last Post follow.

On this day, New Zealanders traditionally wear poppies purchased from the Returned Services' Association (RSA), with the profits going to returned service personnel. After the morning service, people visit their local RSA club to enjoy complimentary hot drinks and snacks. People also commonly eat Anzac *biscuits* (cookies) on this day. These long-lasting

biscuits were made by relatives to send to the armed forces during World War I. Eggs, which were scarce at the time, are not included in the recipe.

Waitangi Day

Waitangi Day marks the anniversary of the 1840 signing of the Treaty of Waitangi between Maori and the British. Differences in interpretation over English and Maori versions of the treaty led to years of misunderstanding and conflict between the groups. As a result, this holiday has been controversial since its inception in 1974, at times leading to demonstrations, some of which are violent, carried out by Maori over contested claims to land. As past wrongs have been admitted to by the government and land claims settled, Waitangi Day has become more peaceful. Most people spend the day relaxing outside or have barbecues.

Christmas Day

Christmas Day is one of New Zealand's most popular holidays. Families gather in the morning to exchange gifts and then enjoy a special meal for lunch and dinner. Traditional foods include ham, turkey, and lamb, along with vegetables and *Christmas pudding* (steamed fruitcake drizzled with caramel or brandy sauce).

Today, Christmas meals are often adapted to better fit the summer weather and feature cold meats, salad, and a dessert of fresh berries, fruit salad, and *pavlova* (a meringue-like cake topped with cream and fresh fruit and served cold). In the afternoon, families usually play board games and go for a walk. Barbecues and vacations during Christmas are also popular. Boxing Day comes from a British tradition of giving small boxed gifts to service workers or the poor. It is now a day to visit and relax.

SOCIETY

Government

Structure

New Zealand, a member of the Commonwealth of Nations, recognizes Queen Elizabeth II as head of state. She is represented in the country by a governor-general. The head of government is the prime minister, who is appointed by the governor-general and is the leader of the majority party or coalition in the nation's unicameral parliament, the House of Representatives. Parliament has a minimum of 120 seats, and its members are elected to three-year terms; 71 constituencies elect one representative each through a majoritarian system (7 of these seats are reserved for Maoris) and 49 through proportional representation. Parties must earn at least 5 percent of the vote or win one constituency seat to be eligible to earn seats through proportional representation.

New Zealand is divided into 16 regions and one territory. The powers that the regional and local governments have in relation to the national government are relatively weak when compared with similar situations in many other developed countries.

Political Landscape

Because some seats in the House of Representatives are filled through proportional representation, several parties in New Zealand are able to gain representation in the legislature. This

also has resulted in frequent coalition governments. Major political parties include the center-right New Zealand National Party and the center-left Labour Party. Other influential political parties include the centrist New Zealand First party and the left-wing Green Party. Immigration and economic policies are some of the major political issues in New Zealand.

Government and the People

Freedoms of speech, religion, press, and assembly are protected by law and respected by the government. Levels of corruption are among the lowest in the world. Elections are not only transparent but also free and fair. Voter turnout for national elections regularly exceeds 75 percent of registered voters. Voter registration is mandatory, but citizens are not required to actually vote. The voting age is 18.

Economy

New Zealand has a modern industrialized economy. While only 7 percent of the population is employed in agriculture, New Zealand's international trade depends heavily on the sector. The most important exports include dairy products, meat, timber products, and fruit. New Zealand is one of the world's largest exporters of wool. In addition to agriculture, other important industries include fishing, manufacturing, mining, and construction.

Tourism is another vital economic sector; the nation's diverse landscapes attract foreign visitors with interests in hiking, river rafting, skiing, wildlife watching, and other outdoor activities. Real gross domestic product per capita has expanded significantly in the last generation—a reflection of growing prosperity and a strong middle class. Unemployment is relatively low but higher among Maori and Pacific Islanders. The currency is the New Zealand dollar (NZD).

Transportation and Communications

Private cars are the preferred mode of transportation, although many urban residents ride a bus to work. All major cities have good bus systems. Trains and domestic airlines also operate between cities and industrial centers. Many New Zealanders use bicycles for short-distance transportation. Ferries regularly carry passengers and cars between the two main islands.

An excellent communications system provides efficient domestic and international service. Numerous radio and television stations and other media operate throughout New Zealand. Auckland, Christchurch, Dunedin, and Wellington have daily newspapers. Internet usage is common.

Education

Structure and Access

Education is highly valued in New Zealand. Most children enter school at age five, but preschools are also available. Secondary education begins at age thirteen. Some high schools are segregated by sex. The majority of schools are public.

Education is free and compulsory between ages six and sixteen. Public and *state-integrated schools* (schools that teach religion in addition to the state curriculum) are government funded, while private schools receive some

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funding from the state. Though public education is free, most schools request an annual voluntary donation. Parents must also pay for costs related to school trips, supplies, and uniforms. These costs may be waived in cases of financial hardship.

Maori and Pacific Island students sometimes struggle in English-language schools, and literacy rates among these groups tend to be lower than among Pakeha. The government has addressed this problem by establishing (mostly secondary) schools in which some or all subjects are taught in Maori or Samoan, the language of the largest Pacific Islander group in the country.

School Life

Uniforms are obligatory at the majority of schools. Most primary school children are required to wear a sunhat while playing outside.

Teaching styles emphasize discussion, questions, and debate; both individual and group work is common. Materials include textbooks, photocopies, and audiovisual equipment. Nearly all schools have high-speed internet access, and many are equipped with laptops, interactive whiteboards, and other technological tools. Teachers are involved in coaching sports, directing music and art activities, and mentoring students outside of the classroom. Most high school students study for an hour or two daily. Cheating and plagiarism are not tolerated.

Parents are heavily involved in their children's educations. They often attend weekly meetings, called *whanau* (family) time, during which information related to school events is announced and students perform songs and skits. Many parents also volunteer as classroom aids and in the Parent-Teacher Association (PTA). Schools have strict attendance policies, and truancy officers make home visits to discuss unexcused student absences with parents. Under the Education Act, parents may be fined for a student's truancy.

Higher Education

Most students stay in high school (also called *college*) until at least their 17th birthday. A rigorous state exam given in the fifth year of secondary school is required for university admission. New Zealand women have higher qualification rates than men and have a larger enrollment in higher education. The government administers eight universities. Government loans are available to students to cover tuition costs, and stipends are paid to those with low incomes. Continuing, technical, and vocational education are available to those who do not pursue a university degree.

Health

A comprehensive social security program provides healthcare coverage for the aged, disabled, sick, and unemployed. The public healthcare system is maintained by taxes, although some elements of care are being privatized or simply left to an emerging private sector. While all New Zealanders are entitled to use the public system, many workers choose to carry private insurance to expand their healthcare options. Private hospitals receive some government subsidies. Medical facilities are generally good and readily available.

AT A GLANCE

New Zealand

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Country and Development Data

Capital	Wellington
Population	4,545,627 (rank=124)
Area (sq. mi.)	103,363 (rank=75)
Area (sq. km.)	267,710
Human Development Index	16 of 188 countries
Gender Inequality Index	34 of 188 countries
GDP (PPP) per capita	\$39,000
Adult Literacy	99%
Infant Mortality	5 per 1,000 births
Life Expectancy	80 (male); 83 (female)
Currency	New Zealand dollar

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New Zealand country profile



New Zealand is a wealthy Pacific nation dominated by two cultural groups - New Zealanders of European descent, and the Maori, who are descendants of Polynesian settlers.

It is made up of two main islands and numerous smaller ones. Around three-quarters of the population lives on the North Island, which is also home to the capital, Wellington.

Agriculture is the economic mainstay, but manufacturing and tourism are important. Visitors are drawn to the glacier-carved mountains, lakes, beaches and thermal springs. Because of the islands' geographical isolation, much of the flora and fauna is unique to the country.

New Zealand plays an active role in Pacific affairs, and has special constitutional ties with the Pacific territories of Niue, the Cook Islands and Tokelau.

- Read more **country profiles** - Profiles by **BBC Monitoring**

FACTS

New Zealand

Capital: Wellington

- **Population** 4.7 million
- **Area** 270,534 sq km (104,454 sq miles)
- **Major languages** English, Maori
- **Major religion** Christianity
- **Life expectancy** 80 years (men), 83 years (women)
- **Currency** New Zealand dollar
UN, World Bank

Getty Images

LEADERS

Head of state: Queen Elizabeth II, represented by a governor-general
Prime minister: Jacinda Ardern



Jacinda Ardern was sworn in as prime minister in October 2017, pledging to lead a government for all despite her Labour Party falling well short of a majority in the previous month's general election.

She stitched together a three-way coalition. Her centre-left party trailed the previously ruling conservative National Party on election night, and required the combined support of the populist New Zealand First party and the Greens to confirm a majority government.

Ms Ardern campaigned on social issues including housing affordability and improved healthcare, and also listed raising the minimum wage, environmental issues, and tackling homelessness and child poverty among her priorities.

In 2018 Ms Ardern gave birth to her first child, making her only the second elected leader in modern history to give birth while in office. Benazir Bhutto gave birth to a daughter while serving as Pakistan's prime minister in 1990.

MEDIA



Broadcasters enjoy one of the world's most liberal media arenas.

The broadcasting sector was deregulated in 1988, when the government allowed competition to the state-owned Television New Zealand (TVNZ). Privately-owned TV3 is TVNZ's main competitor.

Satellite platform SKY TV is the leading pay TV provider. Freeview carries free-to-air digital terrestrial and satellite TV.

The New Zealand Herald newspaper has the biggest circulation.

- **[Read full media profile](#)**

TIMELINE



Waitangi Day is a national holiday

Some key dates in New Zealand's history.

c. 1200-1300 AD - Ancestors of the Maori arrive by canoe from other parts of Polynesia. Their name for the country is Aotearoa (land of the long white cloud).

1642 - Dutch explorer Abel Tasman sights the south island and charts some of the country's west coast. It subsequently appears on Dutch maps as Nieuw Zeeland, named after the Dutch province of Zeeland.

1769 - British captain James Cook explores coastline, also in 1773 and 1777.

1840 - Treaty of Waitangi between British and several Maori tribes pledges protection of Maori land and establishes British law in New Zealand.

1947 - New Zealand gains full independence from Britain.

Country Report

New Zealand

Generated on June 26th 2019

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The Economist Intelligence Unit

The Economist Intelligence Unit is a specialist publisher serving companies establishing and managing operations across national borders. For 60 years it has been a source of information on business developments, economic and political trends, government regulations and corporate practice worldwide. The Economist Intelligence Unit delivers its information in four ways: through its digital portfolio, where the latest analysis is updated daily; through printed subscription products ranging from newsletters to annual reference works; through research reports; and by organising seminars and presentations. The firm is a member of The Economist Group.

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Symbols for tables

"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

New Zealand

Summary

2 [Briefing sheet](#)

Outlook for 2019-23

4 [Political stability](#)

4 [Election watch](#)

5 [International relations](#)

5 [Policy trends](#)

6 [Fiscal policy](#)

6 [Monetary policy](#)

6 [International assumptions](#)

7 [Economic growth](#)

7 [Inflation](#)

8 [Exchange rates](#)

8 [External sector](#)

8 [Forecast summary](#)

9 [Quarterly forecasts](#)

Data and charts

10 [Annual data and forecast](#)

11 [Quarterly data](#)

12 [Monthly data](#)

13 [Annual trends charts](#)

14 [Quarterly trends charts](#)

15 [Monthly trends charts](#)

16 [Comparative economic indicators](#)

Summary

16 [Basic data](#)

18 [Political structure](#)

Recent analysis

Economy

21 [Forecast updates](#)

Briefing sheet

Editor: **Fung Siu**

Forecast Closing Date: **May 23, 2019**

Political and economic outlook

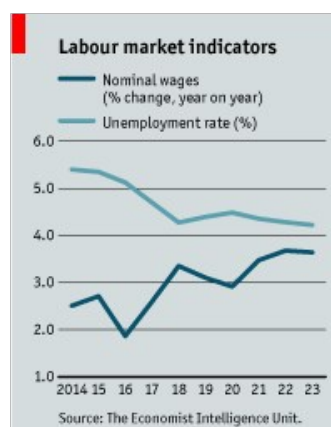
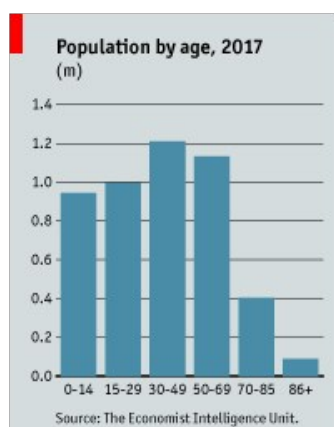
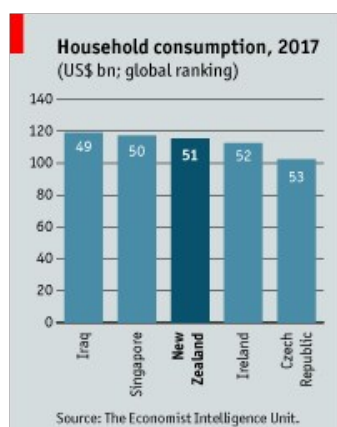
- The Economist Intelligence Unit expects the governing Labour-New Zealand First coalition to serve a full term until the next election in 2020. Tensions arising between the coalition partners over policy differences pose a downside risk to our political stability forecast.
- Security risk will be elevated in the near term, following a terrorist attack on March 15th. However, the incident will not pose a threat to political stability as we expect the government and security forces to remain in firm control.
- We expect the Reserve Bank of New Zealand (RBNZ, the central bank) to continue to loosen monetary policy during the remainder of 2019 and into 2020. The RBNZ will start to tighten policy in 2021 and will continue to raise interest rates gradually in 2022-23.
- We expect real GDP growth of 2.5% in 2019, followed by a sharp deceleration to 2.1% in 2020 owing to weaker external conditions. In 2021-23 real GDP growth will pick up modestly, to an average of 2.4% per year.
- Inflationary pressures will remain contained in 2019-20, owing in part to softer global oil prices, with consumer prices rising by 1.6% per year on average. As demand-side pressures re-emerge in 2021-23, consumer prices will increase by an annual average of 2.3%.
- The current account will remain in deficit in 2019-23, reflecting a persistent wide shortfall on the primary income account. However, we expect the current-account deficit to narrow to the equivalent of 2.2% of GDP in 2023, from 3.4% of GDP in 2019.

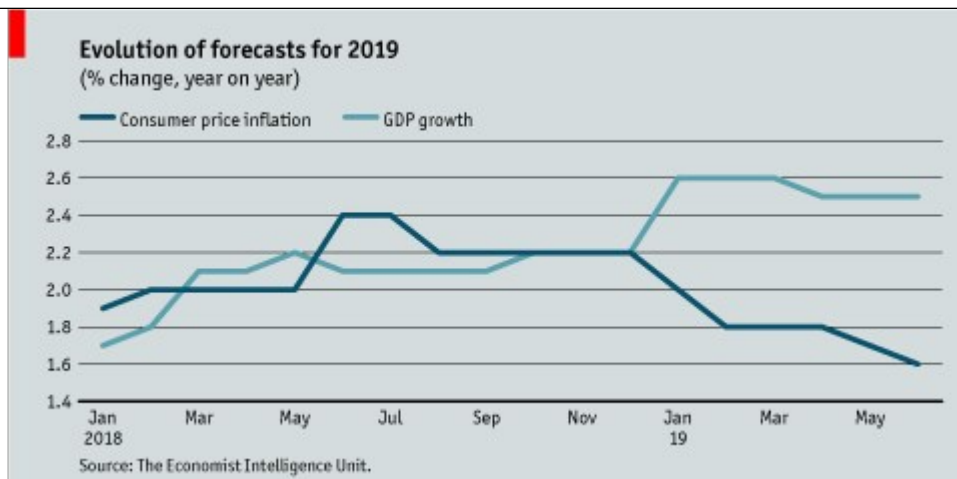
Key indicators

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth (%)	2.8	2.5	2.1	2.3	2.4	2.4
Consumer price inflation (av; %)	1.6	1.6	1.5	2.1	2.4	2.3
Government balance (% of GDP)	2.0	0.8	0.9	1.1	1.2	1.3
Current-account balance (% of GDP)	-3.6	-3.4	-3.2	-2.7	-2.2	-2.2
Money-market rate (av; %)	1.8	1.4	1.1	1.3	2.0	2.4
Unemployment rate (%)	4.3	4.4	4.5	4.4	4.3	4.2
Exchange rate NZ\$:US\$ (av)	1.44	1.50	1.52	1.49	1.47	1.46

^a Actual. ^b Economist Intelligence Unit forecasts.

Market opportunities





Key changes since May 10th

- In view of the latest data, we have revised downwards our forecast for consumer prices for 2019. We now expect consumer prices to increase by an average of 1.6%, compared with 1.7% previously.
- In view of the latest data, which point to much stronger producer price pressures than anticipated, we have revised our forecast for 2019. We now expect producer prices to increase by an average of 1.9%, compared with 1.6% previously.

The month ahead

- **May 30th—Budget for 2019/20 (July-June):** The second budget of the finance minister, Grant Robertson, will be the country's first "wellbeing" budget. We expect that the Labour-New Zealand First coalition will continue to target growing budget surpluses.
- **June 19th-20th—GDP and balance of payments (Q1):** Real GDP grew by 2.5% year on year in the final quarter of 2018. We expect growth to have quickened slightly in the first three months of 2019, but to slow in the second quarter amid sluggish external demand.
- **June 26th—RBNZ interest-rate decision:** The RBNZ trimmed its policy interest rate by 25 basis points following a monetary policy meeting in May. We expect the central bank to assess the impact of the recent cut and leave its policy interest rate unchanged.

Major risks to our forecast

Scenarios, Q2 2019	Probability	Impact	Intensity
Trade suffers a major blow owing to diplomatic tensions between China and New Zealand	Moderate	Very high	15
House prices fall sharply, impairing the health of the banking system	Low	Very high	10
Foreign investors are subject to a major cyber-attack	Moderate	Moderate	9
The new government's immigration policy creates greater labour shortages than anticipated	Moderate	Moderate	9
Accelerating inflation forces the central bank to tighten monetary policy sharply	Low	High	8

Note. Scenarios and scores are taken from our Risk Briefing product. Risk scenarios are potential developments that might substantially change the business operating environment over the coming two years. Risk intensity is a product of probability and impact, on a 25-point scale.

Source: The Economist Intelligence Unit.

Outlook for 2019-23

Political stability

New Zealand enjoys a generally stable political environment, supported by a well-established and transparent political process. The government is led by the prime minister and Labour Party leader, Jacinda Ardern, and has been in power since October 2017. As a minority government, the coalition between Labour and New Zealand First (NZ First) has to work closely with the Green Party, with which it has a confidence and supply agreement; it needs the party's support on any legislation that is opposed by the main opposition National Party.

Intra-coalition policy differences and the long-standing antipathy towards the Greens of the NZ First leader and deputy prime minister, Winston Peters, are likely to test the durability of the arrangements. During the remainder of its term in office, as the government takes decisions on politically divisive issues that have been under review, the risk of tensions between the coalition partners and the Greens will be high. However, The Economist Intelligence Unit expects the government to serve a full term; the next general election is not due until November 2020.

General elections are frequent (a typical parliamentary term lasts two or three years), but changes of administration tend to be smooth. In 2019-20, as an election draws near, the opposition will increasingly question the coalition's performance and highlight its shortcomings. One such line of attack is likely to be the government's promise to tackle the shortage of affordable housing, especially in major urban centres such as Auckland. It has made some progress with its flagship KiwiBuild scheme—a NZ\$2bn (US\$1.4bn) initiative to construct 100,000 affordable homes over ten years. However, the slow pace of the programme will incur further opposition criticism.

The government will continue to face formidable opposition from the National Party, which has 55 seats in parliament—the same number as Labour and NZ First combined. Having been in office from 2008 to 2017, National has many senior figures with experience in government. However, recent changes in its leadership have increased the likelihood that the party will succumb to political in-fighting over the next few years, blunting its effectiveness. The present leader, Simon Bridges, faced challenges from several senior party figures during the leadership election in February 2018. This suggests that he will struggle to unify the party and that the potential that he will be challenged for the leadership during the forecast period is high.

New Zealand suffered one of the deadliest attacks in recent history on March 15th, when a gunman shot worshippers at two mosques in Christchurch, killing 50 people and injuring 50 others. The attack has raised security concerns about the spread of extremist views in the country. However, Ms Ardern has been widely lauded for the sensitive and firm manner with which she has handled the situation. The resulting increase in public support for her will further consolidate her position within the Labour Party, which was already more comfortable than the precarious standing of Mr Bridges as leader of the Nationals. We believe that the Labour Party will reap benefits at the next election from Ms Ardern's high approval ratings.

Election watch

The next general election must be held by November 2020. New Zealand uses a system of mixed-member proportional representation, which makes coalition governments more likely. Mr Bridges and his deputy leader, Paula Bennett, both have Maori heritage. This could ensure that the National Party performs more strongly among the Maori electorate. However, the party's performance will be negatively affected if it continues to display a lack of internal unity in the run-up to the poll.

International relations

Australia will remain New Zealand's closest international partner, with bilateral ties underpinned by the 1983 Closer Economic Relations agreement. The two countries will continue to support one another in maintaining their regional power in the face of China's growing influence. In November 2018 the government committed to a Pacific Enabling Fund worth NZ\$10m (US\$6.9m), to foster sporting, cultural and personal engagement between New Zealand and the Pacific Islands. This highlights a greater commitment to the Pacific Islands, in response to China's increasingly active engagement with the region. The government's concerns about China's influence are likely to grow in the next few years.

New Zealand's diplomatic relations with China frayed in the second half of 2018, and we expect the relationship to remain volatile during the forecast period. In late November 2018, citing cybersecurity concerns, the New Zealand government blocked a domestic telecommunications services provider, Spark New Zealand, from using equipment produced by a Chinese firm, Huawei, for its fifth-generation (5G) network. Officials have since said that this does not constitute a ban, but we believe that this issue was at the root of China's decision to postpone the launch in February of a bilateral tourism initiative. However, given New Zealand's economic dependence on China (its largest export market), it will have limited willingness to take steps that will anger an important trade partner. This will restrict its capacity to support the US and other countries that take a hard line towards China.

New Zealand is one of seven (of 11) signatories to have ratified the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which came into force on December 30th 2018. New Zealand's exports will benefit during the first half of the forecast period from improved access to a wider market. Negotiations will continue during the forecast period on another mega-regional trade deal—the Regional Comprehensive Economic Partnership, which comprises Australia, China, India, Japan, New Zealand, South Korea and the ten members of the Association of South-East Asian Nations (ASEAN).

The US government's commitment to the Asia-Pacific region has generally weakened under the presidency of Donald Trump. New Zealand's relations with the US will be strained during Mr Trump's presidency, but we do not expect a major breakdown in ties.

Policy trends

Despite the creation of a Business Advisory Council in October 2018 to enhance engagement with the business community, we believe that companies will remain unsettled by the populist tone of many of the government's reforms, which will push up costs for firms. One particular concern is the government's longer-term plan to target a reduction in net immigration of 20,000-30,000 people per year, by tightening access to work and international student visas. This could lead to labour shortages, particularly of lower-skilled workers.

In February the government announced a plan to create an Infrastructure Commission that will be tasked with identifying infrastructure deficiencies and finding ways to overcome them. The commission is expected to be operational in the second half of 2019.

The government is pursuing measures to tackle climate change. It is targeting net zero carbon emissions by 2050 and will establish an independent Climate Change Commission to help it to reach this goal. In April 2018 the coalition announced that it had introduced an immediate ban on new offshore oil and gas exploration permits. However, offshore exploration will be allowed in areas with existing permits, and onshore permits will continue to be granted in the Taranaki region (the centre of the oil and gas industry) until at least 2021.

Fiscal policy

Current and future governments will maintain a prudent fiscal approach, aiming to achieve budget surpluses during the forecast period. In the latest Half-Year Economic and Fiscal Update, the Treasury has trimmed its forecast for the fiscal surplus in 2018/19 (July-June) to NZ\$1.7bn (0.6% of GDP). The adjustment mainly reflects spending delays in 2017/18, which contributed to a wider than expected budget surplus in that fiscal year. That expenditure has been carried forward to the current fiscal year, thereby reducing the surplus. The Treasury expects the surplus to rise to NZ\$8.4bn (2.3% of GDP) by 2022/23, as the increase in tax revenue will outstrip the rise in expenditure in the latter part of the forecast period. We forecast that the budget surplus will expand gradually from the equivalent of 0.8% of GDP in 2019 to 1.3% of GDP in 2023. (Our forecasts for New Zealand are based on calendar, rather than fiscal, years.) Our estimates are more conservative than those of the government, as our economic growth expectations are less optimistic. However, a return to deficit is unlikely in the absence of a significant economic shock.

Monetary policy

We expect the Reserve Bank of New Zealand (RBNZ, the central bank) to keep its main policy interest rate, the official cash rate, unchanged at 1.5% until at least the third quarter of this year. It will take time to assess the impact of its decision to trim the official cash rate by 25 basis points on May 8th. In 2019 consumer price inflation will stay below the mid-point of the RBNZ's 1-3% target band. Given the prevailing softness in house prices, we expect the RBNZ to ease monetary policy further from September, especially if there is a sharper than anticipated downturn in the property market. The central bank will, nevertheless, be mindful that lower interest rates could induce households, which are already highly indebted, to borrow more, and this would increase the risks to financial sector stability. In 2020, as external demand conditions deteriorate further on the back of a slowdown in the US, the RBNZ is expected to continue to loosen policy. The central bank will start to tighten monetary policy gradually in 2021, in response to rising consumer price inflation.

International assumptions

	2018	2019	2020	2021	2022	2023
Economic growth (%)						
US GDP	2.9	2.2	1.7	1.8	2.0	1.7
OECD GDP	2.2	1.7	1.6	1.8	1.9	1.8
World GDP	2.9	2.6	2.6	2.8	2.9	2.8
World trade	4.4	3.3	2.9	3.9	4.0	4.1
Inflation indicators (% unless otherwise indicated)						
US CPI	2.4	2.2	1.4	2.2	2.1	1.8
OECD CPI	2.5	2.2	1.9	2.1	2.1	2.1
Manufactures (measured in US\$)	4.9	2.1	3.3	3.5	3.2	3.0
Oil (Brent; US\$/b)	71.1	66.5	60.5	69.8	75.6	75.0
Non-oil commodities (measured in US\$)	1.9	-4.4	3.5	3.0	2.0	0.7
Financial variables						
US\$ 3-month commercial paper rate (av; %)	2.0	2.6	2.2	2.1	2.5	2.9
¥ 3-month money-market rate (av; %)	0.1	0.1	0.1	0.2	0.2	0.3
¥:US\$ (av)	110.4	110.0	108.7	104.9	100.5	96.1
NZ\$:US\$ (av)	1.44	1.50	1.52	1.49	1.47	1.46

Economic growth

In 2019 economic expansion will be slightly slower, at 2.5%, compared with 2.8% in 2018, owing to weaker domestic demand and slower world trade growth. However, the increase in the population, coupled with the RBNZ's loosening monetary policy stance, will help to shore up private consumption growth (the largest component of GDP). The government's investment in housing and infrastructure projects will also contribute to economic expansion. However, weak business confidence, stemming from concerns about populist government policy, is likely to weigh on private investment growth.

In 2020 weaker external conditions (resulting from slower world trade growth, sub-par growth in the US economy and a continued slowdown in the Chinese economy) will cause New Zealand's real GDP growth to decelerate to 2.1%. Both China and the US are major destinations for New Zealand's exports, accounting for 24% and 10% of total exports respectively in 2018. There will be a modest pick-up in growth over the remainder of the forecast period, with an average annual rate of expansion of 2.4% in 2021-23.

We believe that the economy's underlying fundamentals will remain strong throughout the forecast period. However, one major source of uncertainty is the housing market, which has started to show signs of a correction. If house prices were to fall sharply (not our core forecast), consumer confidence would suffer and economic growth would be weaker than we currently expect.

Economic growth

%	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
GDP	2.8	2.5	2.1	2.3	2.4	2.4
Private consumption ^c	3.3	2.8	2.4	2.5	2.3	2.4
Government consumption ^c	2.2	3.1	2.8	2.5	2.6	2.8
Gross fixed investment ^c	3.9	3.0	2.2	2.4	2.2	2.6
Exports of goods & services ^c	3.0	2.8	2.3	3.0	2.9	3.4
Imports of goods & services ^c	5.6	3.7	2.5	3.2	2.6	3.1
Domestic demand ^c	3.5	2.8	2.2	2.4	2.3	2.4
Agriculture	1.9	1.6	1.3	1.6	2.0	2.0
Industry	1.0	1.7	1.4	1.5	2.2	2.2
Services	3.3	2.6	2.2	2.5	2.4	2.4

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Seasonally adjusted.

Inflation

We have revised our consumer price inflation forecast for 2019 in the light of recent data. We now expect consumer prices to increase by an average of 1.6% in 2019, compared with 1.7% previously. The upward pressure on consumer prices stemming from the higher cost of imported goods (owing to the effects of a weaker exchange rate for the New Zealand dollar against the US dollar) will be partly offset by softer global oil prices. Growth in consumer prices will decelerate slightly in 2020, owing to weak demand conditions, resulting from a slowdown in the US economy in that year. Prices will rise at a faster pace in the latter part of the forecast period amid a modest pick-up in domestic demand growth. Consumer price inflation will average 2.3% per year in 2021-23, with a tightening of monetary policy ensuring that price growth remains within the central bank's target range of 1-3%.

Exchange rates

The New Zealand dollar's exchange rate against its US counterpart will depreciate in 2019, averaging NZ\$1.5:US\$1 over the year. However, we expect the Federal Reserve (the Fed, the US central bank) to maintain a dovish monetary policy stance this year, which will help to avert one potential source of downward pressure on the local exchange rate. Nonetheless, the sizeable current-account deficit will continue to exert depreciatory pressure on the New Zealand dollar. In 2020 below-trend growth in the US will prompt the Fed to begin cutting rates. We therefore expect a modest appreciation in the New Zealand dollar in 2021-23 as the differential between local and US interest rates narrows in favour of that currency.

External sector

The country has run a persistently wide current-account deficit in recent years, mainly because of large shortfalls on the merchandise trade and primary income accounts. A surplus on the services account partly offsets this deficit. We expect the current-account deficit to narrow gradually, from the equivalent of 3.6% of GDP in 2018 to 2.2% of GDP in 2023, in line with an improvement in the merchandise trade balance.

We expect the trade deficit to narrow in 2019-23. Merchandise export growth will outpace the rise in imports, which will be held back by weaker domestic demand. We expect domestic demand to grow by an average of 2.4% per year in 2019-23, compared with 4% in 2014-18. Softer global oil prices and (in 2021-23) a modest appreciation of the New Zealand dollar will help to constrain the expansion of the import bill.

The primary income account will remain firmly in deficit, reflecting the cost of servicing the substantial stock of foreign debt, the low rate of domestic saving and the repatriation of profits by foreign-owned companies. Nonetheless, international interest rates will remain low by historical standards, ensuring only a gradual increase in the cost of servicing New Zealand's external liabilities.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth	2.8	2.5	2.1	2.3	2.4	2.4
Unemployment rate (av)	4.3	4.4	4.5	4.4	4.3	4.2
Consumer price inflation (av)	1.6	1.6	1.5	2.1	2.4	2.3
Consumer price inflation (end-period)	1.9	1.6	1.6	2.3	2.5	2.2
Lending interest rate	9.4	9.1	8.8	8.9	9.3	9.7
Government balance (% of GDP) ^c	2.0	0.8	0.9	1.1	1.2	1.3
Exports of goods fob (US\$ bn)	39.8	40.6	41.7	45.8	49.3	53.1
Imports of goods fob (US\$ bn)	43.3	43.5	44.4	47.7	50.1	53.5
Current-account balance (US\$ bn)	-7.4	-6.9	-6.7	-6.0	-5.2	-5.5
Current-account balance (% of GDP)	-3.6	-3.4	-3.2	-2.7	-2.2	-2.2
External debt (end-period; US\$ bn)	92.1 ^d	95.6	102.1	108.3	114.5	120.2
Exchange rate NZ\$:US\$ (av)	1.44	1.50	1.52	1.49	1.47	1.46
Exchange rate NZ\$:US\$ (end-period)	1.49	1.53	1.51	1.48	1.45	1.45
Exchange rate NZ\$:¥100 (av)	1.31	1.36	1.40	1.42	1.46	1.51
Exchange rate NZ\$:€ (end-period)	1.70	1.75	1.81	1.81	1.81	1.81

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Fiscal years (ending June 30th of year shown).

^d Economist Intelligence Unit estimates.

Quarterly forecasts

Quarterly forecasts

	2018				2019				2020			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	0.5	1.0	0.4	0.5	0.7	0.7	0.4	0.7	0.5	0.5	0.5	0.5
% change, year on year	2.9	3.2	2.6	2.5	2.7	2.4	2.4	2.6	2.3	2.1	2.2	2.0
Private consumption												
% change, quarter on quarter	0.2	1.0	1.0	1.3	-	-	-	-	-	-	-	-
% change, year on year	3.2	3.1	3.3	3.5	-	-	-	-	-	-	-	-
Government consumption												
% change, quarter on quarter	0.4	1.3	-0.5	0.7	-	-	-	-	-	-	-	-
% change, year on year	2.3	3.6	0.8	2.0	-	-	-	-	-	-	-	-
Gross fixed investment												
% change, quarter on quarter	1.3	-0.5	-1.1	1.4	-	-	-	-	-	-	-	-
% change, year on year	7.2	5.6	1.9	1.1	-	-	-	-	-	-	-	-
Exports of goods & services												
% change, quarter on quarter	-0.1	2.0	-0.3	1.1	-	-	-	-	-	-	-	-
% change, year on year	4.0	3.2	2.2	2.7	-	-	-	-	-	-	-	-
Imports of goods & services												
% change, quarter on quarter	1.2	1.2	-0.9	-0.7	-	-	-	-	-	-	-	-
% change, year on year	8.2	8.8	5.1	0.8	-	-	-	-	-	-	-	-
Domestic demand												
% change, quarter on quarter	0.9	0.3	-0.1	1.2	-	-	-	-	-	-	-	-
% change, year on year	4.0	4.4	3.5	2.3	-	-	-	-	-	-	-	-
Consumer prices												
% change, quarter on quarter	0.5	0.4	0.9	0.1	0.1	0.6	0.7	0.2	0.0	0.6	0.6	0.4
% change, year on year	1.1	1.5	1.9	1.9	1.5	1.7	1.5	1.6	1.5	1.5	1.4	1.6
Producer prices												
% change, quarter on quarter	0.2	0.9	1.5	0.7	-0.5	0.2	1.3	0.8	0.0	0.5	0.7	0.6
% change, year on year	3.5	3.1	3.6	3.3	2.6	1.9	1.6	1.7	2.2	2.5	1.9	1.8
Exchange rate NZ\$:US\$												
Average	1.37	1.42	1.50	1.49	1.47	1.50	1.51	1.53	1.53	1.52	1.52	1.51
End-period	1.38	1.48	1.51	1.49	1.47	1.50	1.52	1.53	1.53	1.52	1.51	1.51
Interest rates (%; av)												
Money-market rate	1.8	1.8	1.8	1.8	1.8	1.5	1.3	1.3	1.2	1.0	1.0	1.0
Long-term bond yield	2.9	2.8	2.7	2.6	2.2	1.9	1.9	1.8	1.9	2.0	2.0	2.0

Data and charts

Annual data and forecast

	2014 ^a	2015 ^a	2016 ^a	2017 ^a	2018 ^a	2019 ^b	2020 ^b
GDP							
Nominal GDP (US\$ m)	199,702	175,410	185,127	200,580	203,176	202,559	208,609
Nominal GDP (NZ\$ m)	240,419	250,469	265,491	282,083	293,204	303,873	316,928
Real GDP growth (%)	3.1	4.0	4.2	2.7	2.8	2.5	2.1
Expenditure on GDP (% real change)							
Private consumption	3.1	3.6	5.3	4.8	3.3	2.8	2.4
Government consumption	3.4	2.5	2.0	2.9	2.2	3.1	2.8
Gross fixed investment	9.2	3.8	4.3	3.4	3.9	3.0	2.2
Exports of goods & services	3.3	7.4	2.1	1.8	3.0	2.8	2.3
Imports of goods & services	7.9	4.0	3.3	6.9	5.6	3.7	2.5
Origin of GDP (% real change)							
Agriculture	4.9	3.5	1.8	1.2	1.9	1.6	1.3
Industry	4.5	2.8	3.7	2.2	1.0	1.7	1.4
Services	3.1	3.4	4.0	3.5	3.3	2.6	2.2
Population and income							
Population (m)	4.5	4.6	4.7	4.8	4.9	4.9	5.0
GDP per head (US\$ at PPP)	36,975	36,908	38,512	40,116	41,482	42,741	43,943
Fiscal indicators (% of GDP)							
General government revenue	37.1	37.7	37.0	36.7	37.5	37.0	36.9
General government expenditure	38.2	37.4	36.1	35.1	35.5	36.2	36.0
General government balance	-1.1	0.3	0.9	1.6	2.0	0.8	0.9
Public debt ^c	34.1	34.4	32.7	30.9	29.8	28.7	27.6
Prices and financial indicators							
Exchange rate NZ\$:US\$ (end-period)	1.28	1.46	1.44	1.41	1.49	1.53	1.51
Exchange rate ¥:NZ\$ (end-period)	93.83	82.36	81.37	79.98	73.70	72.19	71.05
Consumer prices (end-period; % change)	0.7	0.1	1.3	1.6	1.9	1.6	1.6
Producer prices (av; % change)	1.1	-1.3	0.8	4.8	3.4	1.9	2.1
Stock of money M1 (% change)	6.2	8.9	9.6	8.7	9.6	6.8	7.1
Stock of money M2 (% change)	6.7	9.9	7.7	7.3	6.4	5.5	5.3
Lending interest rate (av; %)	10.0	10.0	9.3	9.3	9.4	9.1	8.8
Current account (US\$ m)							
Trade balance	961	-1,358	-1,890	-1,558	-3,428	-2,939	-2,698
Goods: exports fob	41,962	34,428	33,645	38,180	39,834	40,561	41,720
Goods: imports fob	-41,000	-35,786	-35,535	-39,737	-43,263	-43,500	-44,418
Services balance	1,401	3,119	3,480	3,483	3,433	3,219	3,057
Primary income balance	-8,186	-6,411	-5,549	-7,471	-7,178	-6,948	-6,817
Secondary income balance	-369	-219	-237	-328	-222	-221	-228
Current-account balance	-6,193	-4,869	-4,196	-5,873	-7,395	-6,889	-6,686
External debt (US\$ m)							
Debt stock	93,915 ^d	86,057 ^d	87,550 ^d	92,991 ^d	92,144 ^d	95,569	102,078
Debt service paid	14,906 ^d	15,634 ^d	14,508 ^d	15,008 ^d	16,202 ^d	15,675	15,958
Principal repayments	12,738 ^d	13,750 ^d	12,600 ^d	12,818 ^d	13,615 ^d	12,705	12,810
Interest	2,168 ^d	1,884 ^d	1,909 ^d	2,190 ^d	2,587 ^d	2,970	3,148
International reserves (US\$ m)							
Total international reserves	15,861	14,700	17,808	20,684	17,657	18,624	18,988

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Fiscal years (ending June 30th of year shown). ^d

Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

Quarterly data

	2017			2018				2019
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Output^a								
GDP at chained 2009/10 prices (NZ\$ m)	59,759	60,354	60,763	61,054	61,667	61,943	62,265	n/a
GDP at chained 2009/10 prices (% change, year on year)	2.3	2.8	2.9	2.9	3.2	2.6	2.5	n/a
Industrial production index (2010=100)	104.7	104.6	102.7	103.9	105.4	104.8	103.0	n/a
Industrial production index (% change, year on year)	6.0	3.1	-0.2	1.4	0.7	0.2	0.3	n/a
Employment, wages and prices								
Employment ('000) ^a	2,540	2,588	2,603	2,620	2,634	2,661	2,662	2,658
Employment (% change, year on year) ^a	3.1	4.1	3.7	3.1	3.7	2.8	2.3	1.5
Unemployment rate (% of labour force) ^a	4.7	4.7	4.5	4.4	4.4	4.0	4.3	4.2
Hourly earnings (av; NZ\$)	30.2	30.5	30.7	31.0	31.1	31.4	31.7	n/a
Hourly earnings (av; % change, year on year)	1.6	2.2	3.2	3.6	3.1	2.9	3.1	n/a
Consumer prices (% change, year on year)	1.7	1.9	1.6	1.1	1.5	1.9	1.9	1.5
Producer prices (% change, year on year)	5.2	5.3	4.7	3.5	3.1	3.6	3.3	n/a
Financial indicators								
Exchange rate								
NZ\$:US\$ (av)	1.42	1.37	1.44	1.37	1.42	1.50	1.49	1.47
NZ\$:US\$ (end-period)	1.37	1.38	1.41	1.38	1.48	1.51	1.49	1.47
Deposit rate (av; %)	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Lending rate (av; %)	9.4	9.4	9.4	9.4	9.4	9.3	9.4	9.4
3-month money-market rate (av; %)	1.7	1.6	1.6	1.7	1.7	1.7	1.7	n/a
M1 (end-period; NZ\$ m)	59,808	61,146	65,542	67,077	66,670	67,345	71,855	71,001
M2 (end-period; NZ\$ m)	278,031	281,276	292,600	295,333	297,798	302,781	311,399	312,159
Stockmarket index NZSX-50 (end-period; Feb 28th 2003=1,880.85)	7,611	7,930	8,398	8,319	8,943	9,351	8,811	9,845
Foreign trade (NZ\$ m)								
Exports fob	14,307	12,101	14,677	13,517	15,195	13,565	14,975	n/a
Imports cif	13,456	14,349	16,126	14,142	15,081	16,915	17,275	n/a
Trade balance	851	-2,248	-1,449	-625	114	-3,350	-2,300	n/a
Balance of payments (US\$ m)								
Merchandise trade balance fob-fob	726.9	-1,571.3	-829.0	-280.1	136.0	-2,143.4	n/a	n/a
Services balance	580.3	-26.3	832.6	2,357.6	642.7	-217.9	n/a	n/a
Primary income balance	-1,559.4	-2,071.5	-2,056.0	-1,919.7	-1,852.1	-1,713.7	n/a	n/a
Net transfer payments	-188.0	-97.8	69.0	-93.1	-76.8	-51.5	n/a	n/a
Current-account balance	-440.2	-3,766.9	-1,983.4	64.7	-1,150.2	-4,126.5	n/a	n/a
Reserves excl gold (end-period)	20,138.0	21,264.0	20,684.0	21,714.0	21,736.0	20,264.0	17,657.0	18,806.0

^a Seasonally adjusted.

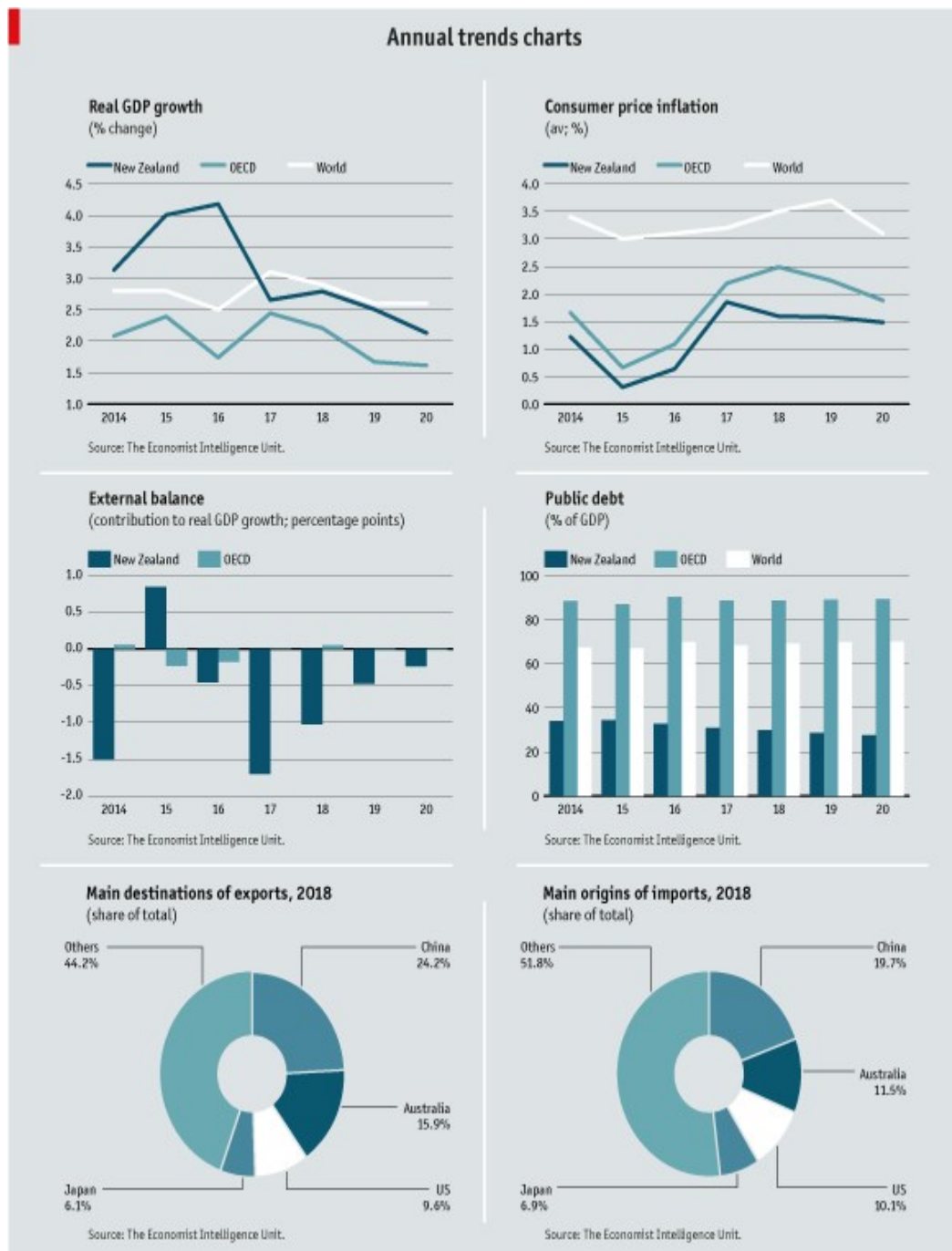
Sources: Reserve Bank of New Zealand; Statistics New Zealand; IMF, International Financial Statistics; OECD, Main Economic Indicators.

Monthly data

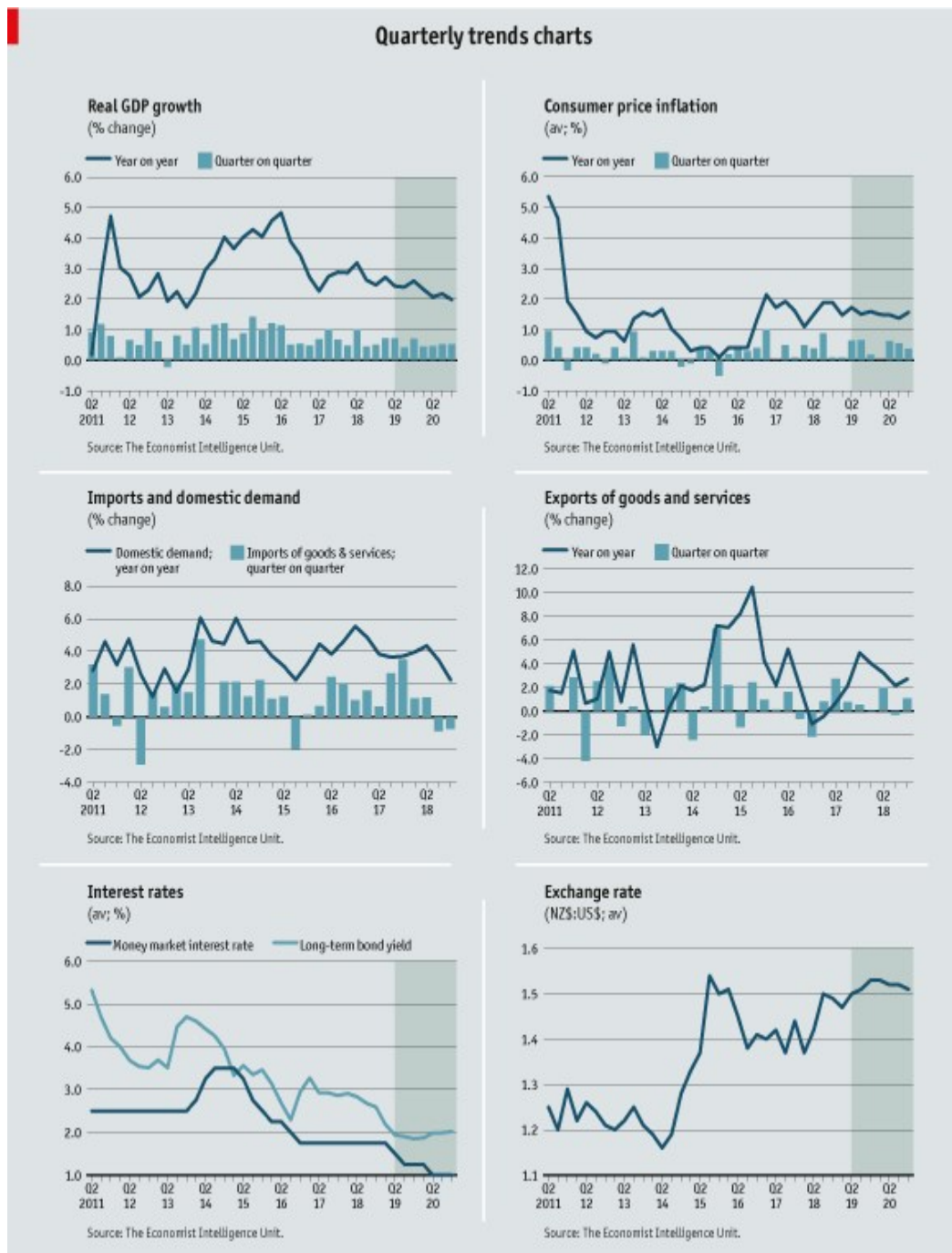
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate NZ\$:US\$ (av)												
2017	1.40	1.38	1.43	1.43	1.44	1.38	1.36	1.37	1.38	1.42	1.45	1.44
2018	1.38	1.37	1.38	1.38	1.44	1.44	1.47	1.50	1.52	1.53	1.48	1.47
2019	1.47	1.46	1.46	1.49	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate NZ\$:US\$ (end-period)												
2017	1.36	1.38	1.43	1.46	1.41	1.37	1.33	1.39	1.38	1.46	1.46	1.41
2018	1.36	1.38	1.38	1.42	1.43	1.48	1.47	1.51	1.51	1.53	1.45	1.49
2019	1.44	1.47	1.47	1.50	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Real effective exchange rate (2010=100; CPI basis)												
2017	111.19	111.89	108.47	107.32	106.19	109.55	110.10	107.98	106.12	104.65	102.30	102.65
2018	104.51	104.59	104.09	104.46	102.17	103.05	101.97	101.13	100.09	99.86	103.70	104.76
2019	103.08	103.85	103.84	102.42	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M1 (% change, year on year)												
2017	11.13	11.36	6.90	8.65	9.52	7.54	9.30	8.22	9.32	9.46	9.80	8.72
2018	10.09	10.49	12.06	9.79	9.51	11.47	8.84	12.68	10.14	7.91	8.17	9.63
2019	7.24	6.88	5.85	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M2 (% change, year on year)												
2017	7.36	6.48	6.35	6.09	6.04	6.28	6.46	6.54	6.97	7.04	7.31	7.30
2018	7.30	7.48	7.23	6.99	6.76	7.11	6.91	7.57	7.65	6.61	6.41	6.42
2019	5.92	5.85	5.70	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Official cash rate (end-period; %)												
2017	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
2018	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
2019	1.75	1.75	1.75	1.75	1.50	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2017	9.19	9.25	9.36	9.36	9.34	9.38	9.38	9.36	9.37	9.36	9.38	9.33
2018	9.33	9.41	9.41	9.38	9.39	9.35	9.39	9.30	9.30	9.30	9.38	9.37
2019	9.42	9.42	9.46	9.45	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Stockmarket index NZSX-50 (end-period; Feb 28th 2003=1,880.85)												
2017	7,051	7,167	7,197	7,379	7,419	7,611	7,694	7,817	7,930	8,146	8,187	8,398
2018	8,442	8,374	8,319	8,444	8,659	8,943	8,922	9,313	9,351	8,752	8,824	8,811
2019	8,985	9,325	9,845	10,014	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (NZ\$ m)												
2017	5,518	5,553	6,551	6,758	7,063	6,487	6,280	5,050	5,224	6,471	6,699	7,907
2018	5,886	6,084	6,609	6,856	7,695	7,027	7,861	5,961	6,445	7,387	7,167	7,756
2019	6,407	6,893	8,333	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (NZ\$ m)												
2017	5,836	5,612	6,177	5,973	6,974	6,151	6,155	6,658	6,829	7,664	8,475	7,026
2018	6,798	5,827	6,817	6,580	7,408	7,438	8,160	8,310	8,840	9,383	8,649	7,742
2019	7,784	6,993	6,984	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (NZ\$ m)												
2017	-318	-59	373	785	89	336	125	-1,608	-1,605	-1,193	-1,775	882
2018	-912	258	-207	276	287	-411	-299	-2,349	-2,395	-1,996	-1,481	13
2019	-1,377	-100	1,349	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2017	18,690	18,435	18,560	18,400	18,972	20,138	18,564	19,927	21,264	22,478	22,258	20,684
2018	21,499	20,722	21,714	20,636	21,429	21,736	20,371	20,916	20,264	18,111	18,080	17,657
2019	20,388	19,686	18,806	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

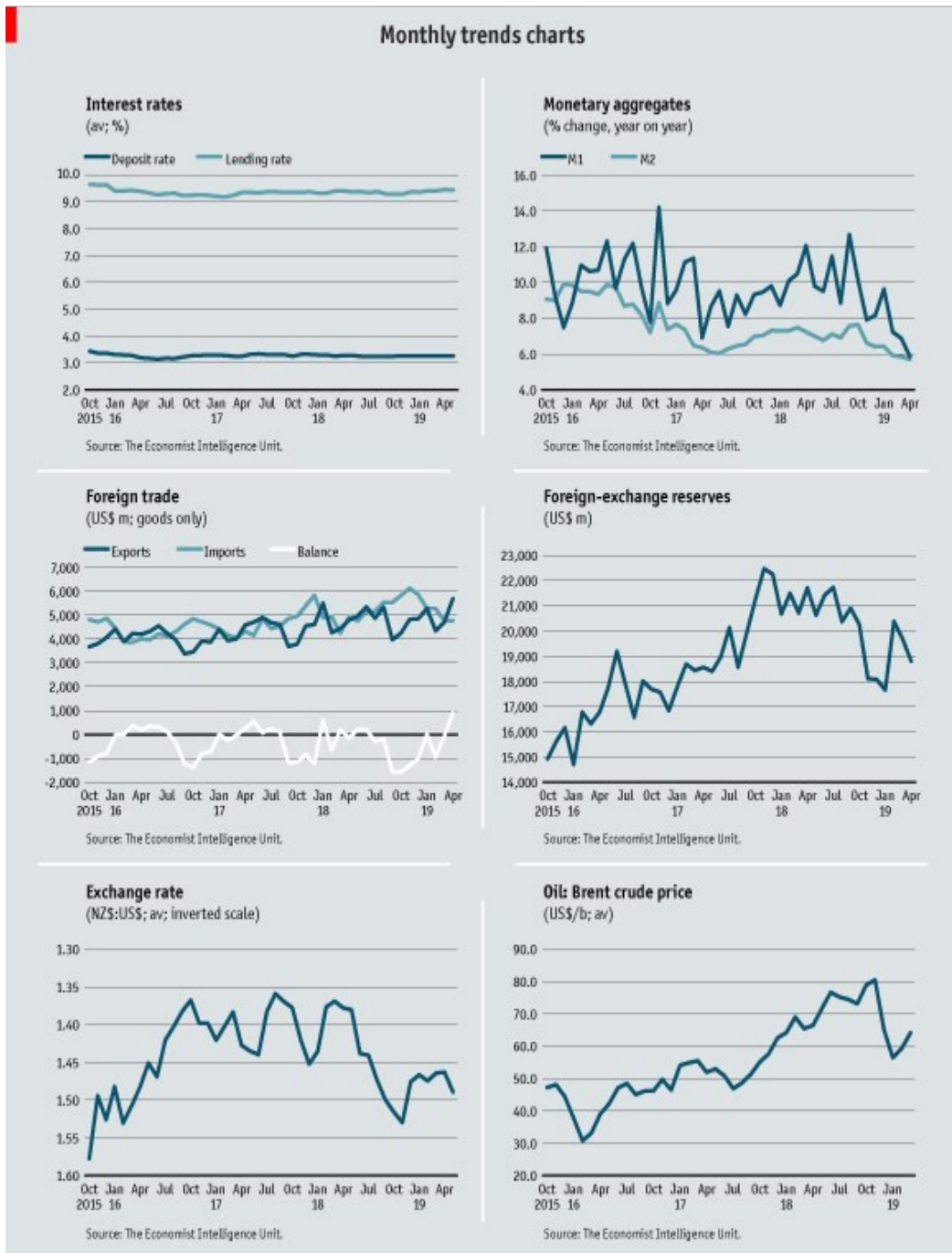
Annual trends charts



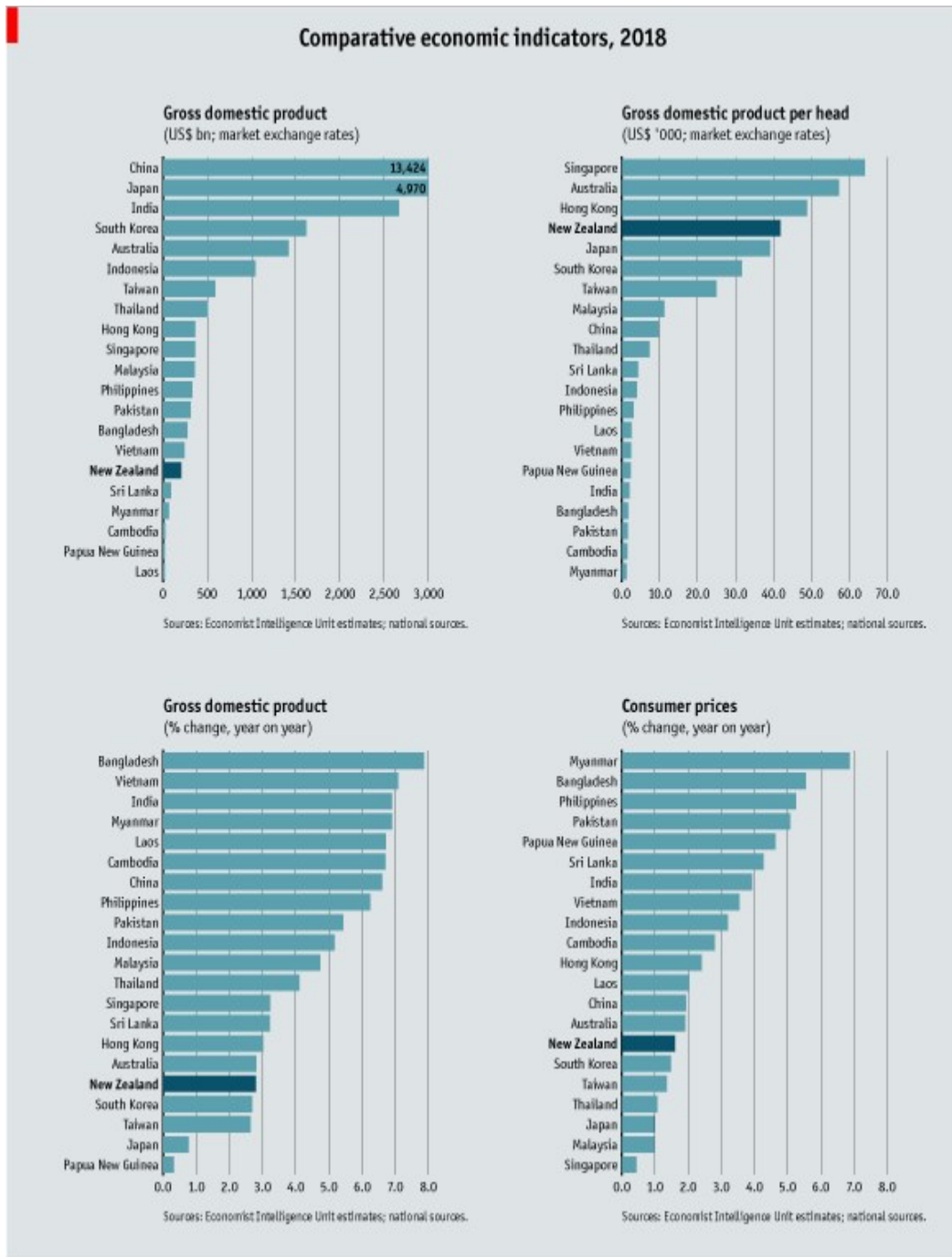
Quarterly trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

270,534 sq km, comprising two main islands, North and South, and several smaller islands

Population

4.8m (2018; Statistics New Zealand estimate)

Urban areas

Population in '000 (mid-2016; Statistics New Zealand estimates):

Auckland: 1,495

Christchurch: 390

Wellington (capital): 207

Hamilton: 194

Tauranga: 135

Dunedin: 119

Climate

Temperate

Weather in Wellington (altitude 126 metres)

Hottest months, January-February, 13-20°C; coldest month, July, 6-11°C (average daily minimum and maximum); driest months, November-February, 87 mm average rainfall; wettest month, July, 143 mm average rainfall; average annual rainfall, 1,240 mm

Language

English; Maori has official status

Measures

Metric system

Currency

New Zealand dollar (NZ\$); NZ\$1 = 100 cents. Average exchange rate in 2018: NZ\$1.44:US\$1

Fiscal year

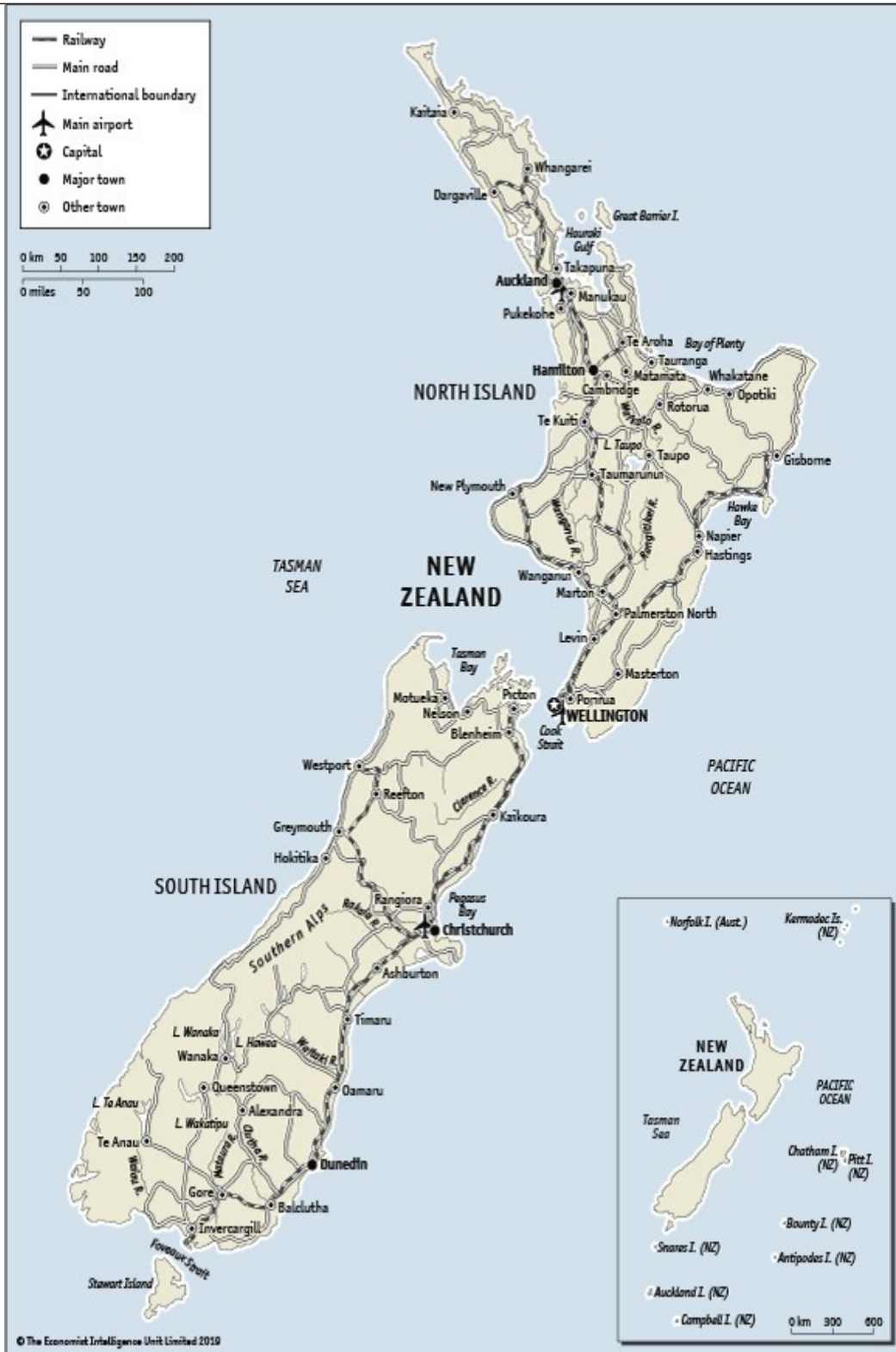
July-June

Time

12 hours ahead of GMT; New Zealand summer time is 13 hours ahead of GMT

Public holidays

January 1st-2nd (New Year); February 6th (Waitangi Day); April 19th (Good Friday); April 22nd (Easter Monday); April 25th (ANZAC Day); June 3rd (Queen's birthday); October 28th (Labour Day); December 25th (Christmas); December 26th (Boxing Day)



Political structure

Official name

New Zealand

Form of state

Parliamentary monarchy

National legislature

Unicameral House of Representatives, 120 members; elected for a three-year term using mixed-member proportional representation

Electoral system

Universal direct suffrage over the age of 18

National elections

The most recent general election took place in September 2017. The next election must be held by November 2020

Head of state

Queen Elizabeth II, represented in New Zealand by the governor-general, Patsy Reddy

National government

The cabinet is presided over by the prime minister, who is appointed by the governor-general on the basis of party strength in parliament. Labour is the leading party in the governing coalition. It is supported by the junior partner, New Zealand First. The coalition government has a confidence and supply agreement with the Green Party

Main political parties

National Party (55 seats); Labour Party (46 seats); New Zealand First (nine seats); Green Party (eight seats); ACT New Zealand (one seat)

Government

Prime minister, minister for national security & intelligence, child poverty reduction, arts, culture & heritage: Jacinda Ardern

Deputy prime minister, minister for foreign affairs, state-owned enterprises & racing: Winston Peters

Ministers

Agriculture & rural communities: Damien O'Connor

Civil defence: Kris Faafoi

Defence: Ron Mark

Economic development, environment, trade & export growth, attorney-general: David Parker

Education: Chris Hipkins

Employment: Willie Jackson

Energy & resources: Megan Woods

Ethnic communities, building & construction: Jenny Salesa

Finance, sport & recreation: Grant Robertson

Health: David Clark

Housing & urban development, transport: Phil Twyford

Immigration, Accident Compensation Corporation, workplace relations & safety: Iain Lees-Galloway

Internal affairs: Tracey Martin

Justice & courts: Andrew Little

Recent analysis

Generated on June 26th 2019

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

Economy

Forecast updates

Central bank censures New Zealand's biggest bank

May 17, 2019: Economic growth

Event

On May 17th the Reserve Bank of New Zealand (RBNZ, the central bank) announced that it was censuring ANZ Bank New Zealand and revoking its right to set its own risk capital requirements, owing to "a persistent failure in its controls and attestation process".

Analysis

The move is a remarkable step for regulators to take against Australia-headquartered ANZ, which is New Zealand's largest bank by assets. The move came after regulators uncovered that ANZ New Zealand had apparently not used the operational risk capital model that had been accredited by the RBNZ since 2014. In a regulatory filing the bank noted that this occurred when its parent company, ANZ, switched to a different model without first ensuring that the regulatory approvals were in place in New Zealand. Forced to use the standardised approach for risk capital weighting, ANZ will need to increase the minimum capital held for risk management by around 60%, to NZ\$760m (US\$517m).

The RBNZ's announcement comes at a time when it has already been pressuring New Zealand's banks (all of which are owned by Australian parent companies) to hold more risk capital within New Zealand. This approach is designed to reduce the risks associated with possible financial turbulence in New Zealand, Australia or elsewhere in the world. According to the RBNZ's latest *Financial Stability Report* (published in November 2018), the total ratio of capital to risk-weighted assets stood at 14% at end-September 2018, well above the required 10.5% under Basel III standards. However, the RBNZ in February proposed an increase in capital ratios to 16% over five years. If implemented, such an increase in risk capital is likely to have a negative effect on lending in New Zealand, which could slow economic activity.

Impact on the forecast

We do not believe that the censuring of ANZ New Zealand will have a material impact on our forecast for 3% real growth in gross fixed capital investment in 2019.

Government unveils first “wellbeing” budget

May 31, 2019: Fiscal policy outlook

Event

On May 30th the finance minister, Grant Robertson, presented the budget for fiscal year 2019/20 (July-June), the Labour-New Zealand First coalition's first "wellbeing" budget.

Analysis

The budget, the second to be handed down by Mr Robertson, revealed that the public finances remain in good shape. This has encouraged the government to lift the allowance for new operating spending in 2019/20 to NZ\$3.8bn (US\$2.5bn), from NZ\$2.4bn in the *Half-Year Economic and Fiscal Update (HYEFU)*, published in December. It has also increased the allowance for new spending in 2020/21, to NZ\$3bn, from NZ\$2.4bn in the *HYEFU*. In keeping with the theme of the "wellbeing" budget, much of the new spending will be directed at supporting mental health, improving the welfare of children and reducing child poverty. There was also a significant increase in funding for health and social development initiatives aimed at Maori groups, another "wellbeing" priority.

The other key announcements were increased funding for rail projects and a change in the indexation of the main social security benefits, which will now increase in line with average wages, rather than consumer price inflation. As we expected, there were no changes to personal or corporate tax rates in the budget, and little in the way of measures likely to lift business confidence, which remains subdued.

The Treasury has revised up its estimate for the operating balance before gains and losses (OBEGAL) in 2018/19 to a surplus of 1.2% of GDP, but has made significant downward revisions to its surplus projections thereafter, compared with those in the *HYEFU*. It now projects that the surplus will narrow to 0.4% of GDP in 2019/20 before widening gradually to 1.7% of GDP by 2022/23. The smaller budget targets mainly reflect the spending increases announced in the budget. The Treasury's economic growth forecasts are little changed overall and remain more optimistic than our own.

Impact on the forecast

We continue to forecast small budget surpluses over the forecast period. In view of the government's latest budget, we are likely to make a modest downward adjustment to our forecast for the size of these surpluses in 2019/20 and 2020/21, although a return to deficit is unlikely.

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The Pacific Islands: Policy Issues

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Summary

The Pacific Islands region, also known as the South Pacific or Southwest Pacific, presents Congress with a diverse array of policy issues. It is a strategically important region with which the United States shares many interests with Australia and New Zealand. The region has attracted growing diplomatic and economic engagement from China, a potential competitor to the influence of the United States, Australia, and New Zealand. Congress plays key roles in approving and overseeing the administration of the Compacts of Free Association that govern U.S. relations with the Marshall Islands, Micronesia, and Palau. The United States has economic interests in the region, particularly fishing, and provides about \$38 million annually in bilateral and regional foreign assistance, not including Compact grant assistance.

This report provides background on the Pacific Islands region and discusses related issues for Congress. It discusses U.S. relations with Pacific Island countries as well as the influence of other powers in the region, including Australia, China, and other external actors. It includes sections on U.S. foreign assistance to the region, the Compacts of Free Association, and issues related to climate change, which has impacted many Pacific Island countries. The report does not focus on U.S. territories in the Pacific, such as Guam, the Northern Mariana Islands, and American Samoa.

The Southwest Pacific includes 14 sovereign states with approximately 9 million people, including three countries in “free association” with the United States—the Marshall Islands, Micronesia, and Palau. New Caledonia, a territory of France, and Bougainville, which is part of Papua New Guinea (PNG), are to hold referenda on independence in 2018 and 2019. U.S. officials have emphasized the diplomatic and strategic importance of the Pacific Islands region to the United States, and some analysts have expressed concerns about the long-term strategic implications of China’s growing engagement in the region. Other experts have argued that China’s mostly diplomatic and economic inroads have not translated into significantly greater political influence over South Pacific countries, and that Australia remains the dominant power and provider of development assistance in the region.

Major U.S. objectives and responsibilities in the Southwest Pacific include promoting sustainable economic development and good governance, administering the Compacts of Free Association, supporting regional organizations, helping to address the effects of climate change, and cooperating with Australia, New Zealand, and other major foreign aid donors. U.S. foreign assistance activities include regional environmental programs, military training, disaster assistance and preparedness, fisheries management, HIV/AIDS prevention, care, and treatment programs in Papua New Guinea, and strengthening democratic institutions in PNG, Fiji, and elsewhere. Other areas of U.S. concern and cooperation include illegal fishing and peacekeeping operations.

Congressional interests include overseeing U.S. policies in the Southwest Pacific and helping to set the future course of U.S. policy in the region, approving the U.S.-Palau agreement to provide U.S. economic assistance through 2024, and funding and shaping ongoing foreign assistance efforts. The Obama Administration asserted that as part of its “rebalancing” to the Asia-Pacific region, it had increased its level of engagement in the region. Other observers contended that the rebalancing policy had not included a corresponding change in the level of attention paid to the Pacific Islands.

Contents

Overview	1
Regional Organizations	2
The Pacific Islands and U.S. Interests.....	2
U.S. Policies in the South Pacific	4
Foreign Assistance	6
South Pacific Tuna Treaty.....	7
Compacts of Free Association	8
Background	8
Palau: Compact of Free Association Review Agreement.....	9
Marshall Islands Nuclear Test Damages Claims	11
U.S. Nuclear Test Compensation	11
Marshall Islands Legal Actions.....	12
China’s Growing Influence.....	13
China’s Foreign Assistance and Trade	14
Australia, New Zealand, and Other External Actors	16
France.....	17
Other External Actors.....	17
Climate Change and Other Environmental Issues	18
The Paris Agreement and the Pacific	19
Ocean Acidification.....	20
Fisheries	20
Referenda on Self-Determination.....	21
New Caledonia.....	21
Bougainville	21

Figures

Figure 1. The Southwest Pacific: Melanesia, Micronesia, and Polynesia	4
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Tables

Table 1. Pacific Island Countries.....	1
Table 2. Selected U.S. Foreign Operations, Compact of Free Association, and Other Assistance to the Pacific Islands, FY2016 (estimated)	7
Table 3. Palau Amended Compact.....	10
Table 4. Pacific Island Trade with the China, Australia, and the United States, 2015	15

Appendixes

Appendix. Social and Economic Indicators	22
--	----

Overview

The Pacific Islands region, also known as the South Pacific or Southwest Pacific, presents Congress with a diverse array of policy issues. It is a strategically important region that encompasses U.S. Pacific territories.¹ U.S. relations with Australia and New Zealand include pursuing common interests in the Southwest Pacific, which also has attracted Chinese diplomatic attention and economic engagement. Congress plays key roles in approving and overseeing the administration of the Compacts of Free Association that govern U.S. relations with the Marshall Islands, Micronesia, and Palau (also referred to as the Freely Associated States or FAS). The United States has economic interests in the region, particularly fishing. The United States provides foreign assistance to Pacific Island countries, which are among those most affected by climate change, particularly in the areas of climate change adaptation and mitigation.

Table 1. Pacific Island Countries

Melanesian Region	Micronesian Region	Polynesian Region
Fiji	Kiribati	Cook Islands (in free association with New Zealand)
Papua New Guinea	Marshall Islands (in free association with the United States)	Niue (in free association with New Zealand)
Solomon Islands	Federated States of Micronesia (in free association with the United States)	Samoa
Vanuatu	Nauru	Tonga
	Palau (in free association with the United States)	Tuvalu

Notes: The Pacific Islands Forum, the main regional organization, includes the 14 states in this table, plus Australia and New Zealand, and 2 territories of France (French Polynesia and New Caledonia).

The Southwest Pacific covers 20 million square miles of ocean and 117,000 square miles of land area (roughly the size of Cuba).² The region includes 14 sovereign states with approximately 9 million people, including three countries in “free association” with the United States—the Marshall Islands, Micronesia, and Palau. Papua New Guinea (PNG), the largest country in the Southwest Pacific, constitutes 80% of region’s land area and 75% of its population. (See **Table 1.**) The region’s gross domestic product (GDP) totals around \$32 billion (about the size of Albania’s GDP). Per capita incomes range from lower middle income (Solomon Islands at \$2,000 per capita GDP) to upper middle income (Nauru and Palau at \$14,200).³

According to many analysts, since gaining independence during the post-World War II era, many Pacific Island countries have experienced greater political than economic success. Despite weak political institutions and occasional civil unrest, human rights generally are respected and international observers largely have regarded governmental elections as free and fair. Of 12

¹ This report does not focus on U.S. territories in the Pacific, such as Guam, the Northern Mariana Islands, and American Samoa.

² This area is also referred to as the “Pacific Islands” and the “South Pacific.”

³ Central Intelligence Agency, *The World Factbook*, 2016 (purchasing power parity); World Bank income categories.

Pacific Island states ranked by Freedom House for political rights and civil liberties, eight are given “free” status, while Fiji, Papua New Guinea, and the Solomon Islands—the three largest countries in the region—are ranked as “partly free.”⁴

Most Pacific Island countries, with some exceptions such as Fiji, Papua New Guinea, and the Solomon Islands, have limited natural and human resources upon which to launch sustained development. Many small atoll countries in the region are hindered by lack of resources, skilled labor, and economies of scale; inadequate infrastructure; poor government services; and remoteness from international markets. In addition, some areas also are threatened by frequent weather-related natural disasters and rising sea levels related to climate change.

Regional Organizations

The Pacific Islands Forum (PIF), which was known as the South Pacific Forum until 1999, seeks to foster cooperation between member states. It is comprised of 18 states and territories. The PIF’s 16 states are Australia, Cook Islands, the Federated States of Micronesia, Fiji, Kiribati, Nauru, New Zealand, Niue, Palau, Papua New Guinea, the Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Its two territories are French Polynesia and New Caledonia. The PIF Secretariat is located in Suva, Fiji. Key issues addressed by the PIF include climate change, regional security, and fisheries. American Samoa, Guam, and the Northern Marianas have observer status with the PIF.

The Melanesian Spearhead Group (MSG), founded in 1986, includes the following Melanesian countries and organizations: Fiji, the Kanak Socialist Liberation Front (FLNKS) of New Caledonia, Papua New Guinea, the Solomon Islands, and Vanuatu. The MSG seeks to have “common positions and solidarity in spearheading regional issues of common interest, including the FLNKS cause for political independence in New Caledonia.”⁵ In 2015, the MSG granted the United Liberation Movement for West Papua observer status and Indonesia associate member status.⁶

The Pacific Islands and U.S. Interests

On the whole, the United States enjoys friendly relations with Pacific Island countries and has benefitted from their support in the United Nations. This is especially true of the Freely Associated States, particularly Palau, which in 2014 reportedly voted with the United States 90% of the time.⁷ (See “Compacts of Free Association” below.) The United States has worked with Australia, the preeminent power in the Southwest Pacific, to help advance shared strategic interests, maintain regional stability, and promote economic development, particularly since the end of the Cold War in the early 1990s. New Zealand also has cooperated with U.S. initiatives in the region, been a major provider of foreign aid, and helped lead peacekeeping efforts. France and Japan also maintain significant interests in the region. China has become a diplomatic force,

⁴ Freedom House, *Freedom in the World, 2016*, <https://freedomhouse.org/report/freedom-world/freedom-world-2016>. The Cook Islands and Niue are not included in the survey.

⁵ “Melanesian Spearhead Group,” Melanesian Spearhead Group Secretariat, 2016, <http://www.msgsec.info/index.php>.

⁶ Gregory Poling, “The Upside of Melanesian Leader’s West Papua Compromise,” Center for Strategic and International Studies, July 2, 2015.

⁷ Matthew Matthews, Deputy Assistant Secretary of State, Bureau of East Asian and Pacific Affairs, Statement before the House Foreign Affairs Committee, Subcommittee on Asia and the Pacific, June 23, 2016; Department of State, *Fact Sheet: U.S. Relations with Palau*, February 4, 2015; Department of State, “Voting Practices in the United Nations 2014,” July 2015.

major source of foreign aid, and leading trade partner in the Southwest Pacific. In addition, more recently, other nations, including Russia, India, and Indonesia, have made efforts to expand their engagement in the region.

The Pacific Islands generally can be divided according to four spheres of influence, those of the United States, Australia, New Zealand, and France. The American sphere extends through parts of the Micronesian and Polynesian subregions. (See **Figure 1**.) In the Micronesian region lie the U.S. territories Guam and the Northern Mariana Islands as well as the Freely Associated States. In the Polynesian region lie Hawaii and American Samoa. U.S. security interests in the Micronesian subregion, including military bases on Guam and Kwajalein Atoll in the Marshall Islands, constitute what some experts call a defensive line or “second island chain” in the Pacific.⁸ The first island chain includes southern Japan, Taiwan, and the Philippines. Some analysts in China have viewed the island chains as serving to contain China and the Chinese navy.⁹ The region also was a key strategic battleground during World War II, where the United States and its allies fought against Japan.

Australia’s interests focus on the islands south of the equator, particularly the relatively large Melanesian nations of Papua New Guinea, which Australia administered until PNG gained its independence in 1975, the Solomon Islands, and Vanuatu. New Zealand has long-standing ties with its territory of Tokelau, former colony of Samoa (also known as Western Samoa), and the Cook Islands and Niue, two self-governing states in “free association” with New Zealand. Australia and New Zealand often cooperate on regional security matters such as peacekeeping. France continues to administer French Polynesia, New Caledonia, and Wallis and Futuna.

U.S. policymakers have emphasized the importance of the Pacific Islands region for U.S. strategic and security interests. In testimony before the Subcommittee on Asia and the Pacific of the House Committee on Foreign Affairs, former Deputy Assistant Secretary of State Matthew Matthews emphasized the changing strategic context of the Pacific Islands region:

The Pacific Island region has been free of great power conflict since the end of World War II, we have enjoyed friendly relations with all of the Pacific island countries. This state of affairs, however, is not guaranteed.... Our relations with our Pacific partners are unfolding against the backdrop of shifting strategic environment, where emerging powers in Asia and elsewhere seek to exert a greater influence in the Pacific region, through development and economic aid, people-to-people contacts and security cooperation. There is continued uncertainty in the region about the United States’ ... willingness and ability to sustain a robust forward presence.¹⁰

During the hearing, then-Chairman of the Subcommittee on Asia and the Pacific former Representative Matt Salmon stated that the countries of the region deserve U.S. attention “for the important roles that they play in regional security, as participants in international organizations, and as the neighbors to our own U.S. territories of American Samoa, Guam and the Commonwealth of the Northern Mariana Islands.”¹¹

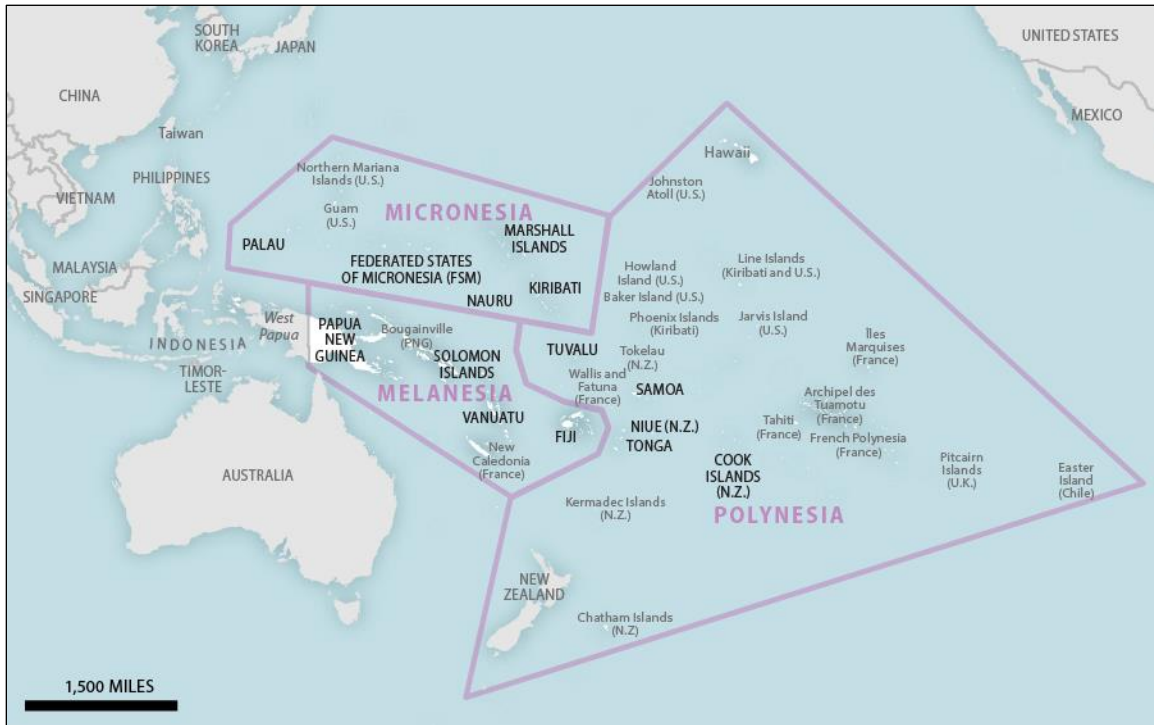
⁸ Robert Scher, “Department of Defense’s Support of the Palau Compact Agreement Review,” Testimony before the Senate Committee on Energy and Natural Resources, June 16, 2011; “The Rising Strategic Stock of Micronesia,” *PACNEWS*, February 3, 2015.

⁹ “Why Islands Still Matter in Asia,” *China and the World Program*, February 5, 2016.

¹⁰ Matthew Matthews, *op. cit.*

¹¹ Rep. Matt Salmon, Opening Statement, “U.S. Policy in the Pacific: The Struggle to Maintain Influence,” House Foreign Affairs Committee, Subcommittee on Asia and the Pacific, June 23, 2016.

Figure I. The Southwest Pacific: Melanesia, Micronesia, and Polynesia



Source: Congressional Research Service

Note: Pacific Island entities in bold are fully independent states and freely associated states.

Some analysts have expressed concerns about the long-term strategic implications of China’s growing engagement in the region. Other experts have argued that China’s diplomatic outreach and economic influence have not translated into significantly greater political sway over South Pacific countries, and that Australia, a U.S. ally, remains the dominant power and provider of development assistance in the region.¹² Some observers also have contended that Chinese military assistance and cooperation in the region remain modest compared to that of Australia, and that China has not actively sought to project “hard power.”¹³

U.S. Policies in the South Pacific

Broad U.S. objectives and policies in the region have included promoting sustainable economic development and good governance, addressing the effects of climate change, administering the Compacts of Free Association, supporting regional organizations, projecting a presence in the region, and cooperating with Australia and regional aid donors. Other areas of concern and

¹² Graeme Smith, “The Top Four Myths About China in the Pacific,” Lowy Institute for International Policy, *The Interpreter*, November 18, 2014; Jenny Hayward-Jones, “Dreaming of China in the Pacific Islands,” Lowy Institute for International Policy, *The Interpreter*, May 16, 2013.

¹³ Joanna McCarthy, “China Extends Its Influence in the South Pacific,” *ABC News Australia*, September 10, 2016; Darryn Webb, “China’s South Pacific Expansion and the Changing Regional Order: A Cause for Concern to the Regional Status Quo?” Australian Defence College, September 2015; Karl Claxton, “Decoding China’s Rising Influence in the South Pacific,” *Australian Strategic Policy Institute*, May 17, 2013; Jian Yang, *The Pacific Islands in China’s Grand Strategy*, New York: Palgrave Macmillan, 2011.

cooperation include combating illegal fishing, supporting peacekeeping operations, and responding to natural disasters.

Areas of particular concern to Congress include overseeing U.S. policies in the Southwest Pacific and the administration of the Compacts of Free Association; regional foreign aid programs and appropriations; approving the U.S.-Palau agreement to provide U.S. economic assistance through 2024; and supporting the U.S. tuna fleet. The Obama Administration asserted that as part of its “rebalancing” to the Asia-Pacific region, it had increased its level of engagement in the Southwest Pacific, including expanding staffing and programming and increasing the frequency of high-level meetings with Pacific leaders.¹⁴ Other observers contended that the rebalancing policy had not included a corresponding change in the level of attention paid to the Pacific Islands region.¹⁵

U.S. diplomatic outreach to the region includes the following:

- In 2011, then-President Obama met with Pacific Island leaders on the margins of the Asia Pacific Economic Cooperation (APEC) Leaders Meeting.
- In 2012, Hillary Clinton attended the Pacific Islands Forum annual summit, the first Secretary of State to do so, in the Cook Islands, where she noted U.S. assistance to the region and highlighted three U.S. objectives: trade, investment in energy, and sustainable growth; peace and security; and women’s empowerment.¹⁶
- In 2013, then-Secretary of State John Kerry met with Pacific Island leaders at the United Nations and pledged to work with the region to address climate change.
- In 2014, then-Secretary Kerry visited the Solomon Islands following devastating floods there.¹⁷
- In 2015, then-President Obama met with leaders of Kiribati, the Marshall Islands, and Papua New Guinea at the Paris Climate Conference.
- In September 2016, then-Assistant Secretary of State for East Asian and Pacific Affairs Daniel Russel led a U.S. delegation to the 28th Pacific Islands Forum in Pohnpei, Micronesia. Main topics of discussion included climate change, management and conservation of fisheries and other marine resources, sustainable development, regional economic integration, and human rights in West Papua.¹⁸

¹⁴ Matthew Matthews, op. cit.; Rep. Matt Salmon, op. cit.

¹⁵ Michael Field, “Pacific Islands Sore About US Inattention,” *Nikkei Report*, March 11, 2016;

¹⁶ Department of State, “Hillary Rodham Clinton: Remarks at the Pacific Islands Forum Post-Forum Dialogue,” Rarotonga, August 31, 2012. The Pacific Islands Forum (PIF) is the main regional organization consisting of the 14 independent Pacific Island states plus Australia and New Zealand. There are currently 14 dialogue partners: Canada, China, the EU, France, India, Indonesia, Italy, Japan, South Korea, Malaysia, the Philippines, Thailand, the U.K., and the United States. The PIF Secretariat is located in Suva, Fiji.

¹⁷ Department of State, “Secretary of State John Kerry at a Meeting of the Pacific Islands Forum,” New York, September 27, 2013; Eileen Natuzzi, “Epilogue to the South Pacific Tuna Treaty,” *PACNEWS*, February 15, 2016.

¹⁸ “Forum Communiqué,” Forty Seventh Pacific Island Forum, Pohnpei, Federated States of Micronesia, 8-10 September, 2016.

Foreign Assistance

The region depends heavily upon foreign aid. In terms of official development assistance (ODA) as defined by the Organization for Economic Cooperation and Development (OECD), which focuses on grant-based assistance, OECD members Australia, New Zealand, the United States, France, and Japan are the principal aid donors in the Southwest Pacific. Major multilateral sources of ODA include the World Bank's International Development Association and the Asian Development Bank. According to the OECD, in 2014, the most recent year for which full data are available, the leading aid donors committed ODA to the region as follows: Australia, \$850 million; New Zealand, \$374 million; the United States, \$277 million; France, \$126 million; and Japan, \$107 million.¹⁹ Although the United States remains one of the largest providers of ODA to the region by some measures, U.S. assistance remains concentrated among the Freely Associated States. China has become a major source of foreign assistance, but Chinese aid differs from traditional ODA due to its heavy emphasis on concessional loans and infrastructure projects (see "China's Foreign Assistance and Trade" below).

The U.S. government administers foreign assistance to Pacific Island countries through the U.S. Agency for International Development (USAID) Office for the Pacific Islands (based in the Philippines) and Pacific Islands Satellite Office (based in Papua New Guinea). U.S. foreign assistance activities include regional environmental programs; military training; disaster assistance and preparedness; fisheries management; HIV/AIDS prevention, care, and treatment programs in Papua New Guinea; and strengthening democratic institutions in Papua New Guinea, Fiji, and elsewhere.²⁰ U.S. assistance also aims to help strengthen Pacific Islands regional fora.²¹

MCC Compact with Vanuatu

The Millennium Challenge Corporation (MCC), an independent U.S. foreign aid agency established in 2004, awards aid packages to countries that have demonstrated good governance, investments in health and education, and a commitment to economic freedom. The 5-year MCC compact with Vanuatu (2006-2011) funded 11 public works projects worth \$65 million, including roads, an air strip, wharves, and storage warehouses.

USAID has partnered with Pacific Islands regional organizations to carry out a five-year program to coordinate responses to the adverse impacts of climate change.²² Through the Coastal Community Adaptation Program, USAID supports local-level climate change interventions in nine Pacific Island countries.²³ The United States supports natural disaster mitigation and response capabilities and weather and climate change adaptation programs in the Marshall Islands and Micronesia, two low-lying atoll nations, and elsewhere in the Pacific Islands region. USAID's Regional Development Mission-Asia (RDM/A) carries out several environmental programs in the region, particularly in Papua New Guinea.

¹⁹ Organisation for Economic Cooperation and Development, *Creditor Reporting System*, <http://stats.oecd.org/index.aspx?DataSetCode=CRS1>, accessed September 22, 2016. These totals include U.S. economic assistance to the Freely Associated States and French foreign assistance to its territory of Wallis and Fortuna.

²⁰ USAID, "Pacific Islands," <https://www.usaid.gov/pacific-islands>, accessed September 22, 2016.

²¹ Department of State, *Congressional Budget Justification, Foreign Operations, Appendix 2, FY2017*.

²² USAID, "U.S. and Pacific Partners Unite to Build Climate Resilience," November 5, 2015.

²³ USAID, "Coastal Community Adaptation Project," February 12, 2016.

Table 2. Selected U.S. Foreign Operations, Compact of Free Association, and Other Assistance to the Pacific Islands, FY2016 (estimated)
(in millions of dollars)

Account	DA	ESF	GHP	IMET	Compact	Total
Fiji				0.200		0.200
Marshall Islands	0.500				109.000	109.500
Micronesia	0.500				75.000	75.500
Palau					13.000	13.000
Papua New Guinea	1.500		4.500	0.250		6.25.0
Samoa				0.100		0.100
Tonga				0.250		0.250
Regional	9.500					9.500
RDM/A	0.436					0.436
SPTT		21.000				21.000
Total	12.436	21.000	4.500	0.800	197.000	235.736

Source: U.S. Department of State, *Congressional Budget Justification, Foreign Operations, FY2017*; U.S. Department of the Interior, Office of Insular Affairs, FY2017 Budget Justification; USAID, *Foreign Aid Explorer*.

Notes: Compact—Compact of Free Association direct economic assistance; DA—Development Assistance; ESF—Economic Support Fund; GHP—Global Health Programs; IMET—International Military Education and Training; RDM/A—Regional Development Mission-Asia; SPTT—South Pacific Tuna Treaty. The amounts in this table do not include disaster assistance.

The United States conducts International Military Education and Training (IMET) programs related to peacekeeping operations, strengthening national security, responding to natural and man-made crises, developing democratic civil-military relationships, and building military and police professionalism in Fiji, Papua New Guinea, Samoa, and Tonga.²⁴ The Obama Administration requested \$1 million in Foreign Military Financing (FMF) for FY2016 for a regional program to promote peacekeeping activities, English language capabilities, and professionalism in the military. (See **Table 2**.) For FY2017, U.S. assistance aims to expand engagement with the PIF and other regional bodies to improve democratic development and governance in the region.²⁵

South Pacific Tuna Treaty

Funding provided pursuant to the South Pacific Tuna Treaty (SPTT) constitutes a major source of U.S. assistance to some Pacific Island countries.²⁶ Under the SPTT, in force since 1988, Pacific Island parties to the treaty provide access for U.S. tuna fishing vessels to fishing zones in the Southwest Pacific, which supplies one-third of the world's tuna. In exchange, the American Tunaboat Association pays licensing fees to Pacific Island parties to the treaty. In addition, as part

²⁴ Fiji, Papua New Guinea, and Tonga are the only Pacific Island states with formal defense forces.

²⁵ Department of State, *Congressional Budget Justification, Foreign Operations, Appendix 2, FY2016*; Department of State, *Congressional Budget Justification, Foreign Operations, Appendix 2, FY2017*.

²⁶ Australia, Cook Islands, Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, the United States, and Vanuatu are parties to the treaty.

of the agreement, the United States provides economic assistance to the Pacific Island parties totaling \$21 million per year. In January 2016, the United States temporarily withdrew from the agreement, arguing that the terms were “no longer viable” for the U.S. tuna fleet. The U.S. fleet argued that it could no longer pay quarterly fees due to sharply declining prices for tuna and competition from other countries, some of which was illegal. U.S. boats resumed fishing in the region in March 2016 but with fewer fishing days allotted than in 2015.²⁷ Talks to renegotiate the SPTT resulted in an agreement in principle in June 2016 that aims to “establish more flexible procedures for commercial cooperation between Pacific Island Parties and US industry.”²⁸

Compacts of Free Association

Congress plays roles in approving and overseeing the administration of the Compacts of Free Association that govern U.S. diplomatic, economic, and military relations with the Marshall Islands, Micronesia, and Palau. U.S. economic commitments to the Freely Associated States—totaling nearly \$200 million in FY2015²⁹—are administered by the Department of the Interior. The Compact of Free Association Review Agreement, signed by the United States and the Republic of Palau in 2010, awaits congressional approval. Since 2000, the Republic of the Marshall Islands has unsuccessfully sought additional compensation for damages related to U.S. nuclear testing on Marshall Islands atolls during the 1940s and 1950s.

Background

In 1947, the Marshall Islands, the Federated States of Micronesia, Palau, and the Northern Marianas, which had been under Japanese control during part of World War II, became part of the U.S.-administered United Nations Trust Territory of the Pacific Islands. In the early 1980s, the Marshall Islands and Micronesia rejected the option of U.S. territorial or commonwealth status and instead chose *free association* with the United States. Compacts of Free Association were negotiated and agreed by the governments of the United States, the Marshall Islands, and Micronesia, and approved by plebiscites in the Trust Territory districts and by the U.S. Congress in 1985 (P.L. 99-239). Congress approved the Compact with Palau in 1986 (P.L. 99-658), which Palau ratified in 1994. The Compacts were intended to establish democratic self-government and to advance economic development and self-sufficiency through U.S. grant and federal program assistance, and to further the national security of the Freely Associated States (FAS) and the United States in light of Cold War geopolitical concerns.

Under the Compacts, the FAS are sovereign nations that conduct their own foreign policy, but the United States and the FAS are subject to certain limitations and obligations regarding international security and economic relations. The United States is obligated to defend the Freely Associated States against attack or threat of attack. The United States may block FAS government policies that it deems inconsistent with its duty to defend the FAS (the “defense veto”), and it has the prerogative to reject the strategic use of, or military access to, the FAS by third countries (the

²⁷ Giff Johnson, “U.S. Officially Pulls out of Pacific Fisheries Treaty,” *Marianas Variety*, January 20, 2016; Michael Field, op. cit. For additional information, see also Brian Hallman, Executive Director, American Tunaboat Association, Statement before the Subcommittee on Water, Power, and Oceans, Committee on Natural Resources, House of Representatives, March 1, 2016.

²⁸ “Parties to South Pacific Tuna Treaty Agree on Principles of Fishing Access,” *ForeignAffairs.co.nz*, July 5, 2016; Department of State, “South Pacific Tuna Treaty,” June 29, 2016.

²⁹ This total includes Compact grant assistance, Kwajalein “impact” assistance, and trust fund contributions. U.S. Department of the Interior, Office of Insular Affairs, FY2017 Budget Justification.

“right of strategic denial”). The United States also may establish military bases in the FAS, and the Marshall Islands is home to a premier U.S. military facility (the Ronald Reagan Ballistic Missile Defense Test Site [RTS], also known as the Kwajalein Missile Range).³⁰

The Freely Associated States and their citizens are eligible for various U.S. federal programs and services. FAS citizens are entitled to reside and work in the United States and its territories as “lawful non-immigrants” and are eligible to volunteer for service in the U.S. armed forces. Several hundred FAS citizens serve in the U.S. military and roughly 12 FAS citizens serving in the U.S. armed forces died in the Iraq and Afghanistan war efforts. The Marshall Islands, Micronesia, and Palau were members of the U.S.-led coalition that launched Operation Iraqi Freedom in 2003.³¹

Kwajalein Missile Range

The United States military regularly conducts intercontinental ballistic missile (ICBM) testing and space surveillance activities from the Kwajalein Missile Range. Former Chairman of the Joint Chiefs of Staff General Martin E. Dempsey referred to the site as the “world’s premier range and test site for intercontinental ballistic missiles and space operations support.”³² Under the Military Use and Operating Rights Agreement (MUORA), the United States makes annual payments (\$18 million) to the Marshall Islands government, which compensates Kwajalein landowners for relinquishing their property through a Land Use Agreement. The amended Compact of 2003 extended U.S. base rights at Kwajalein Atoll through 2066, with the U.S. option to continue the arrangement for an additional 20 years (to 2086).

The FAS economies depend heavily on U.S. support. The Department of the Interior provides direct economic or grant assistance to the FAS. Its Office of Insular Affairs is responsible for administering the Compacts. The Compacts with the Marshall Islands and Micronesia provided economic assistance totaling roughly \$2.5 billion between 1987 and 2003, including payments for damages and personal injuries caused by U.S. nuclear testing on Marshall Islands atolls during the 1940s and 1950s. In December 2003, the Compacts were amended in order to extend economic assistance for another 20 years and establish trust funds that aim to provide sustainable sources of government revenue after 2023. Projected U.S. grant assistance and trust fund contributions to the Marshall Islands for the 2004-2023 period total \$629 million and \$235 million, respectively. Projected grant assistance and trust fund contributions to Micronesia for the same period total \$1.4 billion and \$442 million, respectively.³³

Palau: Compact of Free Association Review Agreement

In 1986, the United States and Palau signed a 50-year Compact of Free Association. The Compact was approved by the U.S. Congress but not ratified in Palau until 1993 (entering into force on October 4, 1994). The U.S.-Palau Compact provided for 15 years of direct economic assistance, the construction of a 53-mile road system, a trust fund, services of some U.S. federal agencies

³⁰ U.S. Army Kwajalein Atoll (USAKA) Reagan Test Site / Kwajalein Missile Range, GlobalSecurity.org, accessed September 22, 2016.

³¹ Tomoko A. Hosaka, “Soldier’s Death, Guantanamo Detainees Rattle Palau,” *Associated Press*, June 16, 2009; Remarks by Peter A. Prahar, Ambassador of the United States of America, Federated States of Micronesia, February 5, 2010; Edgard Kagan, Deputy Assistant Secretary of State, Testimony before the House Committee on Natural Resources, Subcommittee on Fisheries, Wildlife, Oceans, and Insular Affairs, September 10, 2012.

³² Lisa Ferdinando, “Dempsey Visits Strategic, Remote Kwajalein Atoll,” *Federal Information and News Dispatch*, February 21, 2015.

³³ United States Government Accountability Office, *Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, September 2013.

such as the U.S. Postal Service and the National Weather Service, and eligibility for some U.S. federal education, health, and other programs. Between 1995 and 2009, U.S. assistance totaled over \$850 million, including grant assistance, road construction, and the establishment of a trust fund (\$574 million), Compact federal services (\$25 million), and discretionary federal program assistance (\$267 million).³⁴

Table 3. Palau Amended Compact
(in millions of dollars)

Economic Assistance Provisions	
Trust Fund Contributions, FY2013-23	30.3
Infrastructure Maintenance Fund, FY2011-24	28.0
Fiscal Consolidation Fund, FY2011-12	10.0
Economic Assistance, FY2011-23	107.5
Infrastructure Projects, FY2011-15	40.0
Direct Economic Assistance Subtotal	215.0

Source: Government Accountability Office, 2012.

Notes: Numbers may differ slightly from other sources due to rounding.

Under the Compact, direct economic assistance was to terminate in 2009 while annual distributions from the trust fund were to increase, to help offset the loss of economic assistance. However, Palauan leaders and some U.S. policymakers argued that continued assistance to Palau beyond 2009 was necessary. Furthermore, the value of the Compact trust fund fell from nearly \$170 million to \$110 million in 2008-2009 due to the global financial crisis, although it rebounded and was valued at approximately \$184 million in 2015.³⁵ In September 2010, the United States and Palau agreed to renew Compact economic assistance, but it awaits approval by Congress. (See **Table 3**.)

The 2010 accord provided for \$215.75 million in direct economic assistance over an additional 15-year period (2011-2024).³⁶ According to some estimates, U.S. support, including both direct economic assistance and projected discretionary program assistance, would total approximately \$427 million between 2011 and 2024. In addition, the agreement committed Palau to undertake economic, legislative, financial, and management reforms.³⁷

Although there has been bipartisan support for continued assistance, Congress has yet to approve the renewal agreement, also known as the Compact of Free Association Review Agreement,

³⁴ David Gootnick, Government Accountability Office, “Compact of Free Association: Proposed U.S. Assistance to Palau for Fiscal Years 2016 to 2024,” Testimony before the Subcommittee on Indian, Insular, and Alaska Native Affairs, Committee on Natural Resources, House of Representatives, July 6, 2016; David Gootnick, Government Accountability Office, “Compacts of Free Association: Issues Associated with Implementation in Palau, Micronesia, and the Marshall Islands,” Testimony before the Committee on Energy and Natural Resources, U.S. Senate, April 5, 2016; David Gootnick, Government Accountability Office, “Compact of Free Association: Proposed U.S. Assistance to Palau through Fiscal Year 2024,” Testimony before the Subcommittee on Fisheries, Wildlife, Oceans, and Insular Affairs, Committee on Natural Resources, House of Representatives, September 10, 2012.

³⁵ David Gootnick, Government Accountability Office, “Compacts of Free Association: Issues Associated with Implementation in Palau, Micronesia, and the Marshall Islands,” op. cit.

³⁶ David Gootnick, Government Accountability Office, “Compact of Free Association: Proposed U.S. Assistance to Palau through Fiscal Year 2024,” op. cit.

³⁷ Ibid.

largely for budgetary reasons. From FY2010 to FY2016, the U.S. government continued annual direct economic assistance to Palau at 2009 levels (\$13.1 million), pending congressional approval of the 2010 agreement and resolution of funding issues. Other U.S. assistance pursuant to the agreement, however, remained unfunded.³⁸

During the 114th Congress, two bills were introduced in support of the agreement to extend Compact assistance to Palau. S. 2610, A Bill to Approve an Agreement Between The United States and the Republic of Palau, would not significantly alter total U.S. economic assistance to Palau from the levels specified in the 2010 renewal agreement, although the assistance would be allocated in different increments due in part to the delay in implementing the agreement. H.R. 4531, To Approve an Agreement Between the United States and the Republic of Palau, and for Other Purposes, would provide an additional \$31.8 million as well as reschedule U.S. assistance.³⁹ In addition, the conference report (H.Rept. 114-840) to accompany S. 2943, The National Defense Authorization Act for Fiscal Year 2017, included the following statement: “The conferees believe that enacting the Compact Review Agreement is important to United States’ national security interests and, as such, believe that the President should include the Compact Review Agreement in the Fiscal Year 2018 budget request.”⁴⁰

Marshall Islands Nuclear Test Damages Claims

From 1946 to 1958, the United States conducted 67 atmospheric atomic and thermonuclear weapons tests on the Marshall Islands atolls of Bikini and Enewetak. In 1954, “Castle Bravo,” the second test of a hydrogen bomb, was detonated over Bikini atoll, resulting in dangerous levels of radioactive fallout upon the populated atolls of Rongelap and Utrik. Between 1957 and 1980, the residents of the four northern atolls returned to their homelands (Rongelap and Utrik in 1957; Bikini in 1968; and Enewetak in 1980). However, the peoples of Bikini and Rongelap were re-evacuated to other islands in 1978 and 1985, respectively, after the levels of radiation detected in the soil were deemed unsafe for human habitation. Although diving and tourist facilities have operated on Bikini on and off since 1996, and the U.S. government had declared some parts of Rongelap safe for human habitation following a \$45 million cleanup effort, neither atoll has been resettled.⁴¹ Some experts claim that remediation techniques, primarily replacing surface soil in populated areas and adding potassium chloride fertilizer to agricultural areas, has made resettlement possible, although most of the displaced people have refused to return.⁴²

U.S. Nuclear Test Compensation

The Compact of Free Association established a Nuclear Claims Fund of \$150 million and a Nuclear Claims Tribunal (NCT) to adjudicate claims. Investment returns on the Fund were expected to generate revenue for personal injury and property damages awards, health care, resettlement, trust funds for the four atolls, and quarterly distributions to the peoples of the four

³⁸ Esther P. Kia’aina, Department of the Interior, Statement before the House Subcommittee on Indian, Insular, and Alaska Native Affairs, Regarding H.R. 4531, To Approve an Agreement between the United States and the Republic of Palau, July 6, 2016.

³⁹ David Gootnick, Government Accountability Office, “Compact of Free Association: Proposed U.S. Assistance to Palau for Fiscal Years 2016 to 2024,” op. cit.

⁴⁰ S. 2943 was signed into law (P.L. 114-328) on December 23, 2016.

⁴¹ “Islanders Afraid to Go Home 60 Years After Bikini Atoll H-Bomb,” *Agence France Presse*, March 1, 2014.

⁴² Lawrence Livermore National Laboratory, <https://marshallislands.llnl.gov/rongelap.php>; Dan Zak, “A Ground Zero Forgotten,” *Washington Post*, November 29, 2015.

atolls for hardships suffered. In all, the United States reportedly has provided over \$600 million for nuclear claims, health and medical programs, and environmental cleanup and monitoring.⁴³

The Compact deems the Nuclear Claims Fund as part of a “full and final settlement” of legal claims against the U.S. government. However, the Fund was depleted by 2009 and was not sufficient to cover the NCT’s awards of \$96 million to approximately 2,000 individuals for compensable injuries. In addition, the Tribunal awarded, but was unable to pay, approximately \$2.2 billion to the four atoll governments for remediation and restoration costs, loss of use, and consequential damages.⁴⁴

Marshall Islands Legal Actions

The Marshall Islands government and peoples of the four most-affected atolls long have argued that greater U.S. compensation was justified for loss of land, personal injuries, and property damages. They have claimed that the nuclear tests caused high incidences of miscarriage, birth defects, and weakened immune systems, as well as high rates of thyroid, cervical, and breast cancer.⁴⁵ In addition, some experts contend that more than a dozen Marshall Islands atolls, rather than only four, were affected.⁴⁶ Some experts have disputed the Marshall Islands claims, pointing to some earlier studies.⁴⁷

In September 2000, the government of the Republic of the Marshall Islands (RMI) submitted to the U.S. Congress a *Changed Circumstances Petition* requesting additional compensation of roughly \$1 billion for personal injuries, property damages, public health infrastructure, and a health care program for those exposed to radiation. The Petition based its claims upon the “changed circumstances” provision of Section 177 of the Compact, arguing that “new and additional” information, such as greater radioactive fallout than previously known or disclosed and revised radiation protection standards, constituted “changed circumstances” and that existing compensation was “manifestly inadequate.” In November 2004, the George W. Bush Administration released a report evaluating the Petition, *Report Evaluating the Request of the Government of the Republic of the Marshall Islands Presented to the Congress of the United States of America*, concluding that there was no legal basis for considering additional compensation payments.⁴⁸

In April 2006, the peoples of Bikini and Enewetak atolls filed lawsuits against the United States government in the U.S. Court of Federal Claims seeking additional compensation related to the

⁴³ Embassy of the United States, Majuro, Marshall Islands, “The Legacy of U.S. Nuclear Testing and Radiation Exposure in the Marshall Islands,” <http://majuro.usembassy.gov/legacy.html>, accessed September 22, 2016.

⁴⁴ Testimony of Bill Graham, Marshall Islands Nuclear Claims Tribunal, before the House Committee on Foreign Affairs Subcommittee on Asia, the Pacific, and the Global Environment, May 21, 2010.

⁴⁵ Advocates for greater nuclear test compensation have based some claims on a National Cancer Institute study: U.S. Dept. of Health and Human Services, National Institutes of Health, National Cancer Institute, *Estimation of the Baseline Number of Cancers Among Marshallese and the Number of Cancers Attributable to Exposure to Fallout from Nuclear Weapons Testing Conducted in the Marshall Islands*, September 2004. Prepared for the Senate Committee on Energy and Natural Resources.

⁴⁶ James H. Plasman, Testimony before the House Committee on Foreign Affairs, Subcommittee on Asia, the Pacific and the Global Environment, July 25, 2007.

⁴⁷ Steven L. Simon and James C. Graham, “Findings of the Nationwide Radiological Study,” 1994. See also Steven L. Simon and James C. Graham, “Findings of the First Comprehensive Radiological Monitoring Program of the Republic of the Marshall Islands,” *Health Physics*, vol. 73, no. 1 (July 1997).

⁴⁸ U.S. Department of State, *Report Evaluating the Request of the Government of the Republic of the Marshall Islands Presented to the Congress of the United States of America*, November 2004.

U.S. nuclear testing program. The court dismissed both lawsuits on August 2, 2007. The U.S. Court of Appeals for the Federal Circuit upheld the lower court ruling on January 30, 2009, finding that Section 177 of the Compact removed U.S. jurisdiction. In April 2010, the Supreme Court declined to hear the case.⁴⁹

In April 2014, the RMI filed suits in the United States and the International Court of Justice in the Hague against the United States and eight other nuclear powers, claiming their failure to meet their obligations toward nuclear disarmament under Article VI of the Nuclear Non-Proliferation Treaty. The lawsuits did not seek compensation but rather action on disarmament. On February 3, 2015, a federal court in California dismissed the RMI suit against the United States, on the grounds that the RMI lacked standing to bring the case and that the case was resolvable by the political branches of government rather than the courts.⁵⁰

China's Growing Influence

Some policymakers, including Members of Congress, have expressed concerns about China's growing influence in the region.⁵¹ China has become a growing political and economic actor in the Southwest Pacific, and some observers contend that it aims to promote its interests in a way that potentially displaces the influence of traditional actors in the region such as the United States, Australia, and New Zealand. In the view of one analyst, "China clearly does seek to become at least a leading power in the Western Pacific and perhaps the leading power in the Western Pacific."⁵² One expert reports that China's principal strategic activity in the region is signals intelligence monitoring. Toward this end, China reportedly has regularly sent vessels to the region that both track satellites and ballistic missiles and also gather intelligence.⁵³

Other analysts argue that Beijing does not consider the South Pacific to be of key strategic importance, and note that Australian assistance remains significantly larger than that provided by Beijing.⁵⁴ Some believe that although many Pacific Island leaders say they appreciate China's economic engagement and diplomatic policy of "non-interference" in domestic affairs, the region maintains strong ties to Australia and the West that are rooted in shared history and culture as well as migration.⁵⁵

Beijing's engagement in the region has been motivated largely by a desire to garner support in international fora and find sources of raw materials. According to some analysts, China began to fill a vacuum created by waning U.S. attention following the end of the Cold War.⁵⁶ While the United States does not maintain an embassy in several Pacific Islands countries, for example, Beijing has opened diplomatic missions in all eight of the Pacific Island countries with which it

⁴⁹ Warren Richey, "Supreme Court: No Review of Award for US Nuclear Weapons Tests," *Christian Science Monitor*, April 5, 2010.

⁵⁰ This also is known as the "political question doctrine." Department of State, U.S. Relations with Marshall Islands, Fact Sheet, February 4, 2015; "Marshall Islands Will Appeal in Nuclear Case against US," *Daily Mail*, April 2, 2015.

⁵¹ See, for example, Rep. Matt Salmon, op. cit.

⁵² McCarthy, op. cit.

⁵³ "Chinese 'Spy Ship' Slips into Auckland," *New Zealand Herald*, October 3, 2016; "Satellite Tracking Ship in Suva," *Fiji Sun*, August 23, 2015; Joanne Wallis, "China's South Pacific Diplomacy," *The Diplomat*, August 30, 2012.

⁵⁴ McCarthy, op. cit.; Webb, op. cit.; Claxton, op. cit.; Jian Yang, op. cit.

⁵⁵ Cleo Paskal, "The New Battle for the Pacific: How the West Is Losing the South Pacific to China, the UAE, and Just About Everyone Else," East-West Center, October 3, 2013.

⁵⁶ Julie Pendray, "China Pours Aid to Islands: Rising Power's Financial Interest in South Pacific Under Scrutiny," *Washington Times*, October 19, 2007; McCarthy, op. cit.

has diplomatic relations. China-Taiwan “dollar diplomacy,” in which the two entities competed for official diplomatic recognition through offers of foreign aid, has been a declining factor since the late 2000s.⁵⁷

Fiji-China Relations

Some analysts view Fiji as an example of how deteriorating relations between Pacific Island countries and Western powers in the region may result in greater Chinese influence, although the significance of that influence is debated. China has become a main source of foreign aid and diplomatic support to Fiji, particularly after major foreign aid donors, including Australia, New Zealand, the EU, and the United States, imposed limited sanctions in response to the 2006 military coup.⁵⁸ Major donors resumed foreign aid after Fiji held parliamentary elections in 2014, which international observers viewed as free and fair.⁵⁹ During the interim period, Josaia Voreqe “Frank” Bainimarama, who has been the leader of Fiji since 2007 and was elected Prime Minister in 2014, put in place a “Look North” policy under which relations with China became more important.⁶⁰ After Australia and New Zealand supported Fiji’s suspension from the PIF, the Fijian government focused its attention on the Melanesian Spearhead Group. According to analysts, China seized this opportunity, sponsoring the creation of the MSG Secretariat, and building its headquarters in Vanuatu.⁶¹ Prime Minister Bainimarama has argued that Australia and New Zealand should only be allowed to remain members of the Pacific Islands Forum if China and Japan are allowed to join.⁶² In 2015, China and Fiji agreed to expand military cooperation.⁶³

China’s Foreign Assistance and Trade

China is one of the top providers of foreign assistance in the Southwest Pacific, providing \$150 million in foreign assistance per year on average during the past decade. China has held two China-Pacific Island Countries Economic Development and Cooperation Forums (2006 and 2013), where Chinese officials announced large aid packages, including pledges of preferential loans (\$376 million in 2006 and \$1 billion in 2013). In November 2014, Chinese President Xi Jinping travelled to Fiji to establish a strategic partnership between China and eight Pacific Island countries.⁶⁴ China also has provided support to the Pacific Islands Forum and has helped finance some of the organization’s activities and initiatives.

Despite China’s rise, Australia remains the dominant foreign aid donor in the region. Between 2006 and 2014, Australia reportedly provided approximately \$7.7 billion in foreign aid to the region, compared to the United States (\$1.9 billion), China (\$1.8 billion), New Zealand (\$1.3 billion), Japan (\$1.2 billion), and France (\$1.0 billion).⁶⁵ In terms of grant-based aid, China’s

⁵⁷ Taiwan (Republic of China) has official diplomatic relations with Kiribati, the Marshall Islands, Nauru, Palau, the Solomon Islands, and Tuvalu.

⁵⁸ Philippa Brant, “The Geopolitics of Chinese Aid: Mapping Beijing’s Funding in the Pacific,” *Foreign Affairs*, March 4, 2015.

⁵⁹ “Aust-NZ Response to Winston May Reset Diplomatic Relations,” Open Source Center Australia, March 4, 2016.

⁶⁰ “Fiji’s Look North Policy Finds an Open Armed Russia,” *Nikkei*, February 25, 2016.

⁶¹ Joanne Wallis, “China’s South Pacific Diplomacy,” *The Diplomat* August 30, 2012. The Melanesian Spearhead Group, formed in 1986, is composed of Fiji, Papua New Guinea, the Solomon Islands, Vanuatu, and New Caledonia (France), whose native populations are predominantly ethnically Melanesian.

⁶² “Renewed Friction over Fiji’s Stance on Pacific Islands Forum,” Economist Intelligence Unit, April 29, 2015.

⁶³ “China, Fiji Agree to Expand Military Cooperation,” *China Military Online*, July 16, 2015.

⁶⁴ “China, Pacific Island Countries Announce Strategic Partnership,” *Xinhuanet*, November 22, 2014.

⁶⁵ “China Has Become a ‘Major Donor’ in the Pacific Islands Region,” DW.COM, March 3, 2015; Danielle Cave, “Witnessing (an Opaque) Pacific Power Shift,” Lowy Institute for International Policy, *The Interpreter*, September 5, 2016; Lowy Institute for International Policy, “Chinese Aid in the Pacific,” updated September 2016, <http://www.lowyinstitute.org/chinese-aid-map/>

foreign assistance is relatively small. Unlike other major donors, which provide mostly grant assistance, nearly 80% of Chinese aid reportedly has been provided in the form of preferential loans, generally to finance infrastructure projects that use Chinese companies and labor.⁶⁶

Table 4. Pacific Island Trade with the China, Australia, and the United States, 2015

(in millions of dollars)

	China	Australia	United States
Cook Islands	17	7	5
Micronesia	16	5	41
Fiji	352	414	260
Kiribati	49	20	10
Nauru	5	61	2
Niue	0	0	1
Palau	22	2	26
Papua New Guinea	2,875	3,523	299
Marshall Islands	3,399	5	83
Samoa	66	49	27
Solomon Islands	544	124	9
Tonga	30	11	16
Tuvalu	16	6	1
Vanuatu	86	65	10
Totals	7,477	4,292	790

Source: Global Trade Atlas

China's foreign assistance to the Southwest Pacific, like its economic assistance to many other regions, largely consists of concessional loans, infrastructure and public works projects, and investments in the extraction of natural resources. Papua New Guinea is the largest Pacific recipient of Chinese aid, having received 35% of Chinese assistance to the region. Other major recipients include Fiji, Vanuatu, and Samoa. China's foreign assistance has resulted in 218 projects since 2006, including Chinese-built roads, sea ports, airports, hydropower facilities, mining operations, hospitals, government buildings, educational facilities, sports stadiums, and other public works. Other Chinese assistance areas include public health, education, fisheries conservation, the environment, and financial support for Fiji's elections in 2014.⁶⁷ Recent, smaller forms of aid reportedly include rowing machines for Samoa, water supply systems for small towns in Tonga, and quad bikes for Cook Islands legislators. Beijing also reportedly has provided modest military equipment and training to Fiji, Papua New Guinea, and Tonga.⁶⁸

Some observers have criticized Chinese assistance, arguing that some infrastructure projects are poor in quality and that some Chinese loans and aid activities lack transparency and exacerbate

⁶⁶ "Chinese Aid in the Pacific," *ibid.*

⁶⁷ "China in the Pacific: Big Fish in a Big Pond," *Economist.com*, March 25, 2015.

⁶⁸ Danielle Cave, *op. cit.*

corruption, increase debt burdens, or harm the environment. Other concerns are that some Chinese economic projects and investments do not employ local labor or that they are not directly aimed at reducing poverty.⁶⁹ Some experts contend that Chinese aid has reduced the regional influence of Australia, the United States, and European countries, while others dispute this contention. Another issue is the relatively recent influx of Chinese traders and shop owners in some urban areas, which reportedly has caused resentment among some native residents.⁷⁰

China is a major trading partner in the region, surpassing even Australia, and has economic interests in the following sectors: energy production (hydro power and gas), mining, fisheries, timber, agriculture, and tourism. (See **Table 3.**) The largest Chinese investment project is the \$1.6 billion Ramu Nickel mine in Papua New Guinea. China also has become a major source of tourists and is the only non-Pacific Island nation to be a member of the South Pacific Tourism Organization.

Australia, New Zealand, and Other External Actors

The United States has relied upon Australia, and to a lesser extent New Zealand, to help advance shared strategic interests, maintain regional stability, and promote economic development in the Southwest Pacific. Australia has played a critical role in helping to promote security in places such as Timor-Leste, which gained its independence from Indonesia following a 1999 referendum that turned violent, the Solomon Islands, and Bougainville, which is part of Papua New Guinea.⁷¹ The 2016 Australia Defence White Paper articulates Australia's approach to the South Pacific:

The South Pacific region will face challenges from slow economic growth, social and governance challenges, population growth and climate change. Instability in our immediate region could have strategic consequences for Australia should it lead to increasing influence by actors from outside the region with interests inimical to ours. It is crucial that Australia help support the development of national resilience in the region to reduce the likelihood of instability. This assistance includes defence cooperation, aid, policing and building regional organisations.... We will also continue to take a leading role in providing humanitarian and security assistance where required.⁷²

New Zealand's Pacific identity, derived from its geography and growing population of New Zealanders with Polynesian or other Pacific Island ethnic backgrounds, as well as its historical relationship with the South Pacific, undergirds its relationship with the region.⁷³ The June 2016 New Zealand Defence White Paper articulates New Zealand's ongoing interest in the South Pacific:

Given its strong connections with South Pacific countries, New Zealand has an enduring interest in regional stability. The South Pacific has remained relatively stable since 2010, and is unlikely to face an external military threat in the foreseeable future. However, the

⁶⁹ McCarthy, op. cit.; "China in the Pacific: Big Fish in a Big Pond," op. cit.; Matthew Dornan and Philippa Brant, "Chinese Assistance in the Pacific: Agency, Effectiveness and the Role of Pacific Island Governments," *Asia and the Pacific Policy Studies*, vol. 1, no. 2 (May 14, 2014); Kalafi Moala, "The Chinese Are Here to Stay," Pacific Institute of Public Policy, May 14, 2014; Matthew Dornan, Denghua Zhang, and Philippa Brant, "China Announces More Aid, and Loans, to Pacific Island Countries," Development Policy Center, November 13, 2013.

⁷⁰ Moala, op. cit.; Graeme Smith, op. cit.; Jenny Hayward-Jones, op. cit.

⁷¹ "Australia Aims to Begin Troop Withdrawal from E. Timor Next Year," *Kyodo News*, April 15, 2011.

⁷² Government of Australia, Department of Defence, White Paper, 2016.

⁷³ "Demographics of New Zealand's Pacific Population," http://www.stats.govt.nz/browse_for_stats/people_and_communities, accessed October 27, 2016.

region continues to face a range of economic, governance, and environmental challenges. These challenges indicate that it is likely that the Defence Force will have to deploy to the region over the next ten years, for a response beyond humanitarian assistance and disaster relief. New Zealand will continue to protect and advance its interests by maintaining strong international relationships, with Australia in particular, and with its South Pacific partners, with whom it maintains a range of important constitutional and historical links.⁷⁴

New Zealand works closely with Pacific Island states on a bilateral and multilateral basis. It has played a key role in promoting peace and stability in the Southwest Pacific in places such as Timor-Leste, the Solomon Islands, and Bougainville, and Papua New Guinea. Approximately 60% of New Zealand's foreign assistance goes to the Southwest Pacific.⁷⁵ In September 2015, Auckland pledged to increase foreign assistance to the region by \$100 million to reach a total of \$1 billion in expenditures over the next three years.⁷⁶ New Zealand also has provided development and disaster assistance to the region. In 2015, New Zealand's then-Prime Minister John Key reaffirmed New Zealand's support for the Pacific Islands Forum and sustainable South Pacific economic development, including for sustainable fisheries.⁷⁷ An estimated \$2 billion worth of fish is taken legally from the waters of the 14 PIF countries, with an additional \$400 million worth of fish thought to be taken illegally each year.⁷⁸

France

France's decision to stop nuclear testing in the South Pacific in 1996 opened the way for improved relations with the region. Although much of France's regional military presence was withdrawn following its decision to stop nuclear testing, France continues to have a military presence that reportedly includes 2,800 personnel and 7 ships, including surveillance frigates and patrol vessels.⁷⁹ France is also a member of the Quadrilateral Defense Coordination Group, along with the United States, Australia, and New Zealand, which seeks to coordinate maritime security in the South Pacific. France recently signed a \$39 billion deal to provide 12 new submarines to the Australian Navy.⁸⁰

Other External Actors

Other external actors are becoming more active in the Southwest Pacific.⁸¹ Russia reportedly has sent a shipment of weapons with advisors to help train the Fijian military in the use of recently

⁷⁴ Government of New Zealand, 2016 Defence White Paper, June 2016.

⁷⁵ Ministry of Foreign Affairs and Trade, "Strategic Direction," <http://www.mfat.govt.nz> undated, accessed October 27, 2016.

⁷⁶ John Key, "NZ Support for the Pacific to Reach \$1 Billion," September 9, 2015, [beehive.govt.nz](http://www.beehive.govt.nz).

⁷⁷ John Key, "New Funding Supports Sustainable Fisheries," September 11, 2015, <https://www.beehive.govt.nz/release/new-funding-supports-sustainable-pacific-fisheries>.

⁷⁸ Audrey Young, "US Extending Eye on Pacific to Help Cut Illegal Fishing," *New Zealand Herald*, February 22, 2011.

⁷⁹ "France and Security in the Asia-Pacific," France Ministry of Defense, <http://www.defense.gouv.fr/content/download/261113/3194598/file/>, accessed October 27, 2016.

⁸⁰ Bruno Tertrais, "With Military Deals, France Asserts its Presence in the Asia-Pacific," *World Politics Review*, June 15, 2016; Center for Strategic and International Studies, "France: The Other Pacific Power," December 14, 2012.

⁸¹ Euan Graham, "Replacing the Patrol Boats: A Smart Re-Investment Play," PACNEWS, February 3, 2016.

delivered equipment.⁸² India reportedly is exploring the possibility of establishing a satellite monitoring station in Fiji.⁸³

Indonesia, too, has become more interested in the region, often with regards to its relations with the Melanesian countries. Indonesia has been a dialogue partner of the Pacific Islands Forum since 2001. Indonesian objectives related to the PIF include repositioning Indonesia's foreign policy towards a "look east policy" and getting "closer to the countries of the Pacific region," maintaining "the integrity of the unitary Republic of Indonesia," and improving the "image of Indonesia."⁸⁴ The PIF and Melanesian countries have criticized human rights abuses in West Papua, Indonesia, which has a large, ethnically Melanesian indigenous population.⁸⁵ Alleged human rights violations include the harassment of human rights groups and arbitrary arrests of independence activists.⁸⁶ Some Melanesian countries have supported self-determination for West Papua and its inclusion in the Melanesian Spearhead Group.⁸⁷ Indonesia has responded that it is a democratic country that is committed to human rights. It has resisted "interference in its domestic affairs" and in 2015 refused to accept a PIF fact-finding mission to investigate human rights violations.⁸⁸

Climate Change and Other Environmental Issues

Pacific Island countries have sought international support for helping them to cope with the impacts of climate change, reduce greenhouse gas (GHG) emissions, and increase renewable energy use and energy efficiency. U.S. assistance efforts in the region have focused on climate change adaptation and strengthening governmental capacity to attract international financing and successfully implement environmental programs.⁸⁹ Many experts view the Pacific Islands as highly vulnerable to the effects of climate change and other environmental problems, such as sea level rise, ocean acidification, invasive species, and extreme weather events. These environmental issues can have adverse effects on agriculture, drinking water supplies, fisheries, and tourism.

A report by the U.S. Fish and Wildlife Service states

Climate change presents Pacific Islands with unique challenges including rising temperatures, sea-level rise, contamination of freshwater resources with saltwater, coastal erosion, an increase in extreme weather events, coral reef bleaching, and ocean acidification. Projections for the rest of this century suggest continued increases in air and ocean surface temperatures in the Pacific, increased frequency of extreme weather events,

⁸² "Russian Arms Deal with Fiji Prompts Regional Concerns," *Nikkei*, February 15, 2016.

⁸³ "India for Satellite Tracking Unit in Fiji," *Deccan Herald*, August 20, 2015.

⁸⁴ Republic of Indonesia, Ministry of Foreign Affairs, *Pacific Islands Forum*, <http://www.kemlu.go.id/en/kebijakan/kerjasama-regional/Pages/PIF.aspx>, accessed October 27, 2016.

⁸⁵ The island of Papua is divided into two parts: West Papua, Indonesia, in the west and Papua New Guinea in the east.

⁸⁶ Department of State, *Country Reports on Human Rights Practices for 2015—Indonesia*; "Guest Blog: Maire Leadbeater—Pacific Nations Diplomacy for West Papua Puts New Zealand to Shame," *The Daily Blog*, October 18, 2016; "Geo-Politics At Play over Leaders' Lack of Expressed Commitment on West Papua," *PACNEWS*, September 12, 2016.

⁸⁷ "Full Membership for West Papua Expected in December," *PACNEWS*, October 9, 2016.

⁸⁸ Benny Giay, "Finding a Dignified Resolution for West Papua," *The Conversation*, May 6, 2016; Petrus Farneubun, "Commentary: Indonesia Rejects Pacific Leaders' Statement on Human Rights Abuses in Papua," *PACNEWS*, September 27, 2016.

⁸⁹ Gloria Steele, Deputy Assistant Administrator, Bureau for Asia, U.S. Agency for International Development, Statement before the House Foreign Affairs Committee, Subcommittee on Asia and the Pacific, June 23, 2016.

and increased rainfall during the summer months and a decrease in rainfall during the winter months.⁹⁰

Some areas of the region lie only 15 feet above sea level, and if sea levels continue to rise as projected, Kiribati, Tokelau, and Tuvalu may be uninhabitable by 2050.⁹¹ Some experts predict that many Pacific Islanders face displacement over the coming decades. Kiribati reportedly is buying land in Fiji in case its population needs to relocate.⁹²

Much of the Republic of the Marshall Islands is less than six feet above the sea, and some experts say that rising sea levels may make many areas of the country unfit for human habitation in the coming decades.⁹³ Bikini Islanders, with the support of the U.S. Department of the Interior, have asked to be allowed to resettle in the United States. They claim that Kili and Ejit, the islands to which Bikini Islanders were relocated before and after the nuclear tests of the 1940s and 1950s and where about 1,000 of them currently live, can no longer sustain them, due to a lack of resources and a greater frequency of bad weather. Recurrent flooding from storms and high tides has disrupted water supplies and destroyed crops. The Department of the Interior has proposed that the U.S. resettlement fund set up for Bikini Islanders help to support their relocation to the United States.⁹⁴

The Paris Agreement and the Pacific

Pacific Island states were very active in seeking to influence the outcome of the U.N. Climate Change Conference of the Parties (COP) in Paris, France, in 2015. The Paris Agreement includes several outcomes sought by Pacific Island countries, such as a commitment to limit temperature rise.⁹⁵ The Agreement reaffirms “the goal of limiting global temperature increase well below 2 degrees Celsius, while urging efforts to limit the increase to 1.5 degrees.”⁹⁶ Twelve Pacific Island countries signed the Paris Agreement on April 22, 2016.⁹⁷

The Pacific Islands Forum 2016 annual meeting continued the organization’s focus on climate change. The Forum Communique included the following statement:

⁹⁰ Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis*, <http://www.ipcc.ch/report/ar5/wg1/>; U.S. Fish and Wildlife Service, “Climate Change in the Pacific Region,” <https://www.fws.gov/pacific/climatechange/changepi.html>.

⁹¹ CRS In Focus IF10468, *Sea-Level Rise and U.S. Coasts*, by Nicole T. Carter and Peter Folger; Rob Taylor, “Pacific Islands Take Steps to Counter Rising Sea Levels,” *Dow Jones*, November 30, 2015; USAID, “Pacific Islands: Environment and Global Climate Change,” <https://www.usaid.gov/pacific-islands/environment-and-global-climate-change>.

⁹² “Small Islands Demand Coal Moratorium,” *Australian Associated Press*, September 7, 2015; After Paris: Climate Finance in the Pacific Islands,” Oxfam Research Report, September 2016.

⁹³ Coral Davenport, “The Marshall Islands Are Disappearing,” *New York Times*, December 1, 2015.

⁹⁴ Giff Johnson, “Interior Official Focuses on Bikini Resettlement Options,” *Marianas Variety*, July 17, 2016; “Bikini Islanders Demand Refuge in US amid Radiation and Climate Concerns,” *Sputnik News Service*, March 22, 2015; Taryn Tarrant-Cornish, “Bikini Islanders in Desperate Plea to USA as Island Home Disappears Due to Climate Change,” *Express.co.uk*, October 27, 2015; Department of the Interior, Office of Insular Affairs, “Interior Proposes Legislation to Expand Bikini Islanders’ Use of Resettlement Fund beyond the Marshall Islands,” October 20, 2015.

⁹⁵ “Framework for Pacific Regionalism,” *PACNEWS*, February 8, 2016.

⁹⁶ “Outcomes of the UN Climate Change Conference in Paris,” Center for Climate and Energy Solutions, December 12, 2015. <http://www.c2es.org>

⁹⁷ Fiji, Nauru, Palau, Republic of the Marshall Islands, Samoa, and Tuvalu ratified the agreement. “Six Pacific Island Nations Ratify Paris Accord on Climate Change,” *ForeignAffairs.co.nz*, April 26, 2016.

Leaders reiterated the importance of the Pacific Islands Forum in maintaining a strong voice considering the region's vulnerabilities to the impact of climate change. Leaders welcomed the Paris Agreement and reinforced that achieving the Agreement goal of limiting global temperature increases to 1.5°C above pre-industrialised levels is an existential matter for many Forum Members which must be addressed with urgency. Leaders congratulated the eight Forum countries that have ratified the Agreement and encouraged remaining Members and all other countries to sign and ratify the Agreement before the end of 2016 or as soon as possible. Leaders called for ambitious climate change action in and across all sectors and encouraged key stakeholders to prioritise their support for the implementation of key obligations under the Agreement.⁹⁸

Ocean Acidification

Climate change and sea level rise are not the only environmental challenges “substantially enhanced” by anthropogenic activity facing the region.⁹⁹ Ocean acidification is likely to have a severe impact on Pacific Island states. According to some experts, carbon dioxide, absorbed by seawater, creates acidification which in turn reduces the ability of many marine organisms, such as coral, from regenerating.¹⁰⁰ Coral reefs play a key role in supporting fisheries and tourism which are two key components of the economy of many Pacific Island states. A recent study has found that coral cover in the Great Barrier Reef off the coast of Australia has declined by 50% over the past 30 years. Various studies have predicted that if current trends continue, ocean reefs will “be the first major ecosystem in the modern era to become ecologically extinct” by the end of the century. Others predict an earlier demise.¹⁰¹

Fisheries

The Southwest Pacific straddles the largest tuna fisheries in the world. According to one advocacy group, over half of the tuna consumed in the world is harvested from the Western and Central Pacific Ocean at an unsustainable rate.¹⁰² Many of the Pacific Islands states lack the capacity to effectively monitor and patrol their fisheries resources. In one example, Palau, a nation with a land area of 177 square miles and a maritime exclusive economic zone (EEZ) of 230,000 square miles, has a maritime police division of 18 personnel and one patrol ship. The global black market for seafood is estimated to be worth \$20 billion with one in five fish caught illegally.¹⁰³ As a result, poaching of fisheries is a major problem in the Pacific. In order to minimize poaching, the United States and nine Pacific Island states have entered into ship rider agreements. Under the program, enforcement officials from Pacific Island states may ride U.S. Coast Guard ships while they are patrolling the EEZs of those states. U.S. Coast Guard ships are empowered to enforce the laws of the host nation.¹⁰⁴

⁹⁸ “Forum Communique,” op. cit.

⁹⁹ “It is unequivocal that anthropogenic increases in the well-mixed greenhouse gases (WMGHGs) have substantially enhanced the greenhouse effect.” Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis*, op. cit.

¹⁰⁰ “What Is Ocean Acidification?” National Oceanic and Atmospheric Administration Carbon Program, <http://www.pmel.noaa.gov>, accessed October 27, 2016.

¹⁰¹ Elizabeth Kolbert, *The Sixth Extinction* (New York: Picador Publishers, 2014), pp. 130, 138.

¹⁰² Greenpeace, “Pacific Ocean,” <http://www.greenpeace.org>, accessed September 22, 2016.

¹⁰³ Ian Urbina, “Palau vs the Poachers,” *New York Times*, February 17, 2016.

¹⁰⁴ “The Value of Ship Rider Agreements in the Pacific,” cogitASIA, CSIS, December 10, 2014; CRS Report RL34124, *Seafood Fraud*, by Harold F. Upton.

Referenda on Self-Determination

New Caledonia, a territory of France, and Bougainville, which is part of Papua New Guinea, are to hold referenda on independence in 2018 and 2019. Issues and areas of possible concern to Congress include U.S. assistance for the administration of free and fair elections, the building of political institutions, and the mitigation of potential conflict. Developments in Bougainville also may affect U.S. relations with Papua New Guinea.

New Caledonia

The French Overseas Territory of New Caledonia, annexed by France in 1853 and formerly used as a penal colony for French convicts, may become the world's next state. An estimated 39% of New Caledonia's 260,000 people are Kanaks while 27% are European, with the balance composed of "mixed race" persons and others from elsewhere in the Asia-Pacific.¹⁰⁵ In the 1980s, the indigenous Kanaks clashed with pro-France settlers. In a referendum in 1987, which was boycotted by local independence groups, New Caledonians voted to remain with France.¹⁰⁶ Under the Noumea Accord of 1998, signed by France, the Kanak Socialist Liberation Front, and the territory's anti-independence RCPR Party,¹⁰⁷ a referendum on independence must be held by the end of 2018.

Bougainville

The Bougainville conflict between the Papua New Guinea Defense Force and the pro-independence Bougainville Revolutionary Army began over disputes related to the Panguna copper mine on Bougainville in the late 1980s. Key grievances related to the mine included the influx of workers from elsewhere in Papua New Guinea and Australia, environmental damage caused by the mine, and Bougainville islanders' dissatisfaction with their share of mine revenue.¹⁰⁸ Tensions over the mine and secessionist sentiment led to a decade-long, low-intensity war in which an estimated 10,000 to 20,000 government troops, militants, and civilians died. Peace between the government and rebels was restored in 1997 under a New Zealand-brokered agreement.¹⁰⁹ Under the terms of the agreement, a referendum on self-determination is to be held by mid-2020. A target date of June 2019 has now been agreed to by the Papua New Guinea government and Bougainville regional government.¹¹⁰ Some factions reportedly have held onto their weapons out of concern that the PNG government will not go through with the referendum.¹¹¹

¹⁰⁵ "Introducing Your Future Pacific Neighbors," *PACNEWS*, April 5, 2016.

¹⁰⁶ "New Caledonia Rights Campaigner Found Dead on Nudist Beach," *The Guardian*, June 7, 2016.

¹⁰⁷ *Rassemblement pour une Calédonie dans la République*

¹⁰⁸ Timothy Hammond, "Resolving Hybrid Conflicts: The Bougainville Story," *Foreign Policy Journal*, December 2012, and "Bougainville Island," *Encyclopedia Britannica*, <http://britannica.com>.

¹⁰⁹ Bede Cory, "The Bougainville Peace Process," in Bruce Vaughn ed. *The Unraveling of Island Asia? Governmental, Communal, and Regional Instability* (Westport: Praeger Publishers, 2002).

¹¹⁰ "Ball Rolling on Bougainville Referendum," *Radio New Zealand*, May 23, 2016.

¹¹¹ "Decision Set to Change Bougainville Future," *PACNEWS*, May 22, 2016.

Appendix. Social and Economic Indicators

Country	Population	GDP per capita \$US (PPP)	Life Expectancy (years)
Papua New Guinea	6,672,429	2,700	67
Fiji	909,389	9,000	72
Solomon Islands	622,469	1,900	75
Vanuatu	272,264	2,500	73
Samoa	197,773	5,200	73
Tonga	106,501	5,100	76
Kiribati	105,711	1,800	65
Micronesia	105,216	3,000	72
Marshall Islands	72,191	3,200	72
Palau	21,265	15,100	72
Tuvalu	10,869	3,400	66
Cook Islands	9,838	12,300	75
Nauru	9,540	14,800	66
Niue	1,190	5,800	n/a

Source: Central Intelligence Agency, *The World Factbook*, 2016.

Note: PPP = Purchasing Power Parity

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Acknowledgments

Amber Wilhelm and Hannah Fischer created the map of the Southwest Pacific (**Figure 1**).

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India

Subject	Page
Ambassador Kenneth L. Juster.....	125
US Relations with India.....	127
CultureGram 2019.....	129
BBC Country Profile.....	139
Economist Intelligence Unit Country Report.....	145
CRS: U.S.- India Trade Relations	187

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U.S. Ambassador to India Kenneth I. Juster



Kenneth I. Juster was unanimously confirmed by the U.S. Senate on November 2, 2017 and appointed by the President on November 3, 2017 to be the 25th United States Ambassador to the Republic of India. He presented his credentials to the President of India on November 23, 2017. Mr. Juster has almost 40 years of experience as a senior business executive, senior law partner, and senior government official.

Mr. Juster previously served from January to June 2017 as the Deputy Assistant to the President for International Economic Affairs and Deputy Director of the National Economic Council. He was a senior member of both the National Security Council staff and the National Economic Council staff. In this role, Mr. Juster coordinated the Administration's

international economic policy and integrated it with national security and foreign policy. He also served as the lead U.S. negotiator ("Sherpa") in the run-up to the G7 Summit in Taormina, Italy.

Prior to that, Mr. Juster was a Partner and Managing Director, from 2010-2017, at the global investment firm Warburg Pincus, where he focused on a broad range of issues, including geopolitical risk, global public policy, and regulatory matters relating to the Firm's investment activities and portfolio companies. From 2005-2010, Mr. Juster was Executive Vice President of Law, Policy, and Corporate Strategy at salesforce.com, a software company that pioneered cloud computing for business enterprises

Mr. Juster served as U.S. Under Secretary of Commerce from 2001-2005, in charge of the Bureau of Industry and Security. In that capacity, he oversaw issues at the intersection of business and national security, including strategic trade controls, imports and foreign investments that affect U.S. security, enforcement of anti-boycott laws, and

industry compliance with international arms control agreements. Mr. Juster co-founded and served as the U.S. Chair of the U.S.-India High Technology Cooperation Group, and was one of the key architects of the Next Steps in Strategic Partnership initiative between the United States and India. That initiative helped provide the foundation for the historic civil nuclear agreement between the two countries. Upon completion of his term at the Commerce Department, Mr. Juster received the William C. Redfield Award, the Department's highest honor.

From 1992-1993, Mr. Juster served as the Counselor (Acting) of the U.S. Department of State, and from 1989-1992 as the Deputy and Senior Adviser to Deputy Secretary of State Lawrence S. Eagleburger. Mr. Juster was one of the key officials involved in establishing and managing U.S. assistance programs to Central and Eastern Europe and the former Soviet Union, including setting up the initial Enterprise Funds for the region. He also was part of the five-man team, led by Deputy Secretary Eagleburger, that traveled to Israel prior to and during the first Gulf War to coordinate with the Israelis regarding their posture during the war. Upon completion of his term at the State Department, Mr. Juster received the Distinguished Service Award, the Department's highest honor.

From 1981-1989 and 1993-2001, Mr. Juster practiced law at the firm Arnold & Porter, where he became a senior partner and his work involved international arbitration and litigation, corporate counseling, regulatory matters, and international trade and transactions. Among his noteworthy cases was the representation of the Government of Panama-in-exile against the Noriega regime. The President of Panama subsequently awarded him the Vasco Núñez de Balboa en el Grado de Gran Cruz Decoration and Medal.

Mr. Juster also has served as a Visiting Fellow at Harvard's Kennedy School of Government in 2010, a Member of the President's Advisory Committee for Trade Policy and Negotiations from 2007- 2010, a Visiting Fellow at the Council on Foreign Relations in 1993, a law clerk in 1980-1981 to Judge James L. Oakes of the U.S. Court of Appeals for the Second Circuit, and at the National Security Council in 1978. In addition, he has served as the Chairman of the Advisory Committee of Harvard's Weatherhead Center for International Affairs, the Chairman of Freedom House, and the Vice Chairman of the Asia Foundation. He is currently a member of the Council on Foreign Relations and the American Academy of Diplomacy.

Mr. Juster holds a law degree from the Harvard Law School, a Master's degree in Public Policy from the John F. Kennedy School of Government at Harvard, and a Bachelor of Arts degree in Government (Phi Beta Kappa) from Harvard College.



United States Department of State

U.S.-INDIA RELATIONS

Our relationship is rooted in common values, including the rule of law, respect for diversity, and democratic government. We have a shared interest in promoting global security, stability, and economic prosperity through trade, investment, and connectivity. The United States supports India's emergence as a leading global power and a key partner in our efforts to ensure that the Indo-Pacific is a region of peace, stability, and growing prosperity. On September 6, 2018, India will host Secretary Pompeo and Secretary Mattis for the inaugural 2+2 ministerial dialogue in New Delhi. This engagement will support increased diplomatic, security, and military cooperation to confront pressing global challenges, including the threat of terrorism. The strong people-to-people ties between our countries and our common values are a tremendous source of strength for our partnership.

Bilateral Economic Relations

The United States seeks to expand trade in a relationship that is open and fair with a level playing field on both sides. Bilateral trade increased by \$12 billion in 2017, to \$126.1 billion, and two-way investment to \$45 billion. Since October 2018, Indian petroleum companies have placed orders for near 12 million barrels of crude oil from the United States with a value of approximately \$580 million. The total number of Indian students in the United States has more than doubled over the last decade, from 81,000 in 2008 to 186,000 in 2017. Last year Indian students in U.S. colleges and universities contributed \$6.54 billion to the U.S. economy.

India's Membership in International Organizations

India and the United States share membership in a variety of international organizations, including the United Nations, G-20, Association of Southeast Asian Nations (ASEAN) Regional Forum, International Monetary Fund, World Bank, and World Trade Organization. The United States supports a reformed UN Security Council that includes India as a permanent member. India is an ASEAN dialogue partner, an Organization for Economic Cooperation and Development partner under its Enhanced Engagement program, and an observer to the Organization of American States. India is also a member of the Indian Ocean Rim Association (IORA), of which the United States is a dialogue partner.

Bilateral Representation

Principal U.S. embassy officials are listed on the embassy [website](#) and in the Department's Key Officers List.

India maintains an embassy in the United States at 2107 Massachusetts Avenue NW, Washington, DC 20008 (tel. 202-939-7000).



Boundary representations are not necessarily authoritative.

BACKGROUND

Land and Climate

India is roughly one-third the size of the United States. The Himalayas, the tallest mountain system in the world, are located on India's northern border. South of the Himalayas, the fertile Ganges Plain is India's most densely populated region. The Great Indian (Thar) Desert extends westward from the plain into Pakistan. The Deccan Plateau, in the south, lies between the Western Ghats and Eastern Ghats, hill regions along the coasts of peninsular India. About half of the country is under cultivation, and less than one-fourth is forested.

Most of the country experiences three basic seasons: hot (March–May), rainy (June–October), and cool (November–February). Temperatures rarely go below 40°F (4°C) in January or reach above 100°F (40°C) during the summer. Variations exist according to region and elevation. Droughts and earthquakes are common, as are floods (especially during the monsoon season).

History

Foreign Empires

The Indus Valley civilization dates back more than five thousand years. Around 1500 BC, Aryans arrived from central Asia and gradually pushed the native Dravidians

southward. Buddhism flourished during King Asoka's reign in the third century BC but declined afterward. The northern Gupta Kingdom, from the fourth to sixth centuries AD, was a golden age of science, literature, and the arts. Southern India also experienced several great empires. Arab, Turk, and Afghan Muslims ruled successively from the eighth to eighteenth centuries, providing some basis for the historical animosity between Hindus and Muslims. Following Portuguese and Dutch traders, the English eventually assumed political control of the area.

Independence and Partition

After World War I, Mahatma Gandhi led a continuing nationalist movement, advocating civil disobedience and passive resistance in a campaign to gain autonomy from Great Britain. Gandhi's goal was realized in 1947, when India was granted independence. Religious rivalry and violence led to the partition of British India into the Islamic Republic of Pakistan and the Union of India. India became a republic within the British Commonwealth, with Jawaharlal Nehru as the first prime minister. Gandhi was assassinated in 1948.

In 1950, after the adoption of the Constitution of India, India officially became a democracy. Nehru won his second term as prime minister in the 1952 elections. Nehru's daughter (Indira Gandhi) was elected prime minister twice (1966–77, 1980–84). In 1984, she was assassinated by her Sikh bodyguards after Indian troops stormed the Sikhs' Golden

Temple in a violent clash with separatists. Recurring violence related to a Sikh movement for independence in Punjab Province subsided by the late 1990s.

Since the partition of the Indian subcontinent in 1947, tensions have been strained between Pakistan and India. In 1965, both countries went to war over Kashmir, the disputed territory north of the Punjab. In 1972, Pakistan and India agreed to a cease-fire line now called the Line of Control (LOC), which divides Kashmir. One-third is under Pakistan's control; two-thirds is part of India as Jammu and Kashmir.

Political Transitions

After Indira Gandhi's death, the powerful Indian National Congress, or Congress Party, gradually weakened in the face of economic troubles, a rise in Hindu fundamentalism, massive corruption, crime, and religious violence. No party won more than one-third of the seats in the 1996 parliamentary elections. The coalition fell apart in 1997; new elections were held in 1998. The Bharatiya Janata Party (BJP) won, though not with a majority of seats, and formed a coalition government under the direction of Prime Minister Atal Bihari Vajpayee.

The BJP, once seen as extremist for its Hindu nationalist ideology, moderated some of its policies and worked to address India's most pressing economic and social concerns. India's nuclear test explosions in 1998 resulted in international condemnation and sanctions. India has since promised not to use nuclear weapons in a first strike. The Congress Party returned to power in May 2004 elections, and Manmohan Singh was appointed prime minister. Singh won a second term in 2009. In May 2014, India's BJP won a majority of seats in the *Lok Sabha* (House of the People) during parliamentary elections. The BJP's leader, Narendra Modi, was appointed as prime minister. Modi has focused largely on growing the economy, improving health and sanitation standards, and strengthening foreign relations (with an emphasis on improving relations with neighboring countries and those within East and Southeast Asia).

Recent Events and Trends

- **Presidential election:** In July 2017, Ram Nath Kovind was sworn in as president of India, a largely ceremonial role. Kovind, who was nominated by the ruling BJP party, won over 65 percent of the vote by Indian parliament and state assembly members. The president belongs to the Dalit community, one of the most oppressed groups in India.
- **Temple ban defied:** In January 2019, two women prayed at the Sabarimala Temple, in Kerala, defying a centuries-old ban on women under the age of 50 worshipping at the Hindu complex. In 2018, India's Supreme Court ruled that women of all ages should be allowed to visit the temple, a decision many of the temple's devotees, men and women alike, have protested. Many say the court ruling infringes on their freedom of religion, as they believe that the Hindu god Lord Ayyappa is celibate and cannot be in the presence of menstruating women.
- **India-Pakistan tensions:** In February 2019, India accused Pakistan of orchestrating a suicide bombing in the Indian-controlled area of Kashmir. The attack, which was claimed by the Pakistan-based Jaish-e-Mohammad militant group, killed around 40 Indian paramilitary police. Pakistan

denied involvement and urged India not to retaliate, but India launched airstrikes against Pakistan. Tensions escalated even further when Pakistan later shot down two Indian planes. The Muslim-majority area of Kashmir has been in dispute since the partition of India in 1947.

THE PEOPLE

Population

India has the world's second-largest population, behind China. India is one of the most ethnically diverse countries in the world, with hundreds of linguistic nationalities and hundreds of different castes (tribes) residing in each state. The Indo-Aryan castes comprise 72 percent of the population. Dravidians account for 25 percent. The remaining 3 percent is comprised of a number of other groups.

Nationally, castes are assigned to one of four general classes by the government. These include forward classes (FC), backward classes (BC), scheduled castes (SC), and scheduled tribes (ST). Classifications are based on social, historical, and economic criteria. Individuals in each classification might be rich or poor, as class does not necessarily define wealth in today's India, but BCs, SCs, and STs can access affirmative action programs that reserve jobs, scholarships, and other benefits for castes that historically were persecuted or disadvantaged. People in the SC and ST groups have come to be collectively known as *Dalits* (downtrodden).

A person's caste is a matter of lineage and cannot change, but Parliament technically has power to reassign a caste to another class. For example, if a government leader belongs to a *Dalit* class, his or her offspring can still access affirmative action unless Parliament upgrades the caste to the forward class. Caste still plays an important role in certain social interactions. Castes maintain their distinct culture and identity, and they rarely intermarry (though this is changing over time, especially in cities).

Castes are often confused with the Brahmin classification philosophy, *Chaturvarna Vyavasta* (four-class system), perhaps because the three historically dominant Aryan castes bear the same name as the three highest classes in this system. The ancient Sanskrit scholars believed any society is composed of four classes: *Brahmin* (intellectuals and priests), *Kshatriya* (rulers and warriors), *Vaishya* (merchants and artisans), and *Shudra* (workers). As they dispersed on the Indian subcontinent, the Aryans grouped most non-Aryan castes into the *Shudra* class. The Brahmin philosophy became widespread by AD 1000 because of Aryan dominance in many states, but it does not determine a person's caste.

Indian society is divided along four main lines: rural-urban, male-female, wealthy-poor, and the various castes. Differences are usually manifested in terms of social freedoms and access to educational and economic opportunities. Generally, urban dwellers, males, the wealthy, and those from the higher castes hold more respected positions in society and have more access to opportunities. While improvement has been made in many areas and

government efforts seek to mitigate the discrepancies between groups, these divisions remain in place and pervade most aspects of Indian society.

Language

India is home to several hundred languages, of which dozens have 100,000 or more speakers. Twenty-two languages have official status: Assamese, Bengali, Bodo, Dogri, Gujarati, Hindi, Kannada, Kashmiri, Konkani, Maithili, Malayalam, Manipuri, Marathi, Nepali, Oriya, Punjabi, Sanskrit, Santhali, Sindhi, Tamil, Telugu, and Urdu. Languages spoken vary by region (e.g., Telugu is the language of the state of Andhra Pradesh). Indian law defines English as a “subsidiary official language.” It is used in government, business, education, and national communication. About 41 percent of the population speaks Hindi, the country's most widely spoken language.

People who do not share a common first language generally communicate in either Hindi or English. Linguistic tensions sometimes arise because speakers of India's other languages often feel marginalized by the dominance of Hindi.

Religion

Hinduism, Buddhism, Jainism, and Sikhism were born in India. The country is also an adopted home for Zoroastrianism (called Parsiism in India). A variety of religions exist side by side in India, and it is not uncommon to find Christian churches, Muslim mosques, and Hindu temples all on a single block. About 80 percent of Indians are Hindu. Officially, Hinduism is considered not a religion but a way of life. Shared beliefs of various indigenous religions merged over thousands of years, so people often include images of gods from other religions in their family temples.

Differences between religions usually are minor due to the historical Brahmin influence on most castes. Brahmin spread throughout India over time, adopting and adapting local religions and then writing their philosophies in Sanskrit and the local languages. Hence, Brahmanism helped shape many religious traditions. Buddhism even stems, in part, from Brahmin philosophy. Hindu concepts include reincarnation and veneration for trees and animals, which can be symbols of a certain god. Among the most prominent Hindu gods in various states are Narayana, Rama, Krishna, Shiva, Durga, Jagannath, Ganesh, Murugan, and Vishnu.

About 14 percent of Indians are Muslims, who follow the teachings found in the *Qur'an* (Muslim holy book) and regard Muhammad as the last messenger of God (*Allah*). The Sikh religion (2 percent, mostly in Punjab) emerged around the 16th century, drawing on principles from both Hinduism and Islam. Sikhism stresses simple teachings, tolerance, and devotion. Beginning in India, Buddhism flourished for a time but did not maintain a following there. Less than 1 percent of the population is Buddhist. Jains, though economically and politically powerful in India, also comprise less than 1 percent. Jains practice a reverence for life (*ahimsa*; literally, “nonviolence”), self-denial (especially monks), and vegetarianism. About 2 percent of the population is Christian.

General Attitudes

Indians tend to be religious, family oriented, and

philosophical. Indians traditionally value simple material comforts, physical purity, and spiritual refinement. Even in hardship, one is expected to accept one's course in life as the will of God or fate. Abundant expressions of gratitude are generally reserved for real favors rather than routine courtesies. Many Indians are highly superstitious, often turning to holy men, believed to mediate between heaven and earth, for guidance and blessings.

Most Indians deeply respect the nation's founder, Mahatma Gandhi, and his ideals, which included humility, nonviolence, self-denial, and religious harmony. Yet many Indians sadly acknowledge that Gandhi's principles are hard to find in practice in today's India. Many are equally troubled by the fact that the government has not adequately addressed basic needs: sanitation, health care, education, and housing. Tensions between Hindus and Muslims, social classes, rural and urban populations, and traditional and modern values make it difficult for India's people to seek common ground amid their diversity. Nevertheless, as citizens of the world's most populous democracy, Indians are pressing forward to find balance amid continual social change.

Personal Appearance

Clothing styles vary by region and religion. Western-style clothing is commonly worn by men and women in urban areas. Rural men are more likely to wear western fashions than rural women. The younger generation follows Western fashion trends and may often mix Western and traditional Indian styles together. For example, young men might wear a *kurta* (long, loose shirt) over a pair of jeans.

In southern India, married women generally wear a *saree* (a long length of fabric draped in variations that can represent socio-economic status and religious affiliation) daily. For most Indian women, *sarees* are reserved for special occasions such as weddings. The *salwar kameez*, a colorful pantsuit with a knee-length shirt, is popular among women in northern India.

Many women also wear considerable jewelry. Hindu women may have a *bindi*, or red dot, on their foreheads. Traditionally a sign of femininity, gracefulness, and marital status, the *bindi* has become for many an optional beauty aid, and its color frequently matches the wearer's outfit. After marriage, the *bindi*, accompanied by red powder on her upper forehead (or vermilion powder in the part of her hair), signifies the woman's husband is alive; widows do not wear a *bindi*. Women may decorate their hands and feet with henna, a plant dye, during special occasions.

Hindu and Muslim men may also wear a *salwar kameez* (a long shirt worn over pants), sometimes accompanied by a jacket or a vest. Sikhs typically wear the “five k's”: *kesh* (uncut hair), *kanga* (a wooden comb worn in the hair), *kaach* (undershorts), *kara* (an iron bracelet), and *kirpan* (a ceremonial sword). Sikh men generally wear turbans. A colorful *lungi* (a long piece of cloth, knotted at the waist) is desired attire for men in the south, but it is not popular in northern parts of India. In the north, men traditionally wear a *kurta pajama*, which consists of two garments: a long, loose shirt and a lightweight drawstring trouser. Though mostly worn on formal occasions, the *kurta pajama* may also be

worn casually. For special occasions, men may wear Western-style suits or more traditional clothing, such as a white *dhoti* (large piece of cloth wrapped around the waist).

CUSTOMS AND COURTESIES

Greetings

The *Namaste* is India's traditional greeting. One presses the palms together (fingers up) below the chin and says *Namaste* (in the south, *Namaskaram*). When greeting superiors or to show respect, a slight bow is added. Younger people may greet an elder by touching the person's feet as a sign of respect and to seek blessings.

Out of respect, men usually do not shake hands with or touch women in public. However, Indian men will shake hands with Westerners, and educated Indian women may shake hands as a courtesy. People generally do not greet strangers. Doing so would be considered suspicious. However, foreigners are often greeted warmly. "Hello" and "Hi" are acceptable greetings among equals, but people address superiors with more formal terms such as "Good morning" or its equivalent. Indians usually ask permission before taking leave of others.

Men are often addressed as *Sar* (a title stemming from the English "Sir") and women as *Madam*. It is polite to use titles such as *Professor*, *Doctor*, *Mr.*, *Shri* (for men), or the suffix *-ji* with a last name to show respect.

Gestures

Excessive hand gestures or verbal articulation is considered impolite. Indians beckon with the palm turned down; they often point with the chin. To say "yes" or "okay," people may bob their head side to side. Particularly in the north, the right hand is used for passing objects, eating, and shaking hands, as the left is traditionally reserved for personal hygiene. Grasping one's own ears expresses repentance or sincerity. Whistling is very impolite. Women do not wink or whistle; such behavior is commonly considered unladylike. Public displays of affection are inappropriate. One's feet or shoes should not touch another person, and if they do, an immediate apology is necessary. Footwear is removed before entering a temple, mosque, or Sikh shrine. When entering a Sikh shrine, all people cover their heads. Women also cover their heads in temples.

Visiting

Visits in the home between friends or family are often unannounced. Such visits are sometimes seen as a chance for the hosts to prove that they are able to entertain well even on short notice. The need for prior arrangements is increasing in large cities. It is impolite to say "no" to an invitation; if one cannot attend, one more likely says, "I'll try." Among traditional Indian families, women may not be involved in social functions. At certain gatherings, guests adorned with a garland of flowers remove and carry them as an expression of humility. Guests repay hosts' hospitality by giving gifts, such as flowers, specialty foods (such as fruits or sweets) from other areas of the country, or something for their children.

Many Indians do not wear shoes inside the home. Most guests at least remove shoes before entering the living room. Hosts offer their guests water, tea or coffee, and fruits or sweets. It is polite for a guest initially to refuse these refreshments but eventually to accept them. Visitors often indicate they are ready to leave by saying *Namaste*. In some areas in northern India, people may say *Hare Krishna* before leaving.

In temples, saffron powder, holy water from the Ganges, and sometimes food are offered to visitors as *prasad*, or blessings from the gods; refusing these gifts is discourteous.

Eating

In most parts of India, lunch and dinner are considered the most important meals of the day. A midday meal, called *tiffin*, may refer to a light afternoon tea with snacks or to a full lunch. In southern India, breakfast is the main meal. Rural residents also eat a large, hearty breakfast to prepare for a day's labor; dinners are much lighter. In northern and central India, most people start the day with a light breakfast, followed by a large lunch eaten at home, the office, or school, then a light afternoon tea when family members return home, and a dinner in the evening. Meal times vary by income, location, and schedule of family members.

Indians eat most of their meals in the home, as eating in restaurants is expensive and reserved for special occasions. Working people usually pack their own lunches or purchase home-style cooked food from caterers. India is famous for its efficient lunch delivery service that transports homemade or takeout foods in metal *tiffin* lunch boxes to workplaces.

Eating habits vary sharply between traditional and modern settings. Less traditional (most often urban) families eat meals together and follow many Western customs. Traditional families may eat their food with the right hand or with banana leaves instead of utensils. It is not considered rude to ask for a utensil if desired. At special celebrations, such as weddings, people may eat using banana leaves. People wash their hands before and after eating, and napkins are generally not provided at the table. Women may eat after other members of the family and any guests. When people drink from a communal cup, their lips must never touch it. A gesture of *Namaste* can indicate one has had enough to eat. In rural areas, some Hindus object to having their food handled by members of different castes.

LIFESTYLE

Family Structure

The family is the basic social unit in India and generally takes precedence over the individual. Urban families are generally small, usually with an average of two children. Rural families are usually somewhat larger. An urban household typically consists of a married couple, their children, and the husband's parents and unmarried siblings. A growing number of urban households include only a nuclear family. Rural households are usually made up of several family units—parents, their sons, and the sons' wives and children. As each male in the

family marries, he and his family are given a bedroom.

Extended families often live together or near each other, and bonds between members of the extended family are strong. The extended family serves as a social safety net, and individuals can expect support in times of need. In recent years, these extended family networks have been weakened as people move to urban areas in search of economic and educational opportunities. In these situations, the nuclear family becomes the focus.

Parents and Children

Middle- or upper-class parents expect to provide financially for their children until they finish their education and take a job—regardless of how long it takes. Some parents may continue to support their children even after they marry. In poor families, economic circumstances may force children to start working early to help support the family, often at the expense of attending school. Sons do not generally move out of the family home, as their wives move in with them after marriage. Daughters rarely move out until marriage. The exception is children who leave home to attend a university or to seek better employment opportunities.

The elderly are respected and cared for by their families. The advice of older family members is generally sought out and usually heeded by the younger generations.

Gender Roles

The father or oldest male in the home is head of the household. His decisions are heeded and respected by the rest of the family. The oldest female is generally in charge of managing the household and the kitchen. Daughters-in-law are expected to do most of the cooking. In urban homes, maids may perform most household chores.

A growing number of women seek higher education and work outside the home. This trend is particularly strong in urban areas but is also felt to a lesser degree in rural areas. Despite these changes in the status of many women, women in general lag behind men in terms of access to education and economic opportunities. Women are also more likely to be malnourished and to be victims of violence. Instances of rape and sexual assault against women in India are common; these social problems have gained increased attention and criticism in recent years, which has prompted some legislative changes. While traditionally women did not work outside the home, instead caring for children and the household, women today often have full-time jobs while still maintaining responsibility for the children and household. A growing number of couples share household chores.

Housing

Urban

Building materials and styles of housing vary according to climate, economic standing, and cultural and religious affiliations. In major cities such as Mumbai and New Delhi, there are not enough homes for the millions of residents, some of whom have migrated from rural areas to find work or further their education. Urban slums often stand in the shadow of high-rise apartment buildings. People living in slums live in shelters constructed from whatever materials can be found, often sheets of plastic or aluminum siding. Conditions are crowded, dangerous, and insecure, as these

communities may face demolition at any time. Residents lack access to adequate sanitation facilities and clean drinking water.

A growing trend is enclosed communities in which building maintenance, landscaping, and cleaning are the responsibility of a centralized unit. In these communities, the homeowners contribute monthly fees for these services. In cities and suburbs, apartments are the norm. The roofs of homes and apartment buildings are often flat, providing an open space for water tanks, gardens, and clotheslines. Urban children may use this open space to fly kites and play. Most urban homes have fences for security reasons. Most homes are cooled by air-conditioning units or fans. Central air conditioning is rare. India's warm climate makes central heating unnecessary in most areas.

Rural

Rural homes are usually made from bamboo, mud brick, stone, concrete, or red brick. Roofs may be thatched or made from the same materials as the rest of the home. The kitchen is usually separate from the rest of the house, as smoke from a cooking fire is believed to pollute the home. As the availability of gas and kerosene increases, many in rural areas are choosing these methods over cooking on open fires. Kitchens that use gas or kerosene are often located inside the home. People may also cook on outdoor earthenware stoves powered by firewood or kerosene.

Some rural areas do not have access to running water; instead, people rely on wells. Women in these areas are generally responsible for traveling to and from the well to provide water for the household. Air-conditioning is not common in rural areas, so when the weather is warm, people prefer to spend most of their time outside. When the weather is hot, people in rural areas sometimes sleep on their roofs to take advantage of the cool breeze. Rural families also usually have a garden where they grow produce for their meals. Properties are generally not fenced, and it is considered important to maintain a good relationship with one's neighbors.

Interiors

Indians generally enjoy spending time in their homes and working to improve them. Home decoration varies, but most families prefer traditional paintings and artwork. A statue of the god Ganesh is often placed near the entry of Hindu homes in the belief that doing so will bring prosperity to those living in the home. Hindus may also keep potted basil plants (which are considered sacred and are believed to have medicinal properties) and a small altar in their homes. Wall-to-wall carpeting is unusual. Instead, floors are covered with rugs. While most homes have access to electricity and plumbing, power outages are frequent and droughts are common.

Ownership

Home ownership is an important goal for most people. Special Hindu housewarming rituals (*griha pravesh*) are associated with moving to a new home. Mango leaves are strung across the entrance, and a priest performs a *puja* (religious ritual) in order to ensure that no evil befalls the new residents. Astrological charts are consulted in order to choose the best day on which to move to a new home.

Dating and Marriage

Dating and Courtship

Western-style dating is not common in India but is gaining popularity in larger cities. Despite the rarity of dating, Indian youth generally find the idea fascinating, and media portrayals of dating and romance are popular. Most couples are introduced by their parents or meet at work, school, or social gatherings. Muslim men and women do not form romantic relationships before marriage.

Marriage Arrangements

When a young couple wishes to marry, they approach their parents, who arrange the marriage. Most Indian marriages are arranged by the couple's parents, usually through friends, acquaintances, ads in newspapers, or matchmaking websites. Caste and ancient lineage (called *gotra*) are important considerations when arranging a marriage. In some cases, parents may check the potential couple's horoscopes in order to determine a favorable match. Young people generally provide some input when it comes to arranged marriages and have the right to accept or reject a partner.

Engagement

Hindu engagement traditions differ throughout the country. In northern India, engagements are finalized in the *roka* ceremony. The families meet, and the couple publicly agrees to marry. The occasion is celebrated with food, music, dancing, and exchanging of gifts. After this ceremony, a wedding date is chosen, and the couple is free to court and get to know one another. In western India, at an engagement ceremony (*sagaai*), the bride's family arrives with a *matli* (a steel container full of sweets and gifts) to be given to the groom and his family. In southern Indian families, the bride and groom are not required to attend the engagement function. The commitment is made between their families. The most important ritual in finalizing these engagements consists of each family giving the other a *tattu* (a plate of coconut, flowers, turmeric, betel nuts, and betel leaves).

It is common for the bride's parents to give a dowry (such as money, land, or gifts) to the groom, even though the practice is illegal in India. Today, the dowry may be less of a financial burden than in the past and is often only ceremonial. The bride's family often gives gifts to the groom's family, such as clothes for the wedding and household items for the bride to use after marriage.

Marriage in Society

Marriage is viewed as a union of both two individuals and of two families. Marriage is sacred to most Indians and is believed to endure beyond death. Chastity is considered extremely important for women. While traditionally people married young, often in the late teens, couples today usually marry later. The average urban Indian marries between the ages of 25 and 30. The age can be considerably younger in rural areas.

Islam permits a man to marry up to four wives, but the practice of polygamy is rare today, especially among the younger generation. Homosexuality is taboo in Indian society, although tolerance for LGBT individuals in urban areas has increased somewhat in recent years. Same-sex marriage is illegal.

Weddings

Weddings are cause for great celebration, expense, and feasting. Dates and times for Hindu weddings are carefully chosen based on auspicious astrological timing. Most wedding ceremonies are religious in nature. Ceremonies are often elaborate and vary widely from state to state and from caste to caste. In many, the bride and groom exchange garlands and/or words before they circle around a fire three to seven times to solemnize the marriage. Bright clothing, jewelry, and flowers are part of nearly every type of ceremony. After the wedding, many families hold a reception, usually at an outdoor area of a hotel. Guests celebrate with food and dancing and present the couple with gifts needed to establish a home. After the ceremony or the party, the bride bids good-bye to her family in the *vidai* ritual.

Muslim weddings are finalized with a *akad nikah* ceremony, in which the groom or a representative proposes to the bride in front of at least two witnesses, stating the details of the *mahr* (a formal statement specifying the amount the groom is to pay the bride). Although the couple is already engaged, the symbolic second proposal is part of the ceremony. The bride and groom repeat the Arabic word *Qabul* (I accept) three times. The couple and two male witnesses then sign the marriage contract, making the marriage legal according to civil and religious law.

After the wedding, the bride moves into her husband's family's home. It is extremely rare for newlyweds to move into their own apartment, unless the couple does not live in the same city as the husband's parents. In Hindu families, mango leaves are draped over the entrance, and the bride enters the home stepping first with the right foot, which is considered lucky. Once inside the home, she is welcomed by her mother-in-law, who performs the *ghar nu Lakshmi* ceremony, which includes an *aarti* (a Hindu rite meant to invoke divine blessings). An *aarti* may include reciting mantras in praise of various deities, praying, and rotating clockwise a *thali* (plate) that holds a *diya* (a small bowl of oil in which a wick burns). In Gujarati families, the couple plays a game called *aeki beki* soon after the bride is welcomed. A ring and several coins are placed in a container filled with a mixture of water, vermillion, and milk. Whoever finds the ring four out of seven times is said to rule the household.

Divorce

Divorce is relatively rare, most likely due to the cultural and religious importance of marriage. But in recent years, divorce rates have increased among the urban middle class. In the case of divorce, Indian law stipulates that a man must continue to provide financial support to his ex-wife and any children they have. Divorced men generally find it easier to remarry than divorced women do.

Life Cycle

Birth

For Hindus, life is seen as a spiritual journey, and each step is celebrated with a ceremony or ritual, called a *samskara*. Before a child is born, special ceremonies are often performed in order to ensure the health of the mother and child. Female friends and relatives give gifts to the pregnant woman at a *godh bhara*i (similar to a baby shower). Elderly women may bestow blessings on the pregnant woman.

In some cases, soon after the child is born, the father touches the baby's lips with a spoon dipped in honey, curd, and *ghee* (clarified butter). The sweet mixture is intended to welcome the newborn with the sweetness of the world. Hindu families hold a *namakaran* (naming ceremony) 28 days after a birth; the father or another close relative whispers the baby's name into the right ear. A priest chants mantras praying for a long and healthy life for the newborn and then determines the most auspicious letters to start the baby's name, based on the position of the planets (*nakshatra*) when the child was born. As part of the naming ceremony, the family seeks blessings for the newborn by holding a feast, distributing alms to the poor, and giving gifts to the priest who performs the rituals. Before a girl turns one, the family chooses an auspicious date on which to pierce her ears and nose.

In Hindu families, a baby's first haircut (*mundun*) is a sacred event that occurs in the baby's first or third year. According to Hindu beliefs, the hair present at birth represents unwanted traits from a person's past lives. In order to ensure a new beginning and to encourage the hair to grow back thicker, the head is shaved. The *mundun* is marked by feasting, family gatherings, and religious offerings. An infant's first visit to a Hindu temple is an important milestone.

Muslims celebrate a male baby's circumcision, which takes place soon after birth, with a party for friends and relatives. Christian babies are baptized and christened within the first few months of life. Baptism may include immersing the child or sprinkling water over the head. At a christening, a priest anoints the child with oil and the parents state the given name.

Milestones

Between the ages of six and twelve, most upper-caste Hindu males take part in the *Upanayana* ceremony, an initiation ceremony that marks the transition from childhood to adulthood and brings with it adult religious responsibilities. This ritual is seen as a new birth. At the ceremony, a Hindu priest gives the boy a sacred thread to be worn over the left shoulder at all times. For members of lower castes, a similar ritual takes place before marriage.

Sometime between the ages of six and twelve, Buddhist boys become temporary monks, usually for between two weeks and three months. They stay at the temple and learn about Buddhism from the older monks. To mark their change in status, they shave their heads and wear saffron-colored robes.

In southern India, a young woman's first menstruation is cause for celebration. Some Hindu families hold a party, printing invitations and decorating the home. Guests come to celebrate with the family, bringing gifts for the young woman. Married women in the community may gather to celebrate with the young woman, giving her gifts and distributing *kumkum* (vermilion powder) and *haldi* (saffron powder), both believed to bring good luck and prosperity. This event is considered a way of announcing to the community that the girl is ready for marriage, although in most cases a girl does not marry for a few more years.

In their mid-teens, Muslims of both genders take on religious responsibilities. Prayers, fasting, and other principles are required, and girls begin wearing the *hijab*

(head covering).

At the age of 60, Hindus may offer special prayers, called *shanthi*, meaning "peace." These prayers are seen as a way of giving thanks for all the graces granted throughout one's life and as a way of ensuring a smooth transition to the afterlife.

Death

When an Indian Hindu dies, a procession of mourners accompanies the body as it is taken to be burned on a funeral pyre. Cremation is thought to be the quickest way of releasing a spirit. A close relative of the deceased (usually the oldest son) performs the last rites and lights the funeral pyre. Infants are usually buried rather than being cremated. The body's ashes are typically collected, put in a pot, and then scattered over one of Hinduism's holy rivers. A death is followed by a period of mourning, when the eldest son may shave his head and the immediate family observes dietary and other restrictions. After the funeral, mourners take purifying baths. A few days later, close family members gather for a meal and often give gifts to the poor or donate money to charities in remembrance of the deceased. In honor of the deceased, an altar is constructed where the family makes offerings of food, displays photos of the deceased, and burns incense.

Indian Muslims bury their dead as soon as possible after death. The body is washed and taken to a nearby mosque, where prayers for the deceased are performed. The burial is attended by males only. Buddhists may hold ceremonies at the family home for several days prior to the funeral.

Diet

Diet depends on culture and region. For example, wheat bread (*roti*) is a staple in the north, while rice is the staple food in the rest of the country. In the south, rice shows up in common foods such as *idly* (a steamed mixture of ground rice and lentils), *dosai* (similar to a crepe, made from ground rice and lentils), *uthapam* (flatbread made from ground rice and lentils), *idiyapam* (rice noodles), and *pongal* (rice porridge).

Indian meals are usually very spicy. Onions are used in most dishes. Coconut is a common flavoring, particularly in southern India. Different types of curry (vegetables, eggs, fish, and meat in a spicy sauce) are popular. Betel leaves and nuts commonly are chewed after meals to aid digestion. Vegetarianism is widely practiced, often for religious reasons. All castes have different food laws and customs, as does each religion. Hindus consider cows to be sacred and will not eat beef. Muslims do not eat pork or drink alcohol.

Recreation

Sports

India's most popular sports are cricket, soccer, and field hockey. Professional cricket teams and players have large followings, and fans gather to watch important games. Sports are generally played more by men, but many women enjoy badminton, tennis, ping-pong, and field hockey. In rural areas, people more often play traditional sports. These sports usually do not require expensive equipment, which can be hard to obtain or afford. People enjoy *kabaddi* (a team sport that combines elements of rugby and wrestling) and *gilli danda* (similar to cricket but played with a stick). Bullock-cart racing is also popular in rural areas.

Leisure

The growth of India's middle class has brought with it an increased demand for entertainment, and cinemas are well attended. Most people also enjoy watching television, and all but the poorest Indians own a television. While Western media is available and influences Indian media, most people prefer Indian-made movies and television.

Indians do not wait for a holiday in order to celebrate. They celebrate a variety of life events, from major events like the birth of a child to more everyday occasions like purchasing a new car. People often get together on the weekends for movies, picnics, and family gatherings. The most common recreation activities for women include shopping, watching movies, socializing with friends, and gathering for potluck-style dinners. Children enjoy activities like swimming, playing musical instruments, and dancing.

Vacation

Most people take a family vacation once a year, often to the beach or a rural area. It is also common to visit family. The wealthy may vacation in different parts of the country or abroad.

The Arts

India is well known for its architectural treasure the Taj Mahal and its world famous Hindi-language film industry, popularly known as *Bollywood*. Indians appreciate a variety of dance and music styles, which vary by region. Common instruments in Indian classical music include the *sitar* (a stringed instrument), *tabla* (hand drums), and *sarod* (a type of lute). A popular dance form is the *kathakali*, a mimed dance that traditionally lasts all night. Makeup and costumes are elaborate. The dances enact myths and stories through movement, hand gestures, and expression. The epic Sanskrit poems the *Ramayana* and *Mahabharata* greatly influence national and regional literature. These poems' characters and stories are also incorporated into music, dance, and theater. Traditional Indian handicrafts include jewelry, textiles, pottery, and painting.

Holidays

Many of India's most important holidays are religious. While there is much religious diversity in India, religious holidays can be unifying events, as people of different religions commonly celebrate one another's holidays. The Hindu holidays of *Diwali* and *Holi* are celebrated by most people, irrespective of religion. Similarly, Hindus participate in the Muslim *Eid al-Fitr* (the three-day feast celebrated at the end of the holy month of fasting, *Ramadan*) celebrations and Christian Christmas traditions. People often organize Christmas parties and celebrate the season with friends and family. India's national holidays include International New Year's Day (1 January), Republic Day (26 January), May Day (1 May), Independence Day (15 August), and Mahatma Gandhi's Birthday (2 October).

Holiday dates are determined by a number of different calendars. The Indian National Calendar's 365 days correspond with days on the Gregorian calendar (which most of the Western world uses), but the years begin on 22 March. Civil holidays are set according to the national calendar,

while Hindu holidays are determined by the Hindu calendar. Each year, a *panchang* (a Hindu astrological calendar) is published, which people use to determine the most auspicious dates on which to schedule important events.

New Year's

The New Year is celebrated on a variety of dates, depending upon the calendar being used. In northern India, the New Year is called *Baisakhi* and marks the beginning of the Punjab region's harvest season. On this day, Hindus visit temples and Sikhs visit *gurdwaras* (places of worship) to express gratitude for the harvest and to pray for prosperity in the future. Colorful fairs are held, where people enjoy folk dancing, singing, acrobatic performances, and concerts with folk instruments. In southern India, the New Year is called *Ugadi*. People clean their houses and decorate with mango leaves in preparation for the holiday. People put a lot of care into choosing gifts for friends and relatives. On *Ugadi*, people visit nearby temples to offer prayers and chant mantras. International New Year (1 January) is celebrated with parties.

Patriotic Holidays

Republic Day is an important patriotic holiday honoring those who have given their lives for the country. It commemorates the day in 1950 when India became a republic. Celebrations begin with the president awarding medals to members of the armed forces. Citizens attend patriotic parades and performances. Independence Day celebrates India's independence from Britain, achieved in 1947. Indian flags are flown on this day, and children often fly kites in the colors of the Indian flag. The prime minister also gives a televised speech.

Gandhi Jayanti

Mahatma Gandhi's Birthday, also called *Gandhi Jayanti*, is celebrated to honor the leader of the independence movement, who many consider the father of modern India. Tributes are held throughout the country, especially at Raj Ghat (a memorial devoted to Gandhi), and statues of Gandhi are decorated with garlands. Reverent celebrations include prayer services and scripture readings associated with a variety of religions to commemorate Gandhi's respect for different beliefs and groups. An important part of most celebrations is the singing of one of Gandhi's favorite songs, "Raghupati Raghava Raja Ram."

Hindu Festivals

Numerous spring and harvest festivals are common between January and March and are celebrated with dancing, feasting, and many colorful events. One of the most important of these festivals is *Holi*, or the Festival of Colors, which marks the end of the cold season. To celebrate, people toss colored water and powder on each other. Bonfires are also lit, and people gather to reenact the story from Hindu mythology of King Prahlad's triumph over his evil aunt Holika. In some parts of India, effigies of Holika are burned on the fire. Ashes from *Holi* bonfires are thought to bring good luck.

The Hindu festival *Diwali* (Festival of Lights) celebrates the triumph of light over darkness. Thousands of lights decorate stores and homes during this time of goodwill. Special emphasis is placed on the Hindu goddess Lakshmi, associated with happiness and prosperity. Preparations begin weeks in advance, with people cleaning their homes and

decorating with lights.

The four-day harvest festival *Pongal* is celebrated in southern India to give thanks for the year's harvest. In northern India, *Lohri* celebrates the harvesting of crops and the end of winter. At both holidays, people often go sightseeing, take shopping trips, and visit temples to seek blessings for a good and prosperous future.

Snakes are venerated during the summer festival of *Naag Panchami* because of their association with Hindu gods. The Hindu Lord Krishna's birth is celebrated in August or September during *Jan Mashtami*.

Held under different names, *Dussehra* celebrates the triumph of good over evil in the mythological story of Hindu Lord Rama's victory over the demon king Ravana. Customs vary by region, but the 10-day celebration generally includes activities such as worshipping the goddesses Durga, lighting fireworks, burning effigies, singing, and dancing.

SOCIETY

Government

Structure

India is a constitutional democracy and is divided into 29 states and 7 union territories. Because of the country's large population, it has earned the distinction of being the world's largest democracy.

The president is head of state and is elected by an electoral college consisting of members of Parliament and state legislatures. The prime minister is head of government and is chosen by the majority party or coalition in the *Lok Sabha* (House of the People), Parliament's lower house. Parliament's upper house is the *Rajya Sabha* (Council of States).

The *Rajya Sabha* has 245 members; 233 are elected by state and territorial legislatures, while up to 12 are appointed by the president. Members serve six-year terms. Of the 545 members of the *Lok Sabha*, 543 are directly elected by the people through a majoritarian system, and two Anglo-Indian members may be appointed by the president if they are not adequately represented in the house body. Members serve five-year terms.

The constitution mandates that at least one-third of the seats in local government bodies that are filled through direct elections must go to women; some states have raised that requirement to 50 percent.

Political Landscape

Two major coalitions dominate India's political landscape: the National Democratic Alliance (NDA) and the United Progressive Alliance (UPA). The center-right NDA is led by the Bharatiya Janata Party (BJP), which is seen as pro-Hindu and opposes the socialist economic programs that have been a part of India's economic policy. The center-left UPA is led by the Indian National Congress (INC), which prioritizes battling poverty and increasing development. The INC has been in power since independence, but this changed in the 2014 parliamentary elections when the BJP won the majority of seats in the *Lok Sabha*. Dozens of other parties also hold seats in Parliament.

Issues related to improving India's economy tend to

dominate the country's political agenda. Societal divisions (based on religion, caste, region, race, language, and community) are a major characteristic of Indian politics and contribute to political instability. Many political parties are built around the interests of particular groups in society.

Government and the People

Though there are some limits on journalistic freedom and freedoms of assembly, personal rights and civil liberties are generally respected by the government. The government struggles to improve access to basic amenities for poor and rural citizens and to strengthen the economy in general. The government also struggles to eradicate corruption, which is a significant problem in multiple levels of government. A lack of resources contributes in part to police corruption and abuse.

Despite corruption in other areas of government, elections in India are generally free and fair. The voting age is 18. Since independence, voter turnout has generally been between 55 and 65 percent in national elections.

Economy

While India is primarily an agricultural nation, its economy is changing quickly. Almost half of the labor force is engaged in agricultural work, but the majority of economic growth is concentrated in services. India is a leading producer of rice, wheat, oilseed, cotton, jute, tea, and sugarcane. Other important products include dairy products, poultry, and fish. Top export earnings come from petroleum products, precious stones, vehicles, machinery, iron ore, and steel. Textiles are a principal domestic product and also a profitable export. India is rich in natural resources, including coal, iron ore, natural gas, diamonds, crude oil, limestone, and important minerals. High-technology industries lead the way for industrial growth. Tourism is also increasingly vital.

Serious gaps exist between the urban wealthy and the poor. Obstacles to economic growth include outdated or nonexistent infrastructure, lack of educational opportunities, and insufficient economic opportunities for the population. Approximately 22 percent of the population lives below the poverty line. The currency is the *rupee* (INR).

Transportation and Communications

Roads in urban areas are generally well developed, but those in rural regions may be unpaved and impassable in heavy rains. Buses, often crowded, serve as the main source of public transportation in cities. A growing number of people are able to afford cars, and the influx of cars on the road has resulted in increased pollution and traffic. People also travel by motor scooter, tricycle-driven rickshaw, and *tanga* (a covered horse-drawn cart). Taxis are plentiful, but rates are not standardized. In rural areas, bull-drawn carts are a common mode of transportation. Traffic travels on the left side of the road. Trains connect major cities.

Televisions and radios are common throughout the country. Newspapers are plentiful. Domestic telephone service is expanding. Indians without phones in their homes use public calling offices (PCOs) throughout India. Cellular phones are common and are now found in even the most remote villages. Internet use is growing quickly.

Education

Structure

Education is a primary concern in India, and the country has one of the largest education systems in the world. Public schooling is free and compulsory from ages 6 to 14, although facilities are often inadequate. Private schools are available, but the cost is too high for most families. Primary school ends at age 14 or 15. Secondary school is divided into two levels (secondary and upper secondary), each lasting two years.

Access

Most Indians see education as an investment in the future and the key to improving their lives. Families place a strong emphasis on education starting at a young age. Students must pay tuition to attend secondary school. Parents often support their children to help them complete their higher education. It is not uncommon for extended family members to assist with the cost of education in the form of a gift or a low-interest loan.

Literacy rates and access to education are split along social divisions. Levels of education and literacy are higher in urban areas than rural, higher in males than in females, higher among the wealthy than among the poor, and vary between castes. Government programs are trying to meet the increasing need for education and improve all branches of the education system. About 90 percent of children are enrolled in primary school. This rate drops significantly by secondary school, as many children drop out or fail out of school. High levels of poverty force many children to start working early, at the expense of attending school. In rural areas, the lack of nearby schools and the cost of school supplies such as uniforms often make it difficult for families to send their children to school.

School Life

Parents are often very involved in their children's education, helping with homework and receiving frequent progress reports. For these reasons, competition is high at all levels of education. A number of "reserved seats" in education are set aside for members of historically disadvantaged castes. These reservations have increased competition for the remaining seats.

Subjects such as math, science, English, a national or regional language, and physical education are commonly taught in primary schools. In secondary school, students choose an area in which to specialize, such as mathematics, biology, arts, or business. Parents prefer their children to specialize in science, mathematics, or business. Humanities are generally not favored for boys. In order to proceed to each level of education, students must pass qualifying exams, which may be both written and oral. For students pursuing higher education, they must take the Higher Secondary Examination. Cheating on exams is quite common.

Higher Education

There are hundreds of universities and thousands of colleges. Public universities are supported by the government, while private schools are funded by different organizations and groups. Most students opt to study at public universities, as private schools tend to be more expensive. Some of India's top universities include the University of Delhi, Jawaharlal

India

Nehru University, and the Indian Institute of Technology Bombay.

Health

India faces health challenges stemming from poverty, natural disasters, malnutrition, and poor sanitation. Diseases such as cholera, malaria, typhoid, and hepatitis endanger many, especially rural inhabitants who lack access to preventive medical care. The lack of safe drinking water in many areas also contributes to the prevalence of communicable diseases. Healthcare workers are trying to teach people better hygiene, nutrition, and family planning. Similar programs aim to prevent the number of cases of HIV from increasing. Due to the success of widespread immunization campaigns, India was declared polio-free in 2014. The wealthy have private insurance and access to private clinics. Those who cannot afford private care rely on government-run hospitals, which are often short on staff, drugs, and equipment.

AT A GLANCE

Contact Information

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Country and Development Data	
Capital	New Delhi
Population	1,296,834,042 (rank=2)
Area (sq. mi.)	1,269,219 (rank=7)
Area (sq. km.)	3,287,253
Human Development Index	129 of 188 countries
Gender Inequality Index	125 of 188 countries
GDP (PPP) per capita	\$7,200
Adult Literacy	81% (male); 61% (female)
Infant Mortality	41 per 1,000 births
Life Expectancy	67 (male); 70 (female)
Currency	Indian rupee

India country profile



India is the world's largest democracy and, according to UN estimates, its population is expected to overtake China's in 2028 to become the world's most populous nation.

As a rising economic powerhouse and nuclear-armed state, India has emerged as an important regional power.

But it is also tackling huge, social, economic and environmental problems.

Home to some of the world's most ancient surviving civilisations, the Indian subcontinent - from the mountainous Afghan frontier to the jungles of Burma and the coral reefs of the Indian Ocean - is both vast and varied in terms of people, language and cultural traditions.

- See **India in pictures**
- See **more country profiles** - Profiles compiled by **BBC Monitoring**

FACTS

Republic of India

Capital: New Delhi

- **Population** 1.3 billion
- **Area** 3.1 million sq km (1.2 million sq miles), excluding Kashmir
- **Major languages** Hindi, English and more than 20 other official languages
- **Major religions** Hinduism, Islam, Christianity, Sikhism, Buddhism
- **Life expectancy** 67 years (men), 70 years (women)
- **Currency** Rupee
UN, World Bank

Getty Images

LEADERS

President: Ram Nath Kovind



Ram Nath Kovind, a Dalit - one of India's lowest castes - was picked by an electoral college to become president in July 2017.

He is a Supreme Court lawyer and has earned widespread respect as the governor of the northern state of Bihar.

India's presidency is largely ceremonial, but can play a significant role if, for example, no party wins an outright majority in national elections.

Prime Minister: Narendra Modi



Hindu nationalist Narendra Modi stormed to power on a surge of popular expectation and anger at corruption and weak growth.

Despite Mr Modi's polarising image, his Bharatiya Janata Party (BJP) scored an unprecedented landslide victory in the May 2014 parliamentary elections.

It was the first time in 30 years that a single party had won a clear parliamentary majority.

Mr Modi fought on his record as chief minister of the economically successful state of Gujarat, promising to revitalise India's flagging economy.

But his time in Gujarat was overshadowed by accusations that he did too little to stop the religious riots in 2001, which saw more than 1,000 people - mainly Muslims - killed.

- **[Read full biography](#)**

MEDIA



India has a burgeoning media industry, with broadcast, print and digital media experiencing tremendous growth.

There are around 197 million TV households, many of them using satellite or cable. FM radio stations are plentiful but only public All India Radio can produce news.

The press scene is lively with thousands of titles. India has the second largest number of internet users in the world, after China.

- **Read full media profile**

TIMELINE



Indian nationalist leader Mahatma Gandhi with Viceroy of India Lord Mountbatten and his wife in 1947

Some key dates in India's history:

2500 BC - India is home to several ancient civilisations and empires.

1600s - The British arrive and establish trading posts under The British East India Company - by the 1850s they control most of the subcontinent.

1858 - India comes under direct British rule.

1920 - Nationalist leader Mahatma Gandhi heads a campaign of non-violent protest against British rule which eventually leads to independence.

1947 - India is split into two nations at independence - Hindu-majority India and Muslim-majority Pakistan.

1971 - India and Pakistan go to war over East Pakistan, leading to the creation of Bangladesh.

1974 - India conducts its first underground nuclear test.

1990s - Government initiates a programme of economic liberalisation and reform, opening up the economy to global trade and investment.

2000 - India's population tops one billion.

2014 - Hindu nationalist BJP party scores biggest election victory by any party in 30 years.

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Country Report

India

Generated on June 27th 2019

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The Economist Intelligence Unit

The Economist Intelligence Unit is a specialist publisher serving companies establishing and managing operations across national borders. For 60 years it has been a source of information on business developments, economic and political trends, government regulations and corporate practice worldwide. The Economist Intelligence Unit delivers its information in four ways: through its digital portfolio, where the latest analysis is updated daily; through printed subscription products ranging from newsletters to annual reference works; through research reports; and by organising seminars and presentations. The firm is a member of The Economist Group.

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Symbols for tables

"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

India

Summary

2 [Briefing sheet](#)

Outlook for 2019-23

4 [Political stability](#)

5 [Election watch](#)

5 [International relations](#)

6 [Policy trends](#)

6 [Fiscal policy](#)

7 [Monetary policy](#)

7 [International assumptions](#)

8 [Economic growth](#)

9 [Inflation](#)

9 [Exchange rates](#)

9 [External sector](#)

10 [Forecast summary](#)

11 [Quarterly forecasts](#)

Data and charts

12 [Annual data and forecast](#)

13 [Quarterly data](#)

14 [Monthly data](#)

15 [Annual trends charts](#)

16 [Quarterly trends charts](#)

17 [Monthly trends charts](#)

18 [Comparative economic indicators](#)

Summary

18 [Basic data](#)

20 [Political structure](#)

Recent analysis

Politics

23 [Forecast updates](#)

26 [Analysis](#)

Economy

28 [Forecast updates](#)

33 [Analysis](#)

Briefing sheet

Editor: **Shreyans Bhaskar**

Forecast Closing Date: **May 27, 2019**

Political and economic outlook

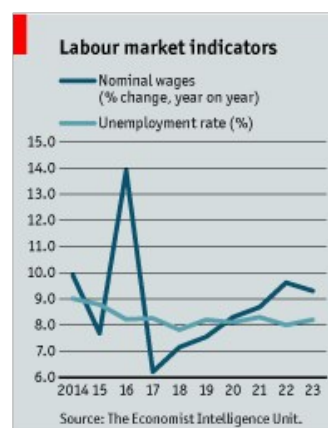
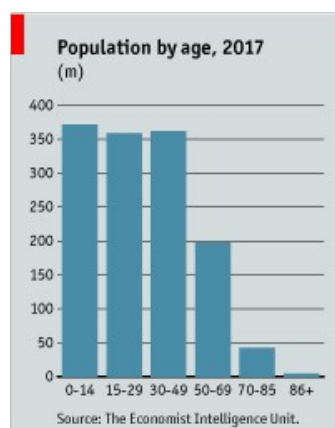
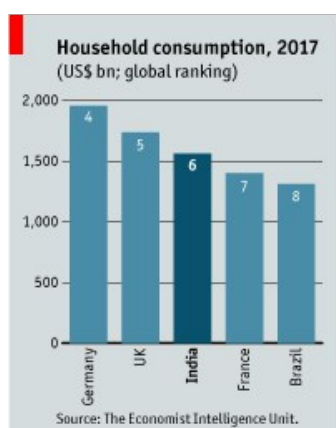
- The Bharatiya Janata Party (BJP) secured a second consecutive majority in the Lok Sabha (the lower house) in the April-May 2019 general elections. The prime minister, Narendra Modi, will retain tight control over the government in the next five years.
- Tensions will persist between the BJP's right-wing sister organisations, which promote a conservative Hindu socio-cultural agenda, and religious minorities and civil society groups. However, they will not become major risks to political stability.
- We believe that the government will focus on labour-intensive sectors in the upcoming budget in order to boost employment, as well as continue with its focus on infrastructure improvement.
- Growth will remain below potential throughout the forecast period, owing to the government's hesitation to undertake productivity-enhancing structural reforms, as well as its market-distorting support to small businesses.
- The rupee will face downward pressure throughout most of the next five years, partly owing to India's chronic current-account deficit. However, it will strengthen against the US dollar in 2020 as the Federal Reserve (the US central bank) cuts US interest rates.
- The current-account deficit will average the equivalent of 1.7% of GDP in 2019-23. Merchandise exports will expand more quickly than imports over the period, but the goods trade deficit will continue to exceed the surplus on India's services trade account.

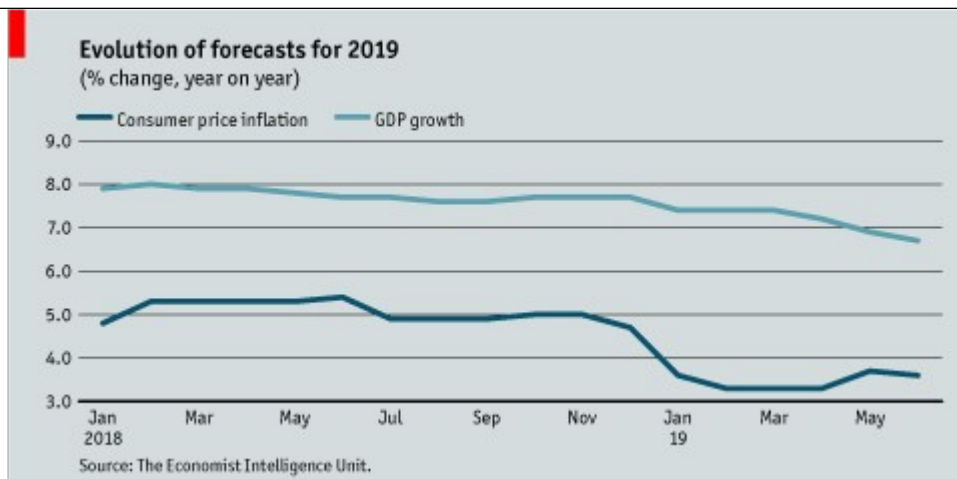
Key indicators

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth (%) ^c	6.8 ^d	6.7	6.6	6.7	6.5	6.4
Consumer price inflation (av; %)	3.9	3.6	4.1	3.9	4.4	4.1
Government balance (% of GDP) ^c	-3.4 ^d	-3.4	-3.5	-3.3	-3.4	-3.5
Current-account balance (% of GDP) ^e	-2.4	-1.8	-1.6	-1.7	-1.7	-1.5
Money market rate (av; %)	7.3	7.6	7.4	7.0	7.6	7.5
Unemployment rate (%)	7.8 ^d	8.2	8.1	8.3	8.0	8.2
Exchange rate Rs:US\$ (av)	68.39	69.30	68.84	70.58	72.06	72.47

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Fiscal years (beginning April 1st of year indicated). ^d Economist Intelligence Unit estimates. ^e Based on average exchange rate in fiscal year beginning April 1st.

Market opportunities





Key changes since April 26th

- Based on weak recent data, we have adjusted down our expectation for merchandise export growth to 5.3% in 2019, from 6.7% previously.

The month ahead

- June 6th—monetary policy meeting:** We expect the Reserve Bank of India (the central bank) to allow another interest-rate cut in the light of a weak domestic economy and still-subdued inflation.

Major risks to our forecast

Scenarios, Q1 2019	Probability	Impact	Intensity
Growing protectionism in the US results in a trade war between India and the US	High	High	16
Conflict breaks out between India and Pakistan	Moderate	Very high	15
Flooding causes major losses for businesses	High	Moderate	12
A Congress-led alliance secures victory in the 2019 election	Moderate	High	12
GDP growth slows down substantially	Moderate	High	12

Note. Scenarios and scores are taken from our Risk Briefing product. Risk scenarios are potential developments that might substantially change the business operating environment over the coming two years. Risk intensity is a product of probability and impact, on a 25-point scale.

Source: The Economist Intelligence Unit.

Outlook for 2019-23

Political stability

The Bharatiya Janata Party (BJP), which controlled the outgoing government, secured a majority of seats in the Lok Sabha (the lower house of parliament) in the recent general elections, results for which were announced on May 23rd. The BJP's hold over the Lok Sabha will be further enhanced by the strong performance of its allies within the larger National Democratic Alliance (NDA) grouping. The BJP and its allies control 352 of the 543 elected seats in the lower house (the largest majority since 1984). In addition, they control governments in a majority of states. This will underpin broad political stability. The Economist Intelligence Unit does not expect any threat to the BJP's dominance of the new central government throughout its full term (2019-24). This will ensure consistency in policy, particularly as this is the second consecutive term for the BJP.

The results have come as a strong vindication of the popularity of the prime minister, Narendra Modi. In the new government, Mr Modi will remain the dominant figure. Decision-making will remain centralised around the prime minister's office (PMO) and key ministers and officials whom Mr Modi trusts. The PMO and the National Security Advisor played a key role in the outgoing government, and we believe that they will continue to dominate the policy agenda in the next five years.

We expect the BJP's allies, such as the Shiv Sena and the Lok Janshakti Party, to join the cabinet, despite the fact that the BJP has a majority of its own in the Lok Sabha. This will be partly owing to the ruling party's need for allies in the Rajya Sabha (the upper house), where the BJP will be short of a majority in the early years of the forecast period. We also expect new ministers to be appointed to key ministries, such as Finance and External Affairs, in part owing to the fact that some senior ministers did not contest the general elections. Given the grip of Mr Modi and his trusted officials over the government, however, this will not have a significant impact on policymaking.

During the term of the first Modi government, sporadic instances of street violence occurred, particularly directed towards minority groups. The BJP's right-wing affiliates and sister organisations within the larger Hindu right-wing ecosystem (colloquially known as the Sangh Parivar) used the BJP's political power to pursue their socio-cultural agenda. This includes a goal of recasting India as a Hindu state, a view that puts them at odds with the country's large Muslim minority. Such attacks will persist over the forecast period, but we do not expect them to have a major impact on the business environment.

There is a risk that clashes between religious groups will intensify in states with a history of communal violence, such as Uttar Pradesh and Assam. Tensions between Hindus and Muslims have increased in recent years amid concerns among some Hindu groups about an influx of people from the neighbouring Muslim-majority nation of Bangladesh. However, state governments (which control the local police in India) will be keen to restore order quickly in instances where communal violence breaks out in order to avoid public criticism and international scrutiny.

Election watch

Under Mr Modi's leadership, the BJP has managed to put the spotlight on socio-cultural issues, pushing its version of Hindu nationalism. In the second half of 2019, assembly elections will be conducted in three states—Jharkhand, Maharashtra, and Haryana. The BJP and its allies currently have over 85% of all available Lok Sabha seats in these three states, and we expect the outgoing BJP governments in all three to secure a second term in office.

In the Rajya Sabha, the BJP and its allies form the largest grouping, although they are significantly short of a majority. Given the BJP's strong performance in the general elections, we now believe that the party will dominate the upcoming state elections, enabling it to nominate more members to the upper house (Rajya Sabha members are elected by state assemblies). The NDA is therefore expected to achieve a majority, or at least have enough votes in the Rajya Sabha, by mid-2021. This will enable the NDA to pass legislation without requiring opposition approval.

International relations

Relations between India and the US will remain warm in 2019-23, partly underpinned by a mutual desire to counter China's growing influence in South Asia. To this effect, India has boosted security co-operation with the US in recent years, and this will continue in our forecast period. Trade tensions between the US and India will persist over the next few years, slowing the expansion of US-India bilateral trade. However, they are unlikely to escalate into a serious deterioration of relations.

A major fatal attack in February 2019 by separatist militants on military personnel in Indian-administered Kashmir has raised tensions between India and Pakistan. India has accused Pakistan of harbouring the leadership of the group that it blames for the attack, Jaish-e-Mohammed. The risk of India conducting additional limited military strikes on targets in Pakistan will be high in the short term. Nevertheless, we continue to believe that the danger of this type of limited clash escalating into a broader India-Pakistan military conflict is low.

China's growing influence in South Asia, particularly its close ties with Pakistan, will remain a bone of contention between China and India. In addition, territorial disputes between China and India will persist, and relations will remain broadly tense in 2019-23.

Policy trends

The BJP's strong performance in the 2019 general elections means that the new government will have considerable flexibility in determining the policy agenda. The government has demonstrated a focus on micro-level policies, notably those designed to improve the "last-mile delivery" of public services. Such efforts will remain a priority in the next five years.

We expect some moves to improve the business environment by streamlining bureaucracy, as the economy has slowed in recent quarters. We expect incentives to be offered to three key sectors—construction, tourism, gems and jewellery, and garments and textiles. These labour-intensive sectors are key for creating jobs. However, the weight of incentives offered to these sectors will be market-distorting, protectionist, and a bone of contention with countries such as the US in 2019-23.

The government is unlikely to push for radical reforms that are politically contentious, such as a comprehensive overhaul of land-acquisition laws or labour regulations. However, piecemeal changes to such legislation, such as the relaxation of certain regulatory requirements, could be undertaken. Once the NDA has control of the Rajya Sabha from mid-July 2021, this will ease the legislative process. However we expect only limited gains from this, as the Modi administration will be hesitant to push ahead productivity-enhancing reforms, which could be politically damaging.

Infrastructure projects, particularly pet projects of the Modi government—such as the Bharatmala roads project and the Smart Cities Mission—will remain a priority, partly as a response to the rapid pace of urbanisation, and partly to boost the business environment. However, many projects are likely to face financing difficulties, as they envision a level of public-private partnership that seems unlikely to be realised, given how subdued private investment activity remains.

Fiscal policy

The new government will present its budgetary plans for the remainder of fiscal year 2019/20 (April-March) in July. We believe that, in order to support weakening rural demand, it will increase the allocation for farm subsidies. We also expect tax cuts for the middle class, in an effort to increase consumer purchasing power. The government will further reduce the number of tiers in the goods and services tax (GST), and make efforts to streamline tax filing regulations. Over the forecast period, efforts to deepen the tax base and increase levels of tax compliance will continue, particularly as India's tax-to-GDP ratio remains low by regional and OECD standards.

Welfare payments and infrastructure spending will remain key areas of focus for the government over the forecast period. It will seek to increase the reach of schemes such as the Ayushman Bharat health insurance scheme. We also expect subsidies for labour-intensive small-scale businesses, particularly those that are export-focused, in an effort to promote exports and employment. This will keep the fiscal deficit wide throughout the forecast period, averaging the equivalent of 3.4% of GDP a year in 2019/20-2022/23.

This federal fiscal picture does not reflect the large deficits being recorded by several state governments, which are not included in the national figure. The deep deficits of some states, such as Punjab, will present implicit liabilities for the central government and could pose downside risks to GDP growth over the next five years by crowding out private investment.

Monetary policy

The Reserve Bank of India (RBI, the central bank) will keep inflation-targeting as the cornerstone of its monetary policy framework in the next five years. It will look to contain consumer price inflation within a 2-6% range and close to a target of 4% throughout 2019-23.

Weak inflation and ebbing growth have led the RBI to cut interest rates by 25 basis points twice so far in 2019. The bank has conceded that the economy is growing below potential, and although inflation is gradually edging up, it still remains relatively mild by historical standards. We therefore expect another 25-basis-point interest-rate cut from the central bank, probably at the next policy meeting in June. The risk to this view comes from the possibility of a sudden spike in crude oil prices in 2019, as the US tightens enforcement of its sanctions on Iran. We believe, however, that weaker global demand and relatively improved supply conditions will inhibit a prolonged rise in oil prices.

We expect the RBI to sanction further interest-rate cuts in 2020, against the backdrop of a loosening of US monetary policy by the Federal Reserve (Fed, the US central bank) in that year. The Indian central bank will then undertake some tightening in 2021-22 as growth in domestic demand accelerates, before adopting a neutral stance in 2023 as the pace of growth eases in that year.

International assumptions

	2018	2019	2020	2021	2022	2023
Economic growth (%)						
US GDP	2.9	2.2	1.7	1.8	2.0	1.7
OECD GDP	2.2	1.7	1.6	1.8	1.9	1.8
World GDP	2.9	2.6	2.6	2.8	2.9	2.8
World trade	4.4	3.3	2.9	3.9	4.0	4.1
Inflation indicators (% unless otherwise indicated)						
US CPI	2.4	2.2	1.4	2.2	2.1	1.8
OECD CPI	2.5	2.2	1.9	2.1	2.1	2.1
Manufactures (measured in US\$)	4.9	2.1	3.3	3.5	3.2	3.0
Oil (Brent; US\$/b)	71.1	66.5	60.5	69.8	75.6	75.0
Non-oil commodities (measured in US\$)	1.9	-4.4	3.5	3.0	2.0	0.7
Financial variables						
US\$ 3-month commercial paper rate (av; %)	2.0	2.6	2.2	2.1	2.5	2.9
¥ 3-month money market rate (av; %)	0.0	0.1	0.1	0.1	0.2	0.3
Exchange rate: ¥:US\$ (av)	110.4	110.0	108.7	104.9	100.5	96.1
Exchange rate: Rs:US\$ (av)	68.4	69.3	68.8	70.6	72.1	72.5
Exchange rate: US\$:€ (av)	1.18	1.13	1.18	1.21	1.24	1.24

Economic growth

High-frequency data suggest that the economy is slowing. We believe that household demand has been adversely affected by rising unemployment and slowing wage growth; particularly in rural areas. We expect a marginal recovery in real wages in 2019/20, as inflation will remain subdued. Meanwhile, business sentiment remains subdued. Despite the beneficial impact of the 2019 general election in shoring up political stability, we do not expect a dramatic acceleration in private investment. This is owing to the fact that businesses remain sceptical about broader economic prospects. Conversely, the government's focus on infrastructure improvement and domestic market opportunities will provide some support to gross fixed capital formation over the next five years.

We do not expect a significant improvement in job creation in the forecast period, as government efforts will focus on small-scale industries and are unlikely to have the desired effect in boosting employment. Meanwhile, the focus on smaller firms will crowd out the larger-scale enterprises that would be more productive and effective job-creators in the longer term. This effect will be aggravated by outdated labour laws that deter companies from scaling up. Economic growth will therefore remain below potential throughout the forecast period, despite stable inflation. Meanwhile, we do not envisage a substantial narrowing in the budget deficit over the forecast period, and so government spending on goods and services will remain supportive of growth in the forecast period. Imports of goods and services will grow more quickly in real terms than export volumes, and so as a whole net exports will exert a drag on economic expansion. Real GDP growth will average 6.6% a year in 2019/20-2023/24, keeping India among the fastest-growing major economies throughout the forecast period.

In factor-cost terms, the services sector will remain the largest component of the economy, and will grow at a relatively brisk pace over the forecast period. Conversely, manufacturing will remain below potential owing to structural limitations such as challenges around land acquisition, and will grow at a much more subdued pace. The agricultural sector, meanwhile, will remain a drag on the economy. Public investment in the sector will be aimed at short-term gains, rather than fostering productivity gains.

Economic growth

(%; fiscal years beginning Apr 1st)	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
GDP	6.8	6.7	6.6	6.7	6.5	6.4
Private consumption	6.9	7.4	6.7	7.0	7.3	6.4
Government consumption	10.3	9.8	5.8	5.1	4.2	6.3
Gross fixed investment	9.8	9.1	8.3	8.0	8.7	7.4
Exports of goods & services	12.3	9.8	6.9	8.4	7.8	7.2
Imports of goods & services	13.9	12.4	8.3	10.4	8.5	5.8
Domestic demand	9.3	7.3	8.3	8.1	7.1	6.1
Agriculture	2.8	3.1	3.4	3.5	3.8	3.7
Industry	6.9	7.1	7.2	6.6	6.3	7.0
Services	7.3	7.0	6.6	7.7	8.1	7.9

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Inflation

Prices of food and oil will remain the key factors driving inflationary pressures in 2019-23. Food and beverages have a weighting of around 45% in the consumer price index, and so any volatility in agricultural output will affect price stability. Food price inflation has been weak in recent months, but we anticipate that it will accelerate in the second half of 2019, as crop yields during the summer harvest are expected to be lower than usual. Nevertheless, headline inflation will cool to 3.6% in 2019 on average, from 3.9% in 2018, owing to weaker crude oil prices this year.

Cooler crude oil prices will have some dampening effect on prices in 2020, but this will be offset by a pick-up in domestic demand, the RBI's accommodative monetary policy and the lagged effects of seasonal climatic factors from 2020. Later in the forecast period, however, strong domestic demand growth will stoke demand-pull inflation. A weakening of the rupee:US dollar exchange rate will also exert an upward influence on prices in 2021-23. We expect consumer prices to rise by an annual average of 4% over this period.

Exchange rates

A narrowing current-account deficit and improved investor sentiment will ease some of the downward pressure on the rupee in 2019. Therefore, the Indian currency's exchange rate is likely to end the year stronger against the US dollar than it was at the end of 2018. However, in annual average terms the rupee will still depreciate in 2019, albeit mildly, weakening to Rs69.3:US\$1, from Rs68.4:US\$1 last year.

The rupee will appreciate slightly against the US dollar in 2020, supported by interest-rate cuts by the Fed against a backdrop of an economic slowdown in the US. In 2021-23 the rupee will return to a gradual depreciating trend against the US dollar, reflecting India's persistent current-account deficit. However, the country's real effective exchange rate will remain relatively stable over 2019-23 as a whole, and benefits to India's export sector from the rupee's weakening against the US dollar will therefore be limited.

External sector

India's dependence on imported crude oil for its energy needs will continue to keep merchandise imports high. Imports will also be lifted by growing demand for foreign consumer products and construction-related machinery. Merchandise exports will grow at a faster pace than imports (largely owing to price factors), but India's export manufacturing sector will continue to be held back by restrictive labour laws and difficulties in securing land for production facilities.

Increased competition from other countries and changing industrial trends will weigh on the pace of growth for India's key service export sectors, particularly the business process outsourcing and information technology segments. Nevertheless, the services balance will remain in surplus throughout the forecast period, making a positive contribution to the current account. Owing to the large shortfall on merchandise trade, however, the current account will remain in deficit, averaging the equivalent of 1.7% of GDP annually in 2019-23.

Inward direct investment will remain strong in 2019-23, as the expanding economy and growing consumer demand provide opportunities for businesses. We expect annual direct investment inflows to rise to US\$48.1bn in 2023, from US\$42.2bn in 2018. Inward portfolio investment slid into negative territory in 2018, owing to jittery investor confidence and rising US interest rates. We expect this trend to reverse in 2019-23 as investor confidence is gradually restored.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth ^c	6.8 ^d	6.7	6.6	6.7	6.5	6.4
Industrial production growth ^e	5.2	0.9	3.2	4.2	4.1	4.8
Unemployment rate (av)	7.8 ^d	8.2	8.1	8.3	8.0	8.2
Consumer price inflation (av)	3.9	3.6	4.1	3.9	4.4	4.1
Consumer price inflation (end-period)	2.0	3.9	3.8	4.2	4.2	4.1
Short-term interbank rate	7.3	7.6	7.4	7.0	7.6	7.5
Government balance (% of GDP) ^c	-3.4 ^d	-3.4	-3.5	-3.3	-3.4	-3.5
Exports of goods fob (US\$ bn)	332.1	349.7	372.1	405.8	441.0	478.9
Imports of goods fob (US\$ bn)	-519.0	-528.1	-547.1	-591.5	-635.2	-682.7
Current-account balance (US\$ bn)	-64.9	-54.9	-53.3	-59.3	-64.9	-63.8
Current-account balance (% of GDP)	-2.4	-1.8	-1.6	-1.7	-1.7	-1.5
Total foreign debt (US\$ bn; year-end)	555.0 ^d	595.3	627.4	682.5	707.7	730.5
Exchange rate Rs:US\$ (av)	68.39	69.30	68.84	70.58	72.06	72.47
Exchange rate Rs:US\$ (end-period)	69.79	68.31	69.64	71.39	72.87	72.04
Exchange rate Rs:¥100 (av)	61.93	62.91	63.12	67.30	71.73	75.43
Exchange rate Rs:€ (av)	80.80	80.39	83.99	85.58	89.18	89.68

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Fiscal years (beginning April 1st of year indicated). ^d

Economist Intelligence Unit estimates. ^e Calendar year.

Quarterly forecasts

Quarterly forecasts

	2018				2019				2020			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	2.2	2.1	0.9	1.2	1.7	2.4	1.3	1.2	2.0	2.4	1.3	1.1
% change, year on year	8.1	8.1	6.9	6.5	5.9	6.3	6.9	6.9	7.2	7.2	7.1	7.0
Private consumption												
% change, quarter on quarter	5.3	3.6	1.5	-2.2	-0.1	3.9	2.7	2.6	3.2	1.5	0.4	0.3
% change, year on year	9.0	6.9	9.8	8.2	2.8	3.0	4.3	9.4	13.0	10.4	7.9	5.5
Government consumption												
% change, quarter on quarter	12.1	-6.6	3.0	-1.5	23.5	-1.8	-2.9	-3.0	-2.2	4.7	3.4	3.2
% change, year on year	22.3	5.5	11.6	6.3	17.1	23.1	16.0	14.3	-9.6	-3.6	2.6	9.2
Gross fixed investment												
% change, quarter on quarter	2.7	2.7	2.0	2.6	-0.4	3.6	2.4	2.3	3.0	2.3	1.1	1.0
% change, year on year	12.3	11.6	10.2	10.5	7.1	8.0	8.5	8.1	11.8	10.4	9.0	7.6
Exports of goods & services												
% change, quarter on quarter	-1.6	8.3	3.4	4.2	-6.0	5.3	4.0	3.8	4.4	0.9	-0.2	-0.3
% change, year on year	2.6	11.0	13.9	14.8	9.6	6.6	7.3	6.8	18.7	13.8	9.1	4.8
Imports of goods & services												
% change, quarter on quarter	-1.6	13.5	4.3	-1.7	-6.4	7.7	6.2	5.8	6.2	0.4	-0.8	-0.9
% change, year on year	16.2	10.7	21.8	14.6	9.0	3.4	5.3	13.3	28.6	19.8	12.0	4.9
Domestic demand												
% change, quarter on quarter	5.1	2.3	1.7	-0.7	6.6	1.4	0.4	0.4	1.2	3.5	2.3	2.1
% change, year on year	11.6	8.2	10.0	8.7	10.3	9.3	7.8	8.9	3.3	5.5	7.5	9.3
Consumer prices												
% change, quarter on quarter	1.1	0.6	0.4	0.5	1.0	1.3	1.4	0.8	1.1	0.9	0.9	1.1
% change, year on year	4.6	4.8	3.9	2.5	2.4	3.2	4.2	4.5	4.7	4.2	3.7	4.0
Producer prices												
% change, quarter on quarter	1.2	1.1	1.1	1.0	-0.3	1.5	1.0	0.7	0.9	0.7	1.3	1.0
% change, year on year	2.8	4.7	5.1	4.5	2.9	3.3	3.3	3.0	4.2	3.3	3.5	3.9
Exchange rate Rs:US\$												
Average	64.3	67.0	70.2	72.1	70.5	69.2	68.9	68.7	68.3	68.6	68.2	70.2
End-period	65.0	68.6	72.5	69.8	69.2	69.0	68.8	68.3	68.4	68.4	69.2	69.6
Interest rates (%; av)												
Money market rate	7.1	7.2	7.4	7.5	7.5	7.6	7.6	7.6	7.6	7.5	7.4	7.4
Long-term bond yield	7.5	7.9	7.9	7.7	7.5	7.4	7.4	7.1	7.4	7.3	7.2	7.2

Data and charts

Annual data and forecast

	2014 ^a	2015 ^a	2016 ^a	2017 ^a	2018 ^b	2019 ^c	2020 ^c
GDP^d							
Nominal GDP (US\$ bn)	2,040	2,104	2,289	2,651	2,669	3,027	3,314
Nominal GDP (Rs bn)	124,722	137,717	153,556	170,840	186,602	208,118	229,460
Real GDP growth (%)	7.4	7.9	8.2	7.1	6.8	6.7	6.6
Expenditure on GDP (% real change)^d							
Private consumption	6.5	7.9	8.3	7.5	6.9	7.4	6.7
Government consumption	7.4	7.1	6.2	15.2	10.3	9.8	5.8
Gross fixed investment	2.6	6.5	8.3	9.3	9.8	9.1	8.3
Exports of goods & services	1.9	-5.7	5.0	4.7	12.3	9.8	6.9
Imports of goods & services	0.9	-5.8	4.3	17.6	13.9	12.4	8.3
Origin of GDP (% real change)^d							
Agriculture	0.2	0.8	6.0	4.9	2.8	3.1	3.4
Industry	6.9	9.5	7.7	6.0	6.9	7.1	7.2
Services	11.0	10.6	8.7	8.6	7.3	7.0	6.6
Population and income							
Population (m)	1,294	1,309	1,324	1,339	1,354	1,369	1,383
GDP per head (US\$ at PPP)	5,692	6,139	6,634	7,162	7,741	8,337	8,965
Fiscal indicators (% of GDP)^d							
Central government revenue	9.2	9.0	9.4	9.1	9.8	10.0	10.3
Central government expenditure	13.2	12.9	12.9	12.5	13.2	13.4	13.8
Central government balance	-4.0	-3.9	-3.5	-3.5	-3.4	-3.4	-3.5
Net public debt	51.4	51.5	49.6	49.2	49.0	48.0	47.5
Prices and financial indicators							
Exchange rate Rs:US\$ (av)	61.03	64.15	67.20	65.12	68.39 ^a	69.30	68.84
Consumer prices (av; % change)	6.4	4.9	5.0	3.3	3.9 ^a	3.6	4.1
Producer prices (av; % change)	3.3	-3.9	0.0	3.4	4.2 ^a	3.1	3.7
Stock of money M1 (% change)	10.0	12.3	-18.9	44.7	13.6 ^a	14.0	11.3
Stock of money M2 (% change)	10.7	10.7	6.2	10.0	10.2 ^a	12.7	9.7
Lending interest rate (av; %)	10.3	10.0	9.7	9.5	9.5	9.4	9.0
Current account (US\$ m)							
Trade balance	144,048	-136,885	-107,475	-148,135	-186,895 ^a	-178,465	-175,005
Goods: exports fob	328,387	272,353	268,615	304,107	332,088 ^a	349,666	372,076
Goods: imports fob	472,433	-409,238	-376,090	-452,242	-518,983 ^a	-528,131	-547,080
Services balance	76,077	73,635	65,896	75,924	80,418 ^a	73,884	76,810
Primary income balance	-24,945	-23,360	-27,362	-26,424	-28,272 ^a	-25,253	-28,186
Secondary income balance	65,601	64,154	56,827	60,467	69,893 ^a	74,888	73,048
Current-account balance	-27,316	-22,456	-12,114	-38,168	-64,856 ^a	-54,946	-53,333
External debt (US\$ m)							
Debt stock	457,552	478,875	455,550	513,209	555,009	595,323	627,420
Debt service paid	92,817	49,663	76,981	51,160	71,133	72,674	78,520
Principal repayments	80,786	38,772	65,971	38,600	51,350	49,671	56,498
Interest	12,030	10,891	11,010	12,560	19,783	23,003	22,022
International reserves (US\$ m)							
Total international reserves	322,833	351,551	359,729	409,772	396,115 ^a	432,949	438,827

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d Fiscal years (beginning April 1st of year indicated).

Source: IMF, International Financial Statistics.

Quarterly data

	2017			2018				2019
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Central government finance (Rs m)								
Revenue	2,090	4,412	4,278	4,730	2,786	4,309	4,211	n/a
Expenditure	6,507	4,985	5,498	4,437	7,076	5,966	5,278	n/a
Balance	-4,417	-573	-1,220	293	-4,290	-1,657	-1,067	n/a
Output								
GDP at constant 2004/05 prices (Rs bn) ^a	32,028	32,641	33,167	33,910	34,608	34,903	35,337	n/a
Real GDP (% change, year on year)	6.0	6.7	7.8	8.1	8.1	6.9	6.5	n/a
Industrial production index (2004/05=100)	120.5	121.1	126.3	133.3	126.6	127.5	130.9	134.0
Industrial production (% change, year on year)	1.9	3.3	5.9	6.5	5.1	5.3	3.7	0.5
Prices								
Consumer prices (2010=100)	132.2	133.9	136.3	137.7	138.5	139.0	139.7	141.1
Consumer prices (% change, year on year)	2.2	2.9	4.6	4.6	4.8	3.9	2.5	2.4
Wholesale prices (2004/05=100)								
General index	113.1	113.8	115.6	117.0	118.3	119.6	120.8	120.4
Fuel	90.7	89.8	94.6	98.1	101.9	105.7	107.8	101.0
Manufactured goods	112.6	113.0	114.0	115.4	116.8	118.0	118.7	118.2
Financial indicators								
Exchange rate Rs:US\$ (av)	64.5	64.3	64.7	64.3	67.0	70.2	72.1	70.5
Exchange rate Rs:US\$ (end-period)	64.7	65.4	63.9	65.0	68.6	72.5	69.8	69.2
Deposit rate (av; %)	7.0	6.8	6.8	6.8	6.8	7.1	7.4	7.5
Lending rate (av; %)	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
3-month money market rate (av; %)	6.5	6.4	6.4	7.1	7.2	7.4	7.5	7.5
M1 (end-period; Rs bn) ^b	27,010	28,730	28,863	32,673	31,891	32,917	32,787	37,219
M1 (% change, year on year)	1.3	1.6	44.7	21.8	18.1	14.6	13.6	13.9
M2 (end-period; Rs bn) ^b	127,585	131,843	132,087	139,626	140,032	144,229	145,497	154,425
M2 (% change, year on year)	7.0	5.6	10.0	9.2	9.8	9.4	10.2	10.6
BSE Sensex (end-period; 1978/79=100)	30,922	31,284	34,057	32,969	35,423	36,227	36,068	38,673
BSE Sensex (% change, year on year)	14.5	12.3	27.9	11.3	14.6	15.8	5.9	17.3
Sectoral trends								
Production index (2004/05=100)								
Manufacturing	121.1	123.0	127.8	134.6	127.3	129.9	132.2	134.7
Mining	99.7	93.1	108.0	118.8	105.0	94.0	111.1	121.4
Electricity	152.0	152.6	144.6	147.4	159.4	164.0	154.6	149.6
Foreign trade (US\$ m)								
Exports fob	71,539	74,215	77,014	80,605	81,916	81,412	80,681	85,573
Imports cif	-	-	-	-	-	-	-	-
Trade balance	114,168	108,248	120,922	121,374	128,349	132,945	130,710	120,797
	-42,630	-34,033	-43,908	-40,768	-46,433	-51,532	-50,029	-35,224
Foreign payments (US\$ m)^b								
Merchandise trade balance fob-fob	-41,936	-32,454	-44,023	-41,623	-45,758	-50,023	-49,491	n/a
Services balance	18,309	18,377	20,712	20,164	18,675	20,280	21,299	n/a
Primary income balance	-5,843	-8,550	-6,468	-7,820	-5,821	-8,667	-5,964	n/a
Net transfer payments	14,504	15,684	16,074	16,231	17,053	19,352	17,257	n/a
Current-account balance	-14,966	-6,944	-13,704	-13,047	-15,851	-19,057	-16,900	n/a
Reserves excl gold (end-period)	366,987	379,771	389,350	403,751	385,400	380,813	374,425	390,268

^a At market prices. ^b Reserve Bank of India.

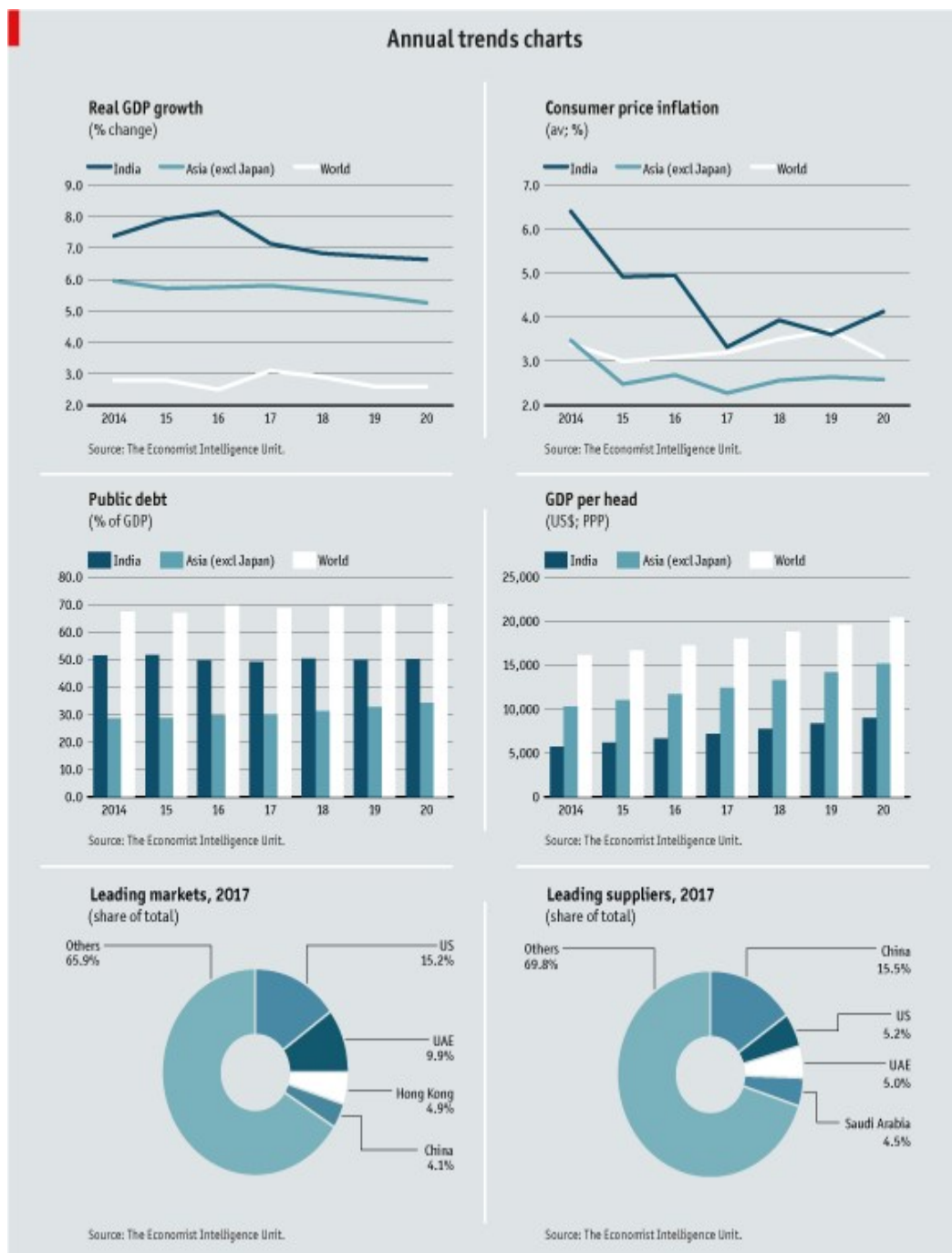
Sources: IMF, International Financial Statistics; Centre for Monitoring Indian Economy, Monthly Review of the Indian Economy; Financial Times; Reserve Bank of India.

Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate Rs:US\$ (av)												
2017	68.1	67.1	65.9	64.5	64.4	64.4	64.5	64.0	64.4	65.1	64.9	64.2
2018	63.6	64.4	65.0	65.6	67.5	67.8	68.7	69.5	72.2	73.6	71.9	70.7
2019	70.7	71.2	69.5	69.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate Rs:US\$ (end-period)												
2017	67.8	66.7	64.8	64.2	64.5	64.7	64.1	64.0	65.4	64.8	64.4	63.9
2018	63.7	65.1	65.0	66.8	67.5	68.6	68.6	70.9	72.5	74.0	69.7	69.8
2019	71.0	71.2	69.2	69.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M1 (% change, year on year)												
2017	-14.1	-10.9	3.1	-2.3	-1.2	1.3	1.5	1.7	1.6	2.4	34.6	44.7
2018	38.9	31.9	21.8	21.7	20.7	18.1	17.4	17.8	14.6	15.1	16.2	13.6
2019	14.8	16.5	13.9	12.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M3 (% change, year on year)												
2017	6.0	6.1	10.1	6.7	6.6	7.0	6.7	6.7	5.6	6.1	8.4	10.0
2018	10.4	9.9	9.2	10.2	10.4	9.8	9.9	10.8	9.4	10.0	10.4	10.2
2019	10.4	10.8	10.6	10.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money market rate (end-period; %)												
2017	6.60	6.58	6.56	6.52	6.56	6.56	6.48	6.31	6.29	6.32	6.37	6.42
2018	6.76	7.21	7.26	6.86	7.36	7.51	7.27	7.39	7.50	7.49	7.56	7.47
2019	7.58	7.48	7.53	7.06	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2017	9.6	9.6	9.6	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
2018	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
2019	9.5	9.5	9.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (% change, year on year)												
2017	3.5	1.2	4.4	3.2	2.9	-0.3	1.0	4.8	4.1	1.8	8.5	7.3
2018	7.5	6.9	5.3	4.5	3.8	7.0	6.5	4.8	4.6	8.4	0.2	2.5
2019	1.4	0.1	-0.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
BSE Sensex stockmarket index (end-period; 1978/79=100)												
2017	27,656	28,743	29,621	29,918	31,146	30,922	32,515	31,730	31,284	33,213	33,149	34,057
2018	35,965	34,184	32,969	35,160	35,322	35,423	37,607	38,645	36,227	34,442	36,194	36,068
2019	36,257	35,867	38,673	39,032	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (% change, year on year; av; seasonally adjusted)												
2017	3.2	3.6	3.9	3.0	2.2	1.5	2.3	3.2	3.3	3.6	4.8	5.2
2018	5.0	4.4	4.2	4.5	4.8	5.1	4.1	3.7	3.7	3.3	2.3	2.0
2019	2.0	2.5	2.8	2.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Wholesale prices (% change, year on year; av; seasonally adjusted)												
2017	4.2	5.6	5.2	3.7	2.3	0.8	2.0	3.3	3.2	3.7	4.0	3.6
2018	2.9	2.7	2.7	3.5	4.9	5.6	5.4	4.6	5.3	5.4	4.6	3.4
2019	2.7	2.9	3.2	3.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (US\$ m)												
2017	22,356	24,727	29,302	24,579	23,947	23,013	22,293	23,355	28,567	22,889	26,293	27,833
2018	25,408	26,031	29,167	25,910	28,866	27,140	25,811	27,810	27,791	26,649	26,122	27,910
2019	26,337	26,688	32,548	26,070	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (US\$ m)												
2017	32,261	34,248	39,947	38,835	38,279	37,055	34,215	36,071	37,963	37,501	41,390	42,031
2018	40,701	37,871	42,801	39,630	43,917	44,801	44,400	45,751	42,794	44,701	43,706	42,303
2019	41,093	36,265	43,440	41,400	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US\$ m)												
2017	-9,905	-9,522	-10,645	-14,256	-14,332	-14,042	-11,922	-12,716	-9,396	-14,613	-15,098	-14,198
2018	-15,293	-11,841	-13,634	-13,720	-15,051	-17,662	-18,590	-17,940	-15,003	-18,052	-17,584	-14,393
2019	-14,756	-9,577	-10,892	-15,330	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2017	344,545	345,181	350,924	353,698	360,820	366,987	374,515	377,935	379,771	379,330	382,006	389,350
2018	401,550	400,133	403,751	399,533	391,850	385,400	383,777	380,574	380,813	371,889	373,188	374,425
2019	378,006	379,584	390,268	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

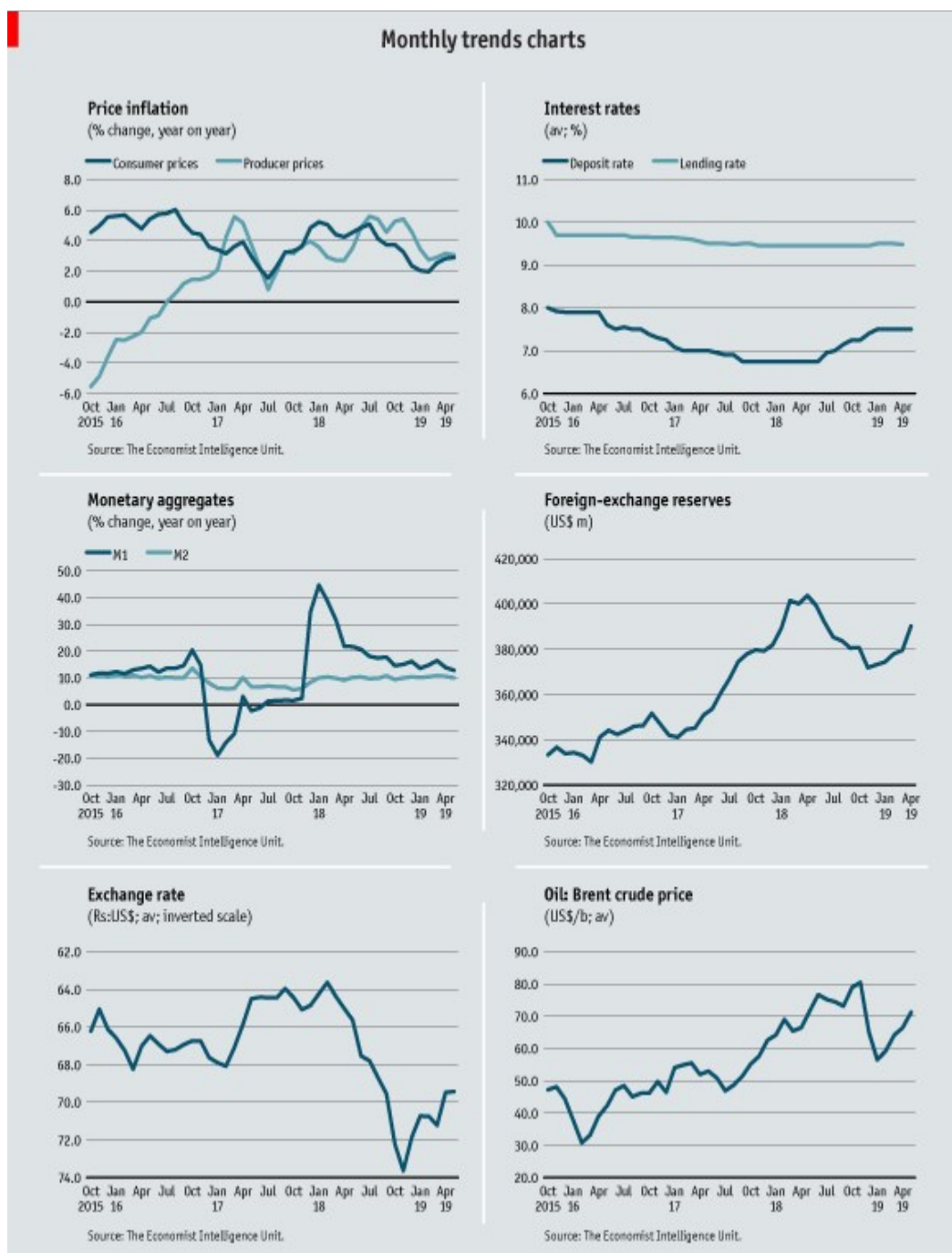
Annual trends charts



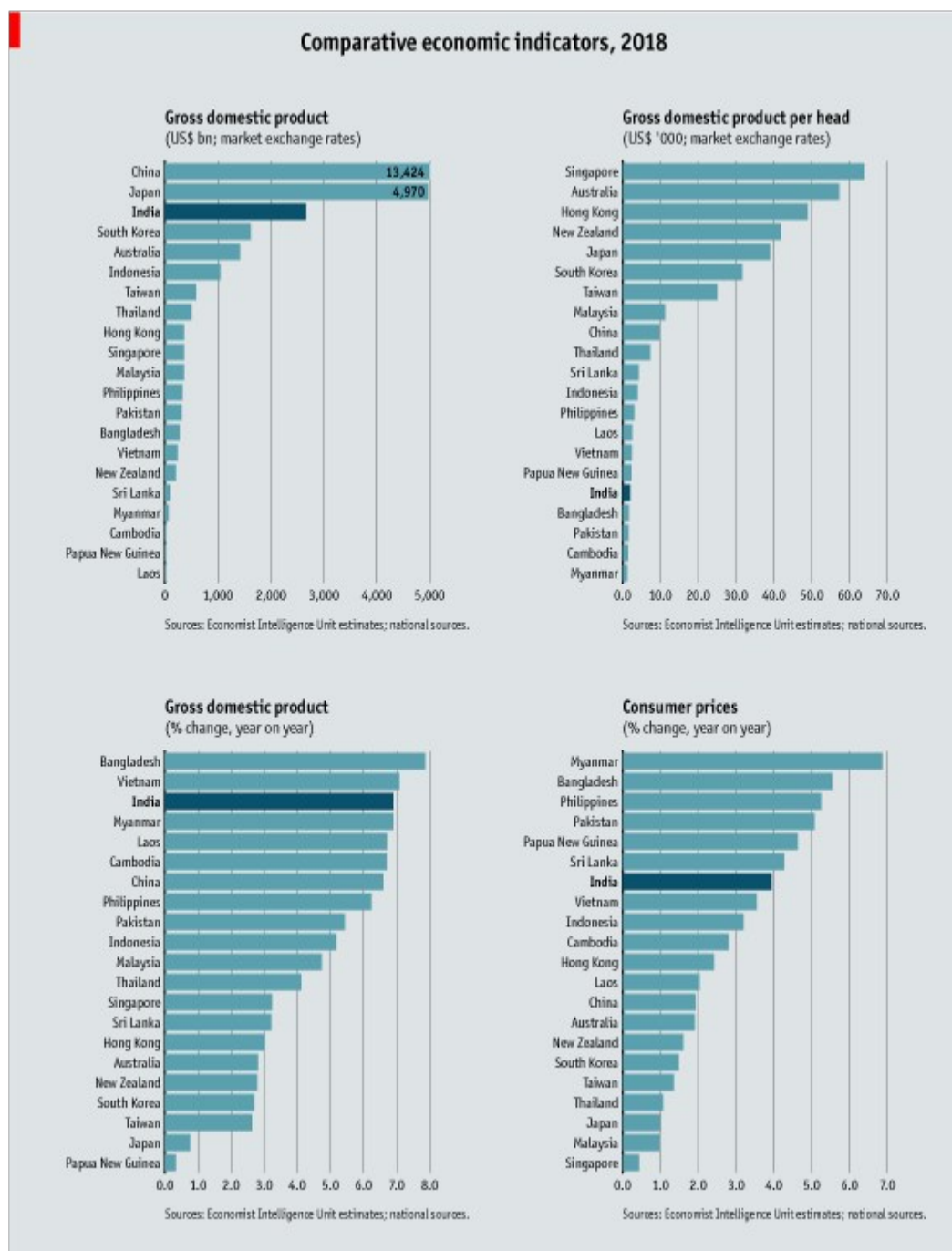
Quarterly trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

3,287,263 sq km (including Indian-administered Kashmir); of the total, 57% is agricultural land and 16% is forest area

Population

1.34bn (2017; UN)

Main towns

Population of metropolitan areas and regions in millions (2011 census)

New Delhi (capital): 21.8

Mumbai (Bombay): 20.8

Kolkata (Calcutta): 14.6

Chennai (Madras): 8.9

Bangalore: 8.7

Hyderabad: 7.7

Climate

Varied: humid subtropical in Ganges basin, semi-arid in the north-west, tropical humid in north-east and most of the peninsula, tundra in the Himalayas. All areas receive rain from the south-west monsoon in June-September; the south is also served by the north-east monsoon in January-March

Weather in New Delhi (altitude 218 metres)

Hottest month, May, 26-41°C (average daily minimum and maximum); coldest month, January, 7-21°C; driest month, November, 4 mm average rainfall; wettest month, July, 180 mm average rainfall

Languages

Hindi is the official language and the primary tongue of 30% of the population. English is an additional language used for official purposes and also used widely in business circles. Individual states may legislate an official language, and several have done so

Religions

Hindu (79.8% in 2011 census); Muslim (14.2%); Christian (2.3%); Sikh (1.7%); Buddhist (0.7%); Jain (0.4%)

Measures

Metric system. Numbers are often written in lakhs (100,000) and crores (10m)

Currency

Rupee (Rs); Rs1 = 100 paisa. Average exchange rate in 2018: Rs68.4:US\$1

Fiscal year

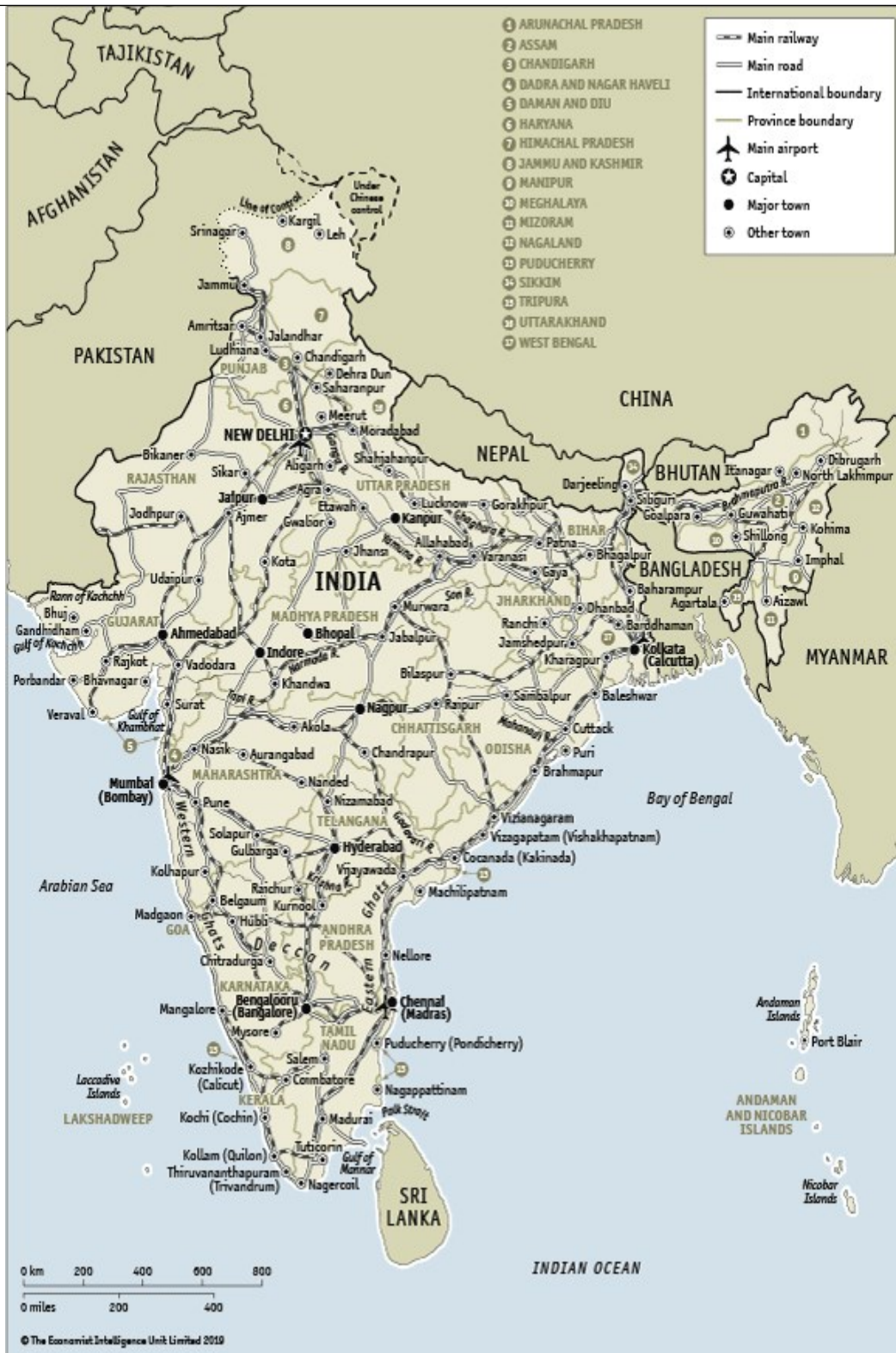
April 1st-March 31st

Time

5 hours 30 minutes ahead of GMT

Public holidays

Republic Day (January 26th); Independence Day (August 15th); Mahatma Gandhi's birthday (October 2nd); also major Hindu, Muslim, Christian and other religious holidays



Political structure

Official name

Republic of India

Form of state

Federal republic, with 29 states and seven union territories

Head of state

The president, Ram Nath Kovind, was elected in July 2017 for a five-year term by the members of the central and state legislatures

The executive

The prime minister presides over a Council of Ministers chosen from the elected members of parliament (MPs)

National legislature

Bicameral. The Lok Sabha (the lower house) has 545 members—543 elected from single-member constituencies (79 seats are reserved for “scheduled castes” and 40 for “scheduled tribes”) and two representatives of Anglo-Indians appointed by the president. The Rajya Sabha (the upper house) has 245 members—233 elected by weighted votes of the elected MPs and the legislative assemblies of states and union territories, and 12 appointed by the president

State legislatures

Unicameral or bicameral, with elected members; state governors are appointed by the president

Legal system

Based on the 1950 constitution and English common law

National government

The National Democratic Alliance, a coalition led by the Bharatiya Janata Party (BJP), won the largest number of seats at the parliamentary election held in April-May 2014 and formed a government

National election

The most recent election for the Lok Sabha was held in April-May 2019; the next is scheduled to take place by May 2024

Main political organisations

BJP; Indian National Congress; All India Anna Dravida Munnetra Kazhagam (AIADMK); Trinamool Congress (TMC); Biju Janata Dal (BJD); Shiv Sena (SHS); Telugu Desam Party (TDP); Telangana Rashtra Samithi (TRS); Communist Party of India (Marxist), or CPI (M); YSR Congress Party (YSRCP); Nationalist Congress Party (NCP); Lok Janshakti Party (LJP); Samajwadi Party (SP); Aam Aadmi Party (AAP); Rashtriya Janata Dal (RJD); Janata Dal (United); Bahujan Samaj Party (BSP); Dravida Munnetra Kazhagam (DMK)

Key ministers

Prime minister: Narendra Modi (BJP)

Agriculture: Radha Mohan Singh (BJP)

Civil aviation: Ashok Gajapathi Raju Pusapati (TDP)

Communications & information technology: Ravi Shankar Prasad (BJP)

Defence: Nirmala Sitharaman (BJP)

External affairs: Sushma Swaraj (BJP)

Finance: Arun Jaitley (BJP)

Health & family welfare: Jagat Prakash Nadda (BJP)

Home affairs: Rajnath Singh (BJP)

Power: Rajkumar Singh (BJP)

Recent analysis

Generated on June 27th 2019

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

Politics

Forecast updates

UN designates chief of militant group as global terrorist

May 7, 2019: International relations

Event

On May 1st the Sanctions Committee of the UN Security Council (UNSC) designated Masood Azhar, the leader of the Pakistan-based Jaish-e-Mohammed (JeM) militant group, as a global terrorist and placed sanctions on him.

Analysis

Since 2008, successive governments in India have sought Mr Azhar's designation as a terrorist by the UNSC, but all attempts so far were blocked by Pakistan's key ally, China. After the JeM claimed responsibility for a major terrorist [attack](#) in Indian-administered Kashmir in February this year, the US, France and the UK asked the UNSC to reconsider a motion to designate Mr Azhar as a global terrorist. China blocked the proposal in March. However, it later relented after revised material for the proposal was resubmitted to the Sanctions Committee.

Pakistan's government announced that it would enforce the decision with immediate effect. Mr Azhar, who resides in Pakistan, will be subjected to a travel ban and arms embargo, and his assets will be frozen. The government is particularly keen to be seen as combating terrorism effectively ahead of a review by the [Financial Action Task Force](#) (FATF)—a multilateral body that sets international standards to combat money laundering and terrorist financing. In recent weeks, the Pakistani authorities have announced a series of anti-terrorism measures to in a bid to thwart attempts by the FATF to place the country on its "black list". Pakistan is currently on the watchdog's "[grey list](#)". The FATF is scheduled to review Pakistan's compliance with its recommendations in June, and a negative assessment could lead to financial and economic sanctions.

Overall, we do not believe that the latest decision by the UNSC will prompt a significant change of policy on Pakistan's part. The military continues to dominate security and foreign affairs. Although it has acted against some militant groups such as the Tehrik-i-Taliban Pakistan (different from the Afghan Taliban) in recent years, similar action against the JeM is unlikely. The Pakistani authorities are likely to continue to face criticism from neighbouring India over the issue of crossborder terrorism.

Impact on the forecast

The latest development reinforces our view that Pakistan will come under increasing pressure from the international community, particularly the US and its allies, to take stronger measures to combat terrorism.

India and Iran negotiate over oil imports

May 15, 2019: International relations

Event

Iran's minister for foreign affairs, Javad Zarif, paid an official visit to the Indian capital, New Delhi, on May 13th-14th, during which he discussed the prospects for oil trade between India and Iran.

Analysis

During his visit, Mr Zarif met the Indian minister for external affairs, Sushma Swaraj. Media reports indicate that the two governments agreed that India will only take a final decision on oil imports from Iran after the conclusion of its ongoing general election, the results of which are due on May 23rd.

India's ties with Iran have come under pressure since 2018, when the US administration re-imposed sanctions over Iran's nuclear weapons programme. On 23rd May sanctions waivers that allowed eight countries (including India) to import oil from Iran expired. Despite its waiver, India's oil imports from Iran have fallen drastically since the US re-imposed sanctions, and in April the Indian minister for petroleum and natural gas, Dharmendra Pradhan, indicated that his country was looking to increase its oil imports from other major suppliers (probably Saudi Arabia and Iraq). Mr Pradhan's comments are a signal that India is prepared to pare down its imports from Iran further as it makes efforts to avoid US sanctions on the issue.

There is a possibility of India and Iran turning to a rupee-based barter system to circumvent restrictions imposed by sanctions on the use of US dollars in trade with Iran. This system was adopted in 2012-15, when the US imposed a similar sanctions regime. However, we believe that India will be more cautious this time, particularly as the current US administration has proved hawkish on foreign policy. In addition, India has diversified its crude oil basket in recent years, attempting to insulate itself from the geopolitical risks associated with importing the commodity from Iran.

Impact on the forecast

We believe that India will continue to trim its oil imports from Iran in order to avoid US sanctions, at least under current circumstances, with the level eventually becoming virtually negligible. We have also incorporated this development into our external trade forecast for Iran.

Political violence mars last leg of campaigning

May 17, 2019: Election watch

Event

Several instances of political violence have been reported in the state of West Bengal in the run-up to the last phase of general elections, scheduled for May 19th. Local media reports indicate these instances led to the deaths of three people in the state.

Analysis

The clashes occurred between supporters of the Bharatiya Janata Party (BJP), which controls the outgoing central government, and those of a regional party, Trinamool Congress (TMC), which runs the West Bengal state government. The 2019 general elections have seen the BJP emerge as the principal opposition party in the state, filling a vacuum caused by a decline in support for the Communist Party of India (Marxist), formerly a significant political force there.

The BJP sees winning more seats in West Bengal as a potential way to offset some of its seat losses in northern parts of the country, where it faces voter discontent over a variety of economic issues. The party won only two of West Bengal's 42 parliamentary seats in 2014, compared with 34 for the TMC. The BJP's campaign in West Bengal has been laced with references to Hindu majoritarianism—an increasingly potent issue in a state with a large Muslim minority—and concerns about illegal immigration from Muslim-majority Bangladesh. The TMC president and West Bengal chief minister, Mamata Banerjee, has been a vocal critic of the BJP leadership. She has made references to "Bengali pride" to counter the BJP's religion-toned campaign, given that the majority in West Bengal speak the Bengali language. The intense competition between the TMC and the BJP has led to violence in parts of the state. In response, the Election Commission of India moved the deadline to end campaigning to May 16th, a day earlier.

Impact on the forecast

We believe that the BJP will make limited gains in the polls in West Bengal and that the TMC will remain the dominant political party in the state. Overall, we retain our view that the BJP will emerge as the largest party in the 2019 general elections.

BJP poised to serve a second term

May 23, 2019: Election watch

Event

Preliminary results indicate that the Bharatiya Janata Party (BJP) has secured a majority of the seats in the Lok Sabha (the lower house of parliament) at the general election held in April-May.

Analysis

The BJP appears to have performed better than The Economist Intelligence Unit had anticipated. With most of the votes counted, the BJP has secured enough parliamentary seats to govern on its own. However, we still expect existing BJP allies to be part of the government.

However, several changes are expected within the government, as some key figures from the previous administration have not taken part in the latest election, including the speaker of the outgoing Lok Sabha, Sumitra Mahajan. That said, we expect the leader of the BJP, Narendra Modi, largely to retain key officials involved in policy making, thereby ensuring policy continuity. Given the clear mandate that the BJP has received in these polls, the party leadership is expected to move quickly on forming the next government and a full cabinet could be unveiled by early June.

Domestic stockmarkets surged during the day, indicating that investors have welcomed the result, since markets expect a government dominated by a single party to be more stable and decisive than a coalition government.

Impact on the forecast

The BJP's performance has been better than our expectations, although we had forecast that the BJP and its allies would be able to form a government. We maintain our view, however, that the pace of policy reform will remain constrained by the BJP's lack of a majority in the Rajya Sabha.

Analysis

Will the NRC damage India-Bangladesh relations?

May 30, 2019

In India, the first round of verification under the National Register of Citizens (NRC) was completed in the state of Assam, which has resulted in the exclusion from the register of about 3.6m people. Although we do not expect this to result in mass deportations—the implementation is in any case subject to judicial challenge—the initiative will strain social stability. Furthermore, the NRC process may cause stresses in relations between India and Bangladesh. Our core forecast, however, assumes that bilateral relations will remain warm.

The NRC, which was first introduced in 1951, is a list of all legal citizens in the state of Assam. It was recently updated to include people who could prove their residency in the state before March 24th 1971 (immediately before Bangladesh declared independence from Pakistan). This was done to identify those who had crossed into Assam before Bangladesh attained independence; the Indian government defines anyone who crossed into the state after the cut-off date as an illegal migrant.

By contrast, in 2018, on a national level, the Indian government sought to introduce a Citizenship Amendment Bill to grant citizenship to non-Muslim migrants from Pakistan, Bangladesh and Afghanistan. The bill was passed in the Lok Sabha (the lower house of parliament). However, it was rejected by the Rajya Sabha (the upper house). It had sparked fierce protests in north-eastern parts of the country because it was perceived as being accommodative to non-Muslim illegal immigrants. Immigration into the north-east is highly controversial, owing to fears of changes in ethnic composition. The Bharatiya Janata Party (BJP), which dominates the ruling coalition, has promised to implement the NRC eventually in all states of the country, which in practice merely means the reaffirmation of the status of legal citizens. We believe that, although the BJP would like to press ahead with the nationwide exercise in a bid to consolidate support among its Hindu voter base, it is unlikely to complete it, owing to pressure from civil society as well as legal

challenges. Nevertheless, in the short term, the move will raise political stability risks, particularly in the regions around the Indian-Bangladesh border.

Bilateral relations remain strong

Bangladesh and India have long enjoyed robust relations, helped by strong trade and investment flows from the latter to the former. India is the second-largest source of merchandise imports for Bangladesh. The total value of goods trade between the two countries stood at more than US\$9bn in 2018, according to the IMF. In addition, over the past decade, India has extended lines of credit in excess of US\$7bn to Bangladesh for various infrastructure development projects. Over the forecast period, we expect Bangladesh and India to increase co-operation in the energy sector and to expand transport links. Both are members of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Co-operation (a grouping of South and South-East Asian countries).

Furthermore, we expect Bangladesh to continue to benefit from concessional financing from India, which will push ahead with its attempts to counter China's growing influence in the region. Almost all countries in South Asia—with the exceptions of India and Bhutan—have signed up to infrastructure projects under China's Belt and Road Initiative. India has chosen to opt out, as some of the proposed projects are located in territory it disputes with China and Pakistan.

Additionally, we expect Bangladesh and India to make progress in solving their water-sharing disputes related to the Teesta River during the forecast period. The issue had been put on the back burner owing to [elections in India](#) in April-May 2019. With these out of the way, and with the new government likely to be of a composition that favours concluding the negotiations, we expect an agreement on water sharing to be signed in 2019-23.

Citizenship verification will be a drawn-out process

The close ties between India and Bangladesh face risks from the NRC, however. In February 2019 the first round of the process was completed in Assam, with further rounds expected in that state; the process is also likely to start in the Indian state of West Bengal. Nevertheless, we do not expect non-registrants to be deported. The people excluded from the register are likely to take legal recourse—which, in India, is invariably a protracted process. In addition, given the porous border between India and Bangladesh, and the violence and chaos that accompanied India's partition, which resulted in the formation of Pakistan (formerly West Pakistan) and subsequently Bangladesh (formerly East Pakistan), a clear-cut identification of illegal immigrants is a major challenge.

If the Indian government were to adopt a hardline stance by insisting that residents it deems to be illegal must be returned to Bangladesh—which is not our core forecast—bilateral relations would deteriorate, not least because Bangladesh does not consider them to be its citizens. Bangladesh is already supporting around 1m [refugees from Myanmar](#), an influx that has severely strained its resources. Our core view remains that stronger co-operation on the economic front, and also as part of wider regional initiatives, is likely to take precedence over the NRC issue. Overall, we expect Bangladesh-India relations to remain cordial in 2019-23.

Economy

Forecast updates

Wheat import duty hiked

May 2, 2019: External sector

Event

On April 26th the Ministry of Finance announced an increase in the customs duty on wheat imports from 30% to 40%. The government also relaxed norms for wheat specification for procurement.

Analysis

The government's decision was motivated by a supply glut in the domestic wheat market. According to government estimates wheat production in the 2019/20 crop year (which runs from July to June) will be 2% higher than the previous year, owing to prospects of a near-normal monsoon period. The government hopes that higher custom duties will ensure that wheat demand is met by domestic stocks.

The Economist Intelligence Unit does not expect the decision significantly to reduce wheat imports or ease the country's trade deficit. It is the third hike in three years to custom duties, which were set at 10% in 2016. The previous hike, from 20% to 30% in May 2018, resulted in a drop of wheat imports from US\$364.5m in 2017/18 to just US\$800,000 in 2018/19. The capacity to further reduce imports is limited, and the crop's share of total imports is tiny.

This also means that the increase in domestic wheat prices for farmers will be modest. While the policy will boost sentiment among local producers during the election period, it will not lead to a meaningful improvement in profits across the sub-sector. The procurement policy change—which relaxes norms for wheat specification—should, however, compensate for some wheat losses that occurred as a result of unseasonable rain in April.

Impact on the forecast

The event does not merit a change to our view that India's current-account deficit will average 1.5% of GDP in 2019-20. The country's trade policies will remain fairly protectionist during this period.

PMI hits record lows across manufacturing and services

May 7, 2019: Economic growth

Event

According to data released on May 6th, the Nikkei composite purchasing managers' index (PMI), a barometer of private sector performance, stood at 51.7 in April. This marked a decline from a reading of 52.7 in March. A level above 50 indicates an expansion of activity.

Analysis

A slowdown in manufacturing and services drove the composite PMI to its lowest level since September 2018. The [manufacturing](#) sector expanded at its slowest rate in eight months, with sector-specific PMI falling from 52.6 in March to 51.8 in April—a reading lower than the index's long-run average. Sluggish growth in new orders drove this decline, as ongoing election uncertainty, tepid consumer sentiment and subdued lending challenged demand. Weakness in new business was felt most sharply in the production of capital goods, signalling excess capacity and the onset of a slight investment slowdown.

Meanwhile, services growth was at the lowest level in seven months, falling from a PMI reading of 52 in March to 51 in April. Competitive pressures, as well as a reported increase in activity on online platforms, contributed to a softening of output growth and new orders for surveyed providers in the sector. Across both services and manufacturing, input cost inflation fell to pronounced lows, limiting the potential for price increases. On the bright side, export sales grew at a faster pace relative to March, reaching a ten-month high in services, indicating robust demand for Indian goods and services.

We expect the transition to a new government to lead to a pick-up in manufacturing and services activity in the second half of 2019, as policy certainty lifts business sentiment. However, we expect structural factors, stemming from global economic weakness and domestic credit conditions, to lead to below-potential industrial production growth in 2019-20.

Impact on the forecast

The latest PMI data are in line with our decision to make a downward revision to our forecast of 7.2% real GDP growth in fiscal year 2019/20 (April-March). This is largely owing to expectations of weakness in manufacturing growth.

Cyclone Fani weakens in India

May 8, 2019: Economic growth

Event

On May 4th the India Meteorological Department (IMD) stated that the cyclonic storm Fani had weakened into a depression over Bangladesh.

Analysis

The IMD first detected the storm on April 26th. A week later it classified the cyclone as "extremely severe"—the second-highest intensity level on its scale. On May 2nd the tropical storm hit coastal Odisha at the strongest intensity witnessed by the state since 2013. Although 34 people are estimated to have been killed by the disaster, a mass evacuation operation led by state authorities mitigated much of the damage, by moving over 1m residents to safety in 24 hours. We do not expect the number of fatalities caused by the disaster to increase significantly, owing to the quick response of the state authorities. The potential for fatalities in Bangladesh and neighbouring regions is much lower now that the cyclone has dissipated.

We do, however, expect infrastructure damage caused by the cyclone to pose sizeable one-off economic costs to the Odisha state government. These will include efforts to restore power and telecommunications infrastructure, reconstruct housing damage and provide financial assistance to those affected. The state will also lose revenue owing to damage to the business environment and declines in tourist arrivals. Although some aid from the central government is expected to be disbursed, the economic costs of the disaster will largely be limited to the federal level.

The occurrence of further natural disasters in 2019-23, likely owing to India's [vulnerability](#) to climate change, may lead to costs and disruptions being felt more widely. We expect these events to pose a moderate long-term risk to economic growth owing to the country's limited infrastructure resilience. Measures taken by the Odisha government will nonetheless serve as a positive example for averting fatalities.

Impact on the forecast

The event does not merit a change to our forecast, owing to the relatively concentrated nature of its impact.

Industrial output contracts in March

May 13, 2019: Economic growth

Event

Industrial output contracted by 0.1% year on year in March, after growing by 0.1% in February, according to data published by the Ministry of Statistics and Programme Implementation on May 10th.

Analysis

The contraction in industrial output was led by a fall in manufacturing, which declined by 0.4% year on year in March. There were declines in the manufacture of machinery and equipment, transport equipment and metal products, reflecting weakness in demand from businesses. Meanwhile, the poor performance of consumer durables and non-durables correlates with other data indicating an underlying tepidness in consumer demand.

The mining and electricity sectors posted modest growth of 0.8% and 2.2% respectively. This is in line with momentum witnessed in eight core industries, including coal, crude oil, natural gas and refining. Separate data released by the government showed that output in the eight core industries expanded by 4.7% year on year in March, compared with 2.2% in February.

The economy is expected to regain some momentum after the current election (the result will be announced on May 23rd) as political risks diminish, coupled with a boost from [lower lending rates](#). However, we expect structural factors, stemming from global economic weakness and domestic credit conditions, to keep industrial production growth below potential in 2019-20.

Impact on the forecast

We will revise down our forecast for industrial production growth for 2019, currently at 4.7%, in the light of these weak data.

Subdued price pressures provide space for RBI to cut rates

May 14, 2019: Inflation

Event

Data released by the Central Statistics Office on May 12th show that consumer prices rose by 2.9% year on year in April, the same pace of increase as in March.

Analysis

Food prices contributed to continued strength in prices, as the food and beverage index, which accounts for nearly 47% of the consumer price index, accelerated from an increase of 0.3% year on year in March to 1.1% in April. The Indian Meteorological Department has predicted a near-normal monsoon this year, although food prices will continue to rise because of supply-side factors, including a shortfall in sowing from the 2019 winter season. We expect some impact on crop output from the developing El Nino weather pattern, which will continue to exert upside pressure on food prices later in the year.

Fuel and light prices increased only slightly, owing to efforts by the government to prevent a spillage of volatility in crude oil prices into retail prices. We expect fuel prices to remain relatively stable in 2019 despite US sanctions on Iran and Venezuela, because of higher inventory levels in the US and pressure from the US government for Saudi Arabia to boost output, which will keep inflation in this category in check. Overall, core inflation (which excludes food and fuel prices) fell from 5.4% in March to 4.8% in April, the lowest level in over a year, signalling that the economy is slowing and dampening underlying price pressures.



Despite the likely pick-up in the coming months, we expect inflation to still trend below the medium-term price-stability target of 4% set by the Reserve Bank of India (RBI, the central bank). The RBI is also cognisant that the economy is growing below potential, and as such we expect another 25-basis-point interest-rate cut in June.

Impact on the forecast

The latest data are broadly in line with our expectations. However, in our next forecasting round we will nevertheless make a slight downward revision to our forecast for consumer price inflation in 2019, which is currently at 3.7%.

Both imports and exports were weak in April

May 20, 2019: External sector

Event

In April merchandise exports grew by 0.6% year on year, to US\$26.1bn, according to data published by the Ministry of Commerce and Industry. Imports grew by 4.5%, to US\$41.4bn, during the same period.

Analysis

Export growth slid to a four-month low, owing mainly to a contraction in outbound shipments of cotton yarn and handloom products, and engineering goods. Meanwhile, crude oil imports rose markedly, mirroring the recent spike in international prices of crude oil. In April the oil import bill rose by 9.3% year on year, reversing a contraction in March. Furthermore, imports of transport equipment and vegetable oil fell sharply, by 32% and 21% respectively. In addition, imports of chemicals and gems and jewellery items also declined, with the latter indicating that there will be a dip in exports of processed jewellery items in the coming months. Overall, the merchandise trade deficit widened to US\$15.3bn in April this year, compared with US\$13.7bn in April 2018.

Global trade pressures and slowing demand will weigh on exports throughout 2019. The prospects for imports are also subdued, as we expect the recent spike in energy prices to be short-lived. In addition, slightly weaker domestic demand will weigh on imports, and so we expect a contraction in the size of the merchandise trade deficit in 2019.

Impact on the forecast

We will adjust down our export growth forecast, currently at 6.3% for 2019, to reflect weak data in the first four months of the year.

Analysis

EIU global forecast - Waiting for an elusive US-China deal

May 14, 2019

The Economist Intelligence Unit has long been forecasting a slowdown in global growth in 2019-20. However, recent data suggest that the world's three major economies proved surprisingly resilient in the first quarter of 2019. In the US, real GDP growth stood at a solid 3.2% year on year, a robust headline for an economy operating at near-full employment. In the euro zone, output expanded by 0.4% quarter on quarter over the same period, the strongest quarterly expansion in a year. The single currency area posts record-low unemployment rates, and the latest high-frequency data paint a positive picture in the services and construction sectors, offsetting softer manufacturing data. In China, a revival in the industrial sector stabilised economic growth, defying our expectations that the slowdown in economic growth that began in the third quarter of 2018 would extend further. Coupled with the roll-out of fifth-generation (5G) technology in a number of Asian countries this year, the recent solid Chinese performance will support global trade in the second half of 2019.

Detailed analysis of US growth data paints a contrasting picture

These rosier data will offer some respite to central bankers across developed economies who were previously weighing up whether a cautious "wait and see" approach was still appropriate, or whether it was time to brace for impact and prepare for more stimulus.

However, a more detailed analysis of the latest growth figures across developed markets does not alter our view that 2019-20 will be marked by a global slowdown. In the US the two main contributors to growth in the first quarter were external trade (owing to a sharp deceleration in import growth) and a surge in inventories. This is cause for serious concern. High inventories will later become a drag on growth; a slowdown in import growth hints at slowing consumer demand,

in line with other high-frequency indicators.

Global trade is slowing sharply

The deceleration in US trade activity mirrors other data that all point to slowing global trade. The South Korean KOSPI-100 equity index, which is mainly made up of export-oriented companies, has been falling since mid-April; cargo volumes at Hong Kong's international airport contracted by 5% year on year in the first quarter; and the number of containers landing at the US port of Long Beach (one of the main trade hubs between the US and Asia) was down by 7% in January-March on an annual basis.

The slowdown in global trade reflects the slowdown in the Chinese economy, as well as uncertainty concerning trade policy. Against this backdrop, recent belligerent declarations by Donald Trump, the US president, cast doubts over the possibility of a US-China trade deal being concluded by late May or early June. Should a trade deal not be agreed (not our core scenario), investor sentiment would drop sharply and global growth prospects deteriorate. The latest trade data from China represent a stark warning: in April Chinese goods exports contracted by 2.7% year on year (in US-dollar terms), compared with a 13.8% increase in March.

The Brexit saga remains unsolved

Recent developments at the regional level also add cause for concern and hint at a deterioration in economic, political, and geopolitical stability. In Europe, almost three years after the Brexit referendum, this issue remains far from resolved. The range of potential outcomes varies from "no deal" to "no Brexit", compounding uncertainty, weighing on sentiment and depressing investment. The latest developments on the Brexit front include negotiations between the ruling Conservative Party and the left-wing opposition Labour Party. Given that the respective red lines of these parties are essentially incompatible, there is little chance that these negotiations will prove conclusive.

The EU has granted the UK an extension of the Brexit deadline to October 31st (from March 29th initially). It is far from guaranteed that the bloc will be willing to extend this timeline again should the UK parliament fail to ratify the Brexit deal by then. This would raise the risk of a no-deal scenario that would provoke catastrophic damage to the British economy.

Rerun of Istanbul mayoral election weighs on the lira

Also in Europe, the decision of Turkey's High Electoral Commission to bow to pressure from Recep Tayyip Erdogan, the Turkish president, to organise a rerun of the Istanbul mayoral election sent jitters through financial markets. Mr Erdogan's ruling Justice and Development Party (AKP) proceeded to lose this election in nationwide local polls at the end of March, causing another plunge in the lira against the US dollar.

This will remind financial markets that Turkey has not yet recovered from the severe currency crisis that it experienced less than a year ago. This will renew capital flight to perceived safe havens, fuelling volatility in emerging-market currencies across the globe. Even if it has been small up to now, the risk of contagion to other emerging-market currencies such as the Indian rupee, the South African rand and the Argentinian peso cannot be discounted. In fact, we believe that a full-blown emerging-markets crisis is the third-largest risk to global growth in 2019-20.

Argentina and Venezuela remain hotspots of volatility in Latin America

The risk of contagion to emerging-market currencies has been compounded by increased political uncertainty in Latin America in recent weeks. In Argentina the peso lost about 10% of its value against the US dollar between mid-April and early May as investors started to price in the risk of a victory by the left-wing populist, Cristina Fernández de Kirchner, in the presidential race in October. We continue to believe that the incumbent president, Mauricio Macri, will be re-elected. However, fears of a Fernández presidency will continue to weigh on the peso in the coming months, fuelling inflation and depressing consumption and sentiment.

Despite peaking at almost 55% in March, annual inflation in Argentina remains far from the levels seen in Venezuela: in the same month Venezuela's annualised consumer price inflation stood at

more than 1,000,000%. To stabilise prices will be one of the main challenges that Juan Guaidó, the interim president of Venezuela, will face when he comes to power in the second half of the year, as we currently forecast. However, we also continue to acknowledge strong risks to this outlook: Nicolás Maduro, the leader of the incumbent regime, has managed to survive what he claimed was an attempted coup orchestrated by Mr Guaidó on April 30th, and has so far clung on to military support surprisingly well.

Iran sanctions will continue to fuel US-EU tensions

In the Middle East, Iran remains a hotspot of geopolitical volatility. On May 2nd the US administration let sanctions waivers expire for the eight countries that continued to import Iranian oil, in an attempt to deprive the Iranian regime of its main source of revenue. Shortly afterwards Iran announced that it would cease complying with some provisions of the nuclear deal, throwing the deal's future into doubt and raising tensions between the US (which has withdrawn from the deal) and the EU (which is trying to salvage it).

So far, this turn of events has not led to a surge in global oil prices, as an increase in tensions between the US and Iran had largely been priced in by global commodities markets. However, the risk of a potential miscalculation by the US or Iran in the Middle East has risen sharply. This, together with trade disputes, has heightened political volatility in emerging markets, and the growing tensions between the US and the EU will continue to weigh on the global economic outlook in the coming months.

World economy: Forecast summary											
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Real GDP growth (%)											
World (PPP^a exchange rates)	3.5	3.4	3.3	3.7	3.5	3.2	3.4	3.5	3.6	3.5	
World (market exchange rates)	2.8	2.8	2.5	3.1	2.9	2.6	2.6	2.8	2.9	2.8	
US	2.5	2.9	1.6	2.2	2.9	2.2	1.7	1.8	2.0	1.7	
Euro area	1.4	2.0	1.9	2.5	1.9	1.3	1.5	1.7	1.7	1.7	
Europe	1.9	1.9	1.9	2.7	2.1	1.3	1.8	1.9	1.9	1.8	
China	7.3	6.9	6.7	6.8	6.6	6.4	6.1	5.6	5.2	5.0	
Asia and Australasia	4.4	4.5	4.5	4.9	4.5	4.5	4.2	4.3	4.2	4.1	
Latin America	1.0	-0.3	-1.2	0.8	0.7	0.5	1.6	2.6	2.6	2.9	
Middle East & Africa	2.8	2.3	4.7	1.5	1.3	1.8	2.4	3.0	3.2	3.2	
Sub-Saharan Africa	4.6	2.7	0.7	2.4	2.4	2.4	0.9	3.8	4.1	4.3	
World inflation (%; av)^b	3.4	3.0	3.1	3.2	3.5	3.7	3.1	3.2	3.2	3.0	
World trade growth (%)	2.9	2.0	2.1	5.4	4.4	3.3	2.9	3.9	4.0	4.1	
Commodities											
Oil (US\$/barrel; Brent)	98.9	52.4	44.0	54.4	71.1	66.5	60.5	69.8	75.6	75.0	
Industrial raw materials (US\$; % change)	-5.1	-15.2	-2.2	20.2	2.2	-2.8	1.9	1.6	3.4	0.6	
Food, feedstuffs & beverages (US\$; % change)	-5.3	-18.4	-3.5	-1.0	1.6	-5.8	4.8	4.1	0.9	0.8	
Exchange rates (av)											
¥:US\$	105.9	121.0	108.8	112.1	110.4	110.0	108.7	104.9	100.5	96.1	
US\$:€	1.3	1.1	1.1	1.1	1.2	1.1	1.2	1.2	1.2	1.2	

^a Purchasing power parity. ^b Excludes Venezuela.

Source: The Economist Intelligence Unit.

Quality check: the challenge of dubious data in India

May 15, 2019

A recent report released by the National Sample Survey Office (NSSO), a government agency charged with conducting surveys to generate socioeconomic data, has caused concern among economists over the quality of GDP data for India. However, this is not the first time that the quality of Indian data has come under a cloud, and there is indeed some divergence in trends

between conventional measures of capturing economic activity and non-traditional measures such as car sales. This issue will persist in the next five years, remaining a challenge for investors in the Indian economy.

In a report published in April, the NSSO found that 39% of agencies included in the MCA-21, a company database used to estimate economic activity from the value-added point of view, were either inactive or misclassified. The estimation of GDP was affected by the use of the faulty database, as a result of which there were errors in calculating output in the services sector. The MCA-21 database has been used in GDP estimation since 2015, when a new GDP series was introduced with fiscal year 2011/12 (April-March) as the base year. As such, the NSSO's finding could have a bearing on GDP estimations since 2015/16.

The Ministry of Finance has responded to the NSSO report by arguing that the level of error in GDP estimation resulting from the issues with the MCA database is "marginal". The ministry cites the possibility that some of the firms highlighted by the NSSO are wrongly classified, implying they are not service sector firms and could just be manufacturing companies. However, that raises the question of double counting, if those firms are already included in a manufacturing database.

Meanwhile, the Ministry of Corporate Affairs, which is responsible for maintaining the MCA-21 database, claims that the database is updated regularly and defunct firms are weeded out from time to time. However, the ministry's stand is contradicted by the NSSO report, which suggests that the database is not updated regularly.

Not an isolated case

The NSSO report supports concerns over data quality among several observers in recent years. Significant revisions to data, particularly GDP, have often raised questions among economists about the credibility of Indian statistics. In January 2019 the two remaining non-government members of the National Statistics Commission (NSC; an agency tasked with setting quality standards in statistics) resigned over concerns that the commission was not being consulted on important issues and its recommendations were being overlooked by the government. The NSC, which can have a total of six members and a chairperson, is now left with just two appointees, both civil servants. Further, in March 2019 108 prominent economists—including academics from leading US and Indian universities—wrote an open letter calling on the government to restore credibility in data-collection standards in India.

Questions over the quality of data are also borne out by the difference between conventional measures of economic activity and more frequent non-traditional data, which give an indication of the way the economy is performing. Data on sales of consumer items and motor vehicles, for instance, paint a grimmer picture of consumer sentiment in the economy than is visible in private consumption data.

A persistent concern

Opposition political groups, including the main opposition party, the Indian National Congress, have criticised the government led by the prime minister, Narendra Modi, for encouraging the administration to doctor GDP data and thereby hide poor economic realities. Indeed, the government has been accused of preventing the release of data that was accessed by some local newspapers and allegedly showed that unemployment rose to a 45-year high in 2017.

Nevertheless, the quality of data is hampered more by institutional shortcomings and structural issues in the Indian economy than electoral politics. The large informal sector in the Indian economy makes it difficult to capture the full extent of economic activity. This is particularly evident in the challenges faced in determining unemployment and wage levels. As such, databases and sample surveys carried out to determine wage growth and employment levels may not be fully reflective of the economy's condition.

It is also affected by the lack of capacity in government agencies and the use of outdated methods to calculate data, both of which weigh on the quality of statistics. Economists and academics tracking India's economy have increasingly turned to alternative sources of data to analyse trends, such as tracking sales of two-wheeled vehicles to gauge rural demand. The Economist Intelligence Unit, for instance, recently [lowered](#) its growth forecast for India for 2019/20, based in part on weak trends in non-traditional indicators such as sales of cars and fast-

moving consumer goods.

Questions over the quality of Indian data will persist over the next five years and will remain a matter of concern for investors. We do not anticipate a swift improvement in data standards; although the government is expected to make gradual efforts to restore credibility in the quality of its data.

Digital India: what's in store?

May 28, 2019

The "Digital India" campaign was launched by the Bharatiya Janata Party in 2015 in hopes of bringing technological progress to India's public and private sectors. Digital transformation continues to represent an enormous opportunity for consumers and businesses. However, many of the campaign's ambitions have not been fully realised, owing to inadequate infrastructure, skilled labour shortages and regulatory concerns. We expect these challenges to continue limiting India's potential for digital growth in 2019-23.

Digital India was launched in July 2015 to improve digital connectivity, increase access to electronic services and invite foreign investment. It focused on nine pillars of growth including infrastructure, governance and empowerment of individuals, and covered initiatives such as universal access to mobile connectivity and technological reforms within government. In pursuing these schemes, the government hoped to facilitate India's transition to a knowledge-based economy (an economic structure based on technological growth), while differentiating itself from growing regional competition for foreign capital.

Untapped potential

The campaign also hoped to capitalise on India's vast consumer opportunity. According to a report by the McKinsey Global Institute (the research arm of McKinsey, a consulting firm), the country boasts one of the world's largest and fastest-growing digital markets (albeit from a small base). According to the report, although the internet penetration rate in the country was a relatively low 40% in 2018, the absolute number of internet subscribers was a sizeable 566m. This was 18% higher than the previous year and second only to China in terms of the number of users. This opportunity varied across urban and rural areas: internet adoption was at 65% in cities, presenting the possibility of rapid uptake on sophisticated applications such as e-commerce. Meanwhile, the same figure was at 25% in rural areas, where over 65% of India's population lived as of 2017 (according to World Bank data). This suggests potential for disseminating more basic electronic services and "leap-frogging" of technology in underserved areas.

Unsurprisingly, India's consumer opportunity has generated significant interest among both foreign and domestic players. This has been helped by the government's initiatives, many of which aim to encourage entrepreneurship and investment in the digital realm, as well as falling prices for mobile data and smartphones. Growing interest from domestic and foreign investors has supported rapid development in the digital space. According to data from the National Association of Software and Services Companies (NASSCOM), over 7,000 tech-based start-ups were launched in 2013-18; these spanned across industries such as financial technology (fintech), e-commerce and logistics. This period not only allowed for homegrown businesses like Paytm (a digital payment platform) to thrive but also helped foreign companies like the US based e-commerce giant, Amazon, to grow their footprint in the Indian market. Meanwhile, government-led projects such as the Unified Payments Interface and the Aadhaar digital identification programme provided opportunities for the private sector to collaborate with public service providers.

Law and disorder

Despite the healthy development of the digital ecosystem, India's potential in this area has not been reached. In the private sector, complex regulation continues to be a barrier to new entrants: despite the government's early efforts to improve the business environment, rules vary substantially across states, subject to implementation capacity and bureaucratic efficiency. More recently, protectionist measures proposed at the central level (such as the recent [data localisation bill](#)) have risked deterring foreign players from entering the Indian market.

Among concerns raised by prospective businesses, data privacy has emerged as key. Weak

regulation on cyber-security has heightened risks of security breaches and misuse of sensitive personal information. Although the government boasts several legal frameworks to address cyber-security, such as the Information Technology Act (2008) and the National Cyber-Security Policy (2013), poor implementation and enforcement have hindered compliance with standards. According to government estimates, over 50% of Indian organisations were affected by cyber-disruptions in 2017, with a cost of Rs4,552 (US\$64) per breached data record. In 2015 government records highlighted that only 4.9% of such cyber-security incidents led to prosecution by state authorities.

Concerns around weak cyber-security have been compounded by government efforts to centralise data. As part of the Digital India initiatives, the government has consolidated databases to boost co-ordination across departments and programmes. Several of these, including [Aadhaar](#), the world's largest biometric identification system, have been criticised by civil society for enabling improper monitoring and surveillance by state authorities. Meanwhile, other legislation, such as that related to data localisation, has been opposed by foreign governments and companies for increasing state access to private information under the guise of supporting domestic growth. These debates around individual privacy and state overreach have both deterred prospective businesses and imposed costs on existing players (such as the costs of suffering cyber-attacks), thus undermining the sector's overall potential.

The capital challenge

Across the economy, inadequate infrastructure and weakness in human capital have further diluted the impact of reforms. India's digital infrastructure continues to lag behind global standards, which limits the adoption and sophistication of software applications. According to the World Bank, the number of fixed broadband subscriptions stood at 1.3 per 100 people in 2017, compared with the global average of 13.9 that year. Similarly, the mobile download speed in India averaged 10.7 Mbps in April 2019, with the country ranking 121st of the 138 countries assessed in the global Ookla Speedtest measure. Without advancement in infrastructure, which can be led by both private and public players, the adoption of digital services across the country is likely to remain sub-par.

Drawing and retaining skilled labour also poses a business challenge. Although India is home to a large population of technology and engineering workers, the supply and skills of the labour force do not match the scale of its digital ambitions. According to the World Bank, only 2.3% of the total workforce has undergone formal skills training—a shortage likely to be exacerbated as industries change and new technologies emerge. Unsurprisingly, estimates by Gartner, a market research firm, predict that 60% of Indian companies will cite insufficient talent in data and analytics as the biggest barrier to growth in 2022. Indeed, India's ability to bridge the skills gap and retrain workers will emerge as key to realising digital transformation.

Together, challenges in regulation, infrastructure and human capital are likely to limit India's enormous digital potential. Indeed, we expect India's sizeable consumer opportunity to only grow, alongside much-needed development of the technological ecosystem through the proliferation of start-ups, investors and corporate innovators. Despite these favourable factors, we expect the benefits to digital transformation and economic growth to remain only partially realised in 2019-23, owing to the sub-par pace of structural reforms. The lack of measures—to improve technological infrastructure, conduct regulatory reform and close the skills gap—will delay the government's ambitions for Digital India, and worse, may threaten the country's prospects for economic growth.

Modi 2.0: What's in store?

May 30, 2019

Results of the general elections, which were declared on May 23rd, showed that the Bharatiya Janata Party (BJP) secured a majority of seats in the Lok Sabha (the lower house of parliament). This ensures that the BJP will run the central government for the next five years, with Narendra Modi continuing as prime minister. The new government assumed office on May 30th. We expect it to undertake an ambitious fiscal expansion plan aimed at supporting a weak economy. However, the government is likely to prioritise populist measures aimed at retaining electoral support over structural reforms.

Since first assuming office in 2014, Mr Modi has centralised power and decision-making around

his office and a few key officials and ministers that he trusts. This trend will continue in the next five years. The influence of most ministers in government decision-making will be diminished by this centralising tendency. However, they still wield power, as policy implementation and enforcement is carried out by their ministries.

The second Modi government is expected to see new faces, as many outgoing ministers (including the external affairs minister, Sushma Swaraj) opted not to contest the 2019 election. The outgoing finance minister, Arun Jaitley, is one of Mr Modi's most trusted officials, but is reported to be unwell and he has expressed his desire to stay out of office. The BJP leadership is expected to use the mandate it has received to appoint younger faces from the party into government. This will include a large number of ministers from states such as West Bengal, where the BJP exceeded expectations in the recent elections.

Although the BJP could govern alone, its allies within the larger National Democratic Alliance (NDA) are also expected to be included in the cabinet. This will enhance the government's regional representation (some NDA allies come from regions where the BJP does poorly in elections), as well as help the BJP to build a broader political alliance. The BJP will require the support of its allies in the Rajya Sabha (the upper house), where no party enjoys a majority. State assemblies elect Rajya Sabha members on a rolling basis over time. We expect the NDA to be able to secure a majority in the Rajya Sabha by mid-2021. We have revised our expectations on this front in the light of the BJP's strong performance in the general elections, which suggests that it will do well in forthcoming state polls.

We expect that the security establishment will continue to drive the foreign policy priorities of the next Modi administration. Under the current national security advisor, Ajit Doval, foreign policy has been dominated by security hawks, resulting in a hardline approach on security issues. This has led to bouts of tensions with both China and Pakistan, but has strengthened Mr Modi's ability to portray himself as a decisive leader who is tough on national security issues.

Freeing the fiscal

The government will present its budgetary plans for the remainder of fiscal year 2019/20 (April-March) in July. We expect it to retain an expansionary fiscal stance, in the light of subdued domestic demand, particularly in rural areas. There have been growing signals from the ruling establishment, including finance ministry officials, that the government will adopt a more accommodative stance with regard to the fiscal deficit. The latest data indicate that even as public revenue growth has tapered off in recent months, spending has continued to climb. We do not expect this trend to change over the remainder of 2019/20. Indeed, tax cuts for the middle class are likely to be introduced, in an effort to boost consumption. The government's efforts to reflate the rural economy are set to take the shape of cash subsidies for the farm sector. Reviving the sluggish rural economy will be a major policy challenge for the Modi administration, and supporting farm incomes will remain a priority, even in the later years of the government's term.

Infrastructure projects, particularly pet projects of the Modi government—such as the Bharatmala roads project and the Smart Cities Mission—will receive significant fiscal funding. However, many projects are likely to face financing difficulties as they envision a level of public-private partnership that seems unlikely to be realised, given how subdued private investment activity remains. Overall, in the light of the government's spending plans, we expect little progress on narrowing the fiscal deficit over the next five years. Indeed, the shortfall is set to widen slightly as a share of GDP in 2020/21. This will put upward pressure on interest rates and crowd out private sector investment.

Another important element of the upcoming budget will be tax reform. The goods and services tax (GST), which has received criticism for being cumbersome, is set to be simplified further. We expect the highest tier of the GST, a 28% rate that applies to around 19% of goods covered by the GST, to be eliminated completely, in a step that will be welcomed by businesses.

Meanwhile, the government will make efforts to increase rates of tax compliance, particularly for direct taxes. The outgoing government highlighted on multiple occasions India's relatively low tax base and, according to data from the World Bank, India's tax-to-GDP ratio is below both regional and OECD averages. The push towards compliance will centre on linking taxpayer details with the Aadhaar unique identity platform and closer scrutiny of "dummy companies" established for the purposes of tax evasion. Measures to identify and penalise such firms will continue, but will also

mean that, for businesses, India's direct tax regime will remain relatively adversarial over the next five years.

An incomplete reform agenda

The NDA's strong position in parliament will help it to pass reform legislation, particularly after it obtains a majority in the Rajya Sabha in 2021. However, we believe that the BJP will remain reticent on this front, as it will prioritise political gains and focus on socio-cultural issues. It will seek to avoid potentially painful structural reforms that could be counterproductive to its larger political goals. Notably, the government will remain reluctant to implement major changes affecting India's land and labour markets, for fear that reform on these fronts would be politically toxic.

Policy reform efforts will focus on sectors such as textiles and garments, tourism, and construction, which are labour-intensive and therefore have the potential to turn around a recent deterioration in India's unemployment rate. However, we expect the government's approach towards these sectors to be largely counterproductive. The policy measures introduced in the textiles and garments sector, including an expansion of export subsidies, will have a protectionist effect that will attract criticism from countries such as the US. Incentives in tourism and construction will be relatively less distorting. However, the construction sector will continue to be weighed down by regulatory [changes](#) introduced by the Real Estate Regulatory Authority Act, and the impact of an inventory glut in residential housing.

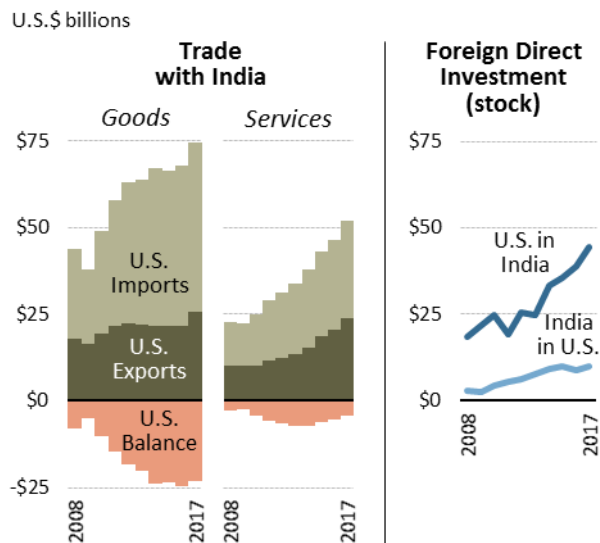
Small-scale enterprises will remain the top priority for the new administration. We expect the government to increase subsidies to small businesses in the apparel, tourism and construction sectors. Yet this will be counterproductive for competition and cause poor productivity to become entrenched. Indeed, the overall shape of the policy agenda suggests that there is unlikely to be a major improvement in economic growth during Mr Modi's second term.

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U.S.-India Trade Relations

The United States and India view each other as important strategic partners to advance common interests regionally and globally. Bilateral trade in goods and services is about 2% of U.S. world trade, but tripled in value between 2005 and 2017, reaching \$126 billion (**Figure 1**). The trade relationship is more consequential for India, for whom the United States was its second largest export market (16% share) after the European Union (EU, 17%), and third largest source of imports (6%) after China (17%) and the EU (10%) in 2017. U.S.-India foreign direct investment (FDI) is small but growing. Defense sales are significant in bilateral trade as well. Civilian nuclear commerce, stalled for years over differences on liability protections, has produced major potential U.S. supply contracts. Many observers believe bilateral commercial ties could be more extensive if trade and investment barriers were addressed. Bilateral trade frictions exist on numerous fronts, though the two sides are working to resolve some issues.

Figure 1. U.S. Trade and Investment with India



Source: CRS analysis, Bureau of Economic Analysis (BEA) data.

India's Economy

India has one of the world's fastest growing economies and the third largest on a purchasing power parity basis. It is the second most populous country, with a large and growing middle class. It also faces economic challenges, including poverty, difficulty absorbing the millions of young new workers joining the labor force, and infrastructure gaps. Rising world energy prices place pressure on India, which imports about 80% of its oil needs. Energy prices and other global factors have caused India's currency to depreciate against the U.S. dollar, raising concerns about inflation. Still, the economy is projected to grow by 7.3% in 2018, up from 6.7% in 2017 (International Monetary Fund data), as shocks abate from domestic economic measures, e.g.,

“demonetization” in 2016, which removed about 86% of currency by value from circulation in India to address tax evasion and corruption, and the roll-out of a nationwide value-added goods and service tax in 2017 to streamline the tax regime. The effectiveness of both reforms is debated.

Selected Issues

Trade Balance. The Trump Administration, which views bilateral trade balances as an indicator of the health of a trading relationship, has taken issue with the U.S. trade deficit with India (\$27 billion deficit in goods and services trade in 2017), and has criticized India for a range of “unfair” trading practices. India favors taking a broader view of their trade ties beyond the trade balance. The consequences of trade deficits are contested.

Tariffs. Bilateral tensions have become heightened over U.S. and Indian tariff policies. On June 1, 2018, the United States began applying 25% steel and 10% aluminum tariffs under Section 232 of the Tariff Expansion Act of 1962. The tariff hikes apply to all countries; India did not receive an initial exception like some trading partners, nor negotiate an alternative quota arrangement. India supplied 2.6% (\$761 million) of U.S. steel and 2.2% (\$382 million) of U.S. aluminum in 2017. It notified the World Trade Organization (WTO) of its plans to retaliate against the United States with tariffs on \$1.4 billion of U.S. goods (e.g., nuts, apples, steel, and motorcycles), but has deferred applying the tariffs until November 2, 2018, in hopes of a bilateral resolution. India also filed a WTO complaint against the U.S. tariff increases, and joined related complaints lodged by other WTO members.

In September, India announced plans to raise duties on “nonessential” goods (e.g., some precious stones, steel, and consumer electronics) from all countries to curb imports in order to support its depreciating rupee. This follows a pattern of tariff hikes by India in recent years (such as on cell phones and solar panels), as well as longstanding U.S. concerns over India's tariff regime. India has relatively high average tariff rates, especially in agriculture, and can raise its applied rates to bound rates without violating its WTO commitments, causing uncertainty for U.S. exporters.

Generalized System of Preferences (GSP). In April, the United States launched a review of India's eligibility for GSP, a U.S. program that gives duty-free tariff treatment to certain U.S. imports from eligible developing countries to support their economic development. The review concerns India's compliance with the GSP “market access” criterion and also relates to U.S. medical and dairy industry market access petitions. Continued GSP eligibility is a top priority for India, GSP's top beneficiary. GSP accounted for 12% (\$5.6 billion) of U.S. goods imports from India in 2017.

Services. The United States and India are competitive in certain services industries. Barriers to U.S. firms' market access include India's limits on foreign ownership and local

presence requirements. For India, a key issue is U.S. temporary visa policies, which affect Indian nationals working in the United States. India is challenging U.S. fees for worker visas in the WTO, and monitoring potential U.S. action to revise the H-1B (professional worker) visa program. India also continues to seek a “totalization agreement” to coordinate social security protection for workers who split their careers between the two countries.

Agriculture. Sanitary and phytosanitary (SPS) barriers in India limit U.S. agricultural exports. The United States questions the scientific and risk-based justifications of such barriers. An ongoing issue is India’s purported compliance with a WTO decision against its ban on U.S. poultry imports and live swine due to avian influenza concerns; the WTO held that India’s measures violated WTO SPS rules. Each side also sees the other’s agricultural support programs as market-distorting; India’s view of its programs from a food security lens complicates matters.

Intellectual Property (IP). The two sides differ on how to balance IP protection to incentivize innovation and support other policy goals, such as access to medicines. India’s IP regime remains a top concern for the United States, which designated India again on its “Special 301” Priority Watch List for 2017, based on such concerns as its treatment of patents, infringement rates, and protection of trade secrets.

Localization Trade Barriers. The United States continues to press India on its “forced” localization practices. Initiatives to grow India’s manufacturing base and support jobs include requirements for in-country data storage and local content for government procurement in some sectors.

Investment. India has made FDI reforms, such as raising foreign equity caps for insurance and defense, but barriers remain in multi-brand retail and other sectors. India’s regulatory transparency and judicial infrastructure present challenges for U.S. investors. Two-way U.S.-Indian FDI are associated with U.S. jobs and exports in a range of economic sectors, but U.S. direct investment in India has prompted some concerns about offshoring.

Defense Trade. The two nations have signed defense contracts worth more than \$15 billion since 2008, up from \$500 million in all previous years combined. Major future sales are anticipated, including the potential direct commercial sale of *Apache* attack helicopters, as well as *Guardian* maritime drones and additional C-17 transport aircraft. India is eager for more technology-sharing and co-production; recent reports indicate U.S. and Indian interest in producing F-16 combat aircraft there. The United States, meanwhile, urges more reforms in India’s defense offsets policy and higher FDI caps in its defense sector. India’s apparent intention to spend billions of dollars to purchase the Russian-made S-400 air defense system may yet trigger U.S. sanctions on India under the Countering America’s Adversaries Through Sanctions Act (P.L. 115-44).

Current Negotiations and Agreements

Bilateral Engagement. The United States and India reportedly are in “intensive” negotiations to address key trade issues, such as on the U.S. steel and aluminum tariffs and India’s GSP status. These talks may build on the inaugural 2+2 Dialogue in September 2018. Other bilateral dialogues include the government-to-government Strategic

and Commercial Dialogue (S&CD) and Trade Policy Forum, and the private sector-based CEO Forum.

The United States and India do not have a bilateral free trade agreement (FTA). In October 2018, President Trump stated that India expressed interest in negotiating an FTA. Some India watchers advocate for an FTA, while others question India’s willingness to open its markets. Under the Obama Administration, the two sides sought a bilateral investment treaty (BIT), but negotiations stalled.

“Both sides committed to further expanding and balancing the trade and economic partnership..., including by facilitating trade, improving market access, and addressing issues of interest to both sides... [They] welcomed [their trade ministries’] ongoing exchanges... and hoped for mutually acceptable outcomes.”—2+2 Dialogue Joint Statement (2018)

Regional Integration. India is party to negotiations on the Regional Comprehensive Economic Partnership (RCEP) with China and 15 other Asia-Pacific nations. Seven RCEP members (but not India) are part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), concluded by the proposed TPP’s 11 remaining parties. President Trump, who prefers bilateral negotiations, ceased U.S. participation in TPP, and recently announced plans to negotiate a bilateral trade agreement with Japan.

India has long sought membership in the Asia-Pacific Economic Cooperation (APEC) forum, a grouping of the United States, China, and 19 other economies. The United States previously stated that it welcomes India in APEC, though some have questioned if India is willing to take on economic liberalization sufficient for APEC membership.

WTO. As WTO members, the United States and India negotiate multilaterally to liberalize trade, but their differing views impeded the Doha Round. The recent Trade Facilitation Agreement (TFA) to remove customs barriers (the first multilateral agreement concluded in over 20 years) was initially blocked by India. The TFA entered into force in 2017 after India reversed its position, in light of a U.S.-Indian understanding not to challenge specific food security programs until a permanent WTO solution is reached—a top priority for India. Presently, however, there is no consensus on a future work plan. There also are many institutional questions about the WTO’s ongoing relevance.

Congressional Interest

Questions on U.S.-India trade relations may include:

- How do U.S. and Indian tariff and other trade policies affect their shared goal to expand bilateral trade ties?
- What are prospects for current U.S.-India trade talks to negotiate a resolution to trade frictions? Should the United States look to multilateral or regional options?
- Are bilateral FTA negotiations or a revival of BIT negotiations a possibility in the near term?

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China

<u>Subject</u>	<u>Page</u>
Ambassador Terry Branstad	191
US Relations with China	193
CultureGram 2019.....	195
BBC Country Profile	203
Economist Intelligence Unit Country Report.....	209
CRS: US-China Trade Issues	263
CRS: US-Taiwan Trade Relations.....	265

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U.S. Ambassador to China Terry Branstad



On December 7, 2016, Governor Branstad announced that he had accepted the nomination from President-elect Donald Trump to serve as Ambassador of the United States to the People's Republic of China. He was confirmed by the Senate on May 22, 2017, and was sworn in on May 24, 2017.

Ambassador Terry Branstad was born, raised and educated in Iowa. A native of Leland, Branstad was elected to the Iowa House in 1972, '74 and '76, and elected as Iowa's lieutenant governor in 1978.

Branstad was Iowa's longest-serving governor, from 1983 to 1999. As the state's chief executive, he weathered some of Iowa's worst economic turmoil, during the farm crisis of the '80s, while helping lead the state's

resurgence to a booming economy in the '90s.

At the end of his tenure, Iowa enjoyed record employment, an unprecedented \$900 million budget surplus, and the enactment of historic government overhauls that led to greater efficiencies in state government. As a result of Governor Branstad's hands-on, round-the-clock approach to economic development, Iowa's unemployment rate went from 8.5 percent when he took office to a record low 2.5 percent by the time he left in 1999.

Following his four terms as governor, Branstad served as president of Des Moines University (DMU). During his 6-year tenure, he was able to grow the university into a world-class educational facility. Its graduates offer health care in all 50 states and in nearly every Iowa county. While there, he grew enrollment, increased the endowment and integrated new buildings, programs and initiatives.

In October of 2009, sensing a need for change in the way state government operates and wanting to “lead Iowa’s comeback,” Branstad retired from DMU and was elected governor in 2010.

During his second tenure as Iowa governor from 2010 to 2017, the Legislature passed, and Gov. Branstad signed, a two-year budget with a 5-year projection for the first time in decades. This budget provided Iowa businesses the predictability and stability they needed to grow. Gov. Branstad also signed historic investments in Iowa’s infrastructure into law, including Iowa’s roads and bridges, as well as the innovative Connect Every Acre Plan that expanded high-speed broadband internet to Iowa’s agriculture industry, schools, businesses and homes.

In April 2017, Iowa Workforce Development announced that the state of Iowa’s unemployment had fallen to 3.1%, well below the national average and 8th lowest in the country.

He and his wife Chris have three grown children: Eric, Allison and Marcus, and seven grandchildren, Mackenzie, Bridget, Sofia, Alexis, Estelle, Everett and Fitzgerald.



United States Department of State

U.S.-CHINA RELATIONS

The United States seeks a constructive, results-oriented relationship with China. The United States works to achieve concrete progress on U.S. interests, including ensuring Chinese support for exerting maximum pressure on North Korea to end its nuclear program, reducing the U.S. trade deficit with China, and stopping the flow of illegal opioids from China to the United States. The United States also seeks progress on areas of disagreement such as China's territorial claims in the South China Sea and lack of respect for human rights and religious freedom. In addition to regular discussions between senior U.S. officials and their Chinese counterparts, the United States uses a range of exchanges, dialogues, and people-to-people ties to pursue its goals.

U.S. ASSISTANCE TO CHINA

Congressionally-mandated U.S. assistance programs in China focus on six principal areas: supporting efforts to protect and preserve Tibetan culture, and promote sustainable livelihoods and market integration in Tibetan communities; building local capacity in targeted Tibetan communities to assess natural resource management issues and appropriately sustain natural resource-based livelihood options; advancing environmental standards and protections, and market-based reforms supporting the environment; advancing the rule of law and human rights; addressing the threat of pandemic diseases; and providing counternarcotics assistance and training to Chinese counterparts.

BILATERAL ECONOMIC RELATIONS

Two-way trade between China and the United States has grown from \$33 billion in 1992 to over \$772 billion in goods and services in 2017. China is currently the third-largest export market for U.S. goods (after Canada and Mexico), and the United States is China's largest export market. The U.S. trade deficit in goods with China grew to an unacceptable \$375 billion as of 2017. The United States seeks fair and reciprocal trade with China, and works to protect American workers and businesses from unfair Chinese economic actions, including market access restrictions, forced technology transfers, and weak protection of intellectual property rights.

CHINA'S MEMBERSHIP in INTERNATIONAL ORGANIZATIONS

The People's Republic of China assumed the China seat at the United Nations in 1971, replacing Taiwan, and is a permanent member of the UN Security Council. Over the years, China has become increasingly active in multilateral organizations, particularly in the United Nations and in various regional fora.

Bilateral Representation

The U.S. Ambassador to China is Terry Branstad; other principal embassy officials are listed in the Department's Key Officers List.



BACKGROUND

Land and Climate

As the fourth largest country in the world, China is just smaller than the United States. Because mountains or deserts cover much of western China, the majority of the population lives in the east, where rivers and plains allow for productive agriculture. China's geographic features range from the Himalaya Mountains to the Qinghai-Tibet Plateau ("the roof of the world") to subtropical islands. Stretching east to west, the Great Wall of China is about 13,170 miles (21,196 kilometers) long. Some of the world's longest rivers are in China; the Yangtze River runs 3,900 miles (6,300 kilometers).

China's diverse plant life includes more than 2,800 species of trees, such as metasequoia, bamboo, palm, oak, China fir, evergreen, and China cypress. Deforestation is an increasing problem, especially in the east, as housing developments and industries replace natural forests. As a result of urbanization and a rapid increase in industrial activity, water and air pollution have become major problems.

China's climate ranges from sub-arctic in the north to sub-tropical in the south. During the summer wet season, monsoons cause frequent summer floods that are both deadly and destructive. Sandstorms in the north are increasingly common due to desertification.

History

Ancient Dynasties

The Chinese have one of the world's oldest continuous

civilizations, spanning thousands of years. China has long been ruled by dynasties. In more than four thousand years, China experienced at least 28 dynasties with more than five hundred emperors. The first Chinese dynasty was the Xia Dynasty, established around 2000 BC. The first imperial dynasty to unify all of China was the Qin Dynasty (221–206 BC). Qin Shi Huang, known as the first emperor of China, built the Great Wall to guard against invading nomadic groups and was the emperor for whom the famous Terra-Cotta Army was fashioned.

The Han Dynasty (206 BC to AD 220) was the second unified imperial dynasty and is considered the first Golden Age of China. The Silk Road, or the trade route between western Asia and Europe, flourished during this time. The Tang Dynasty (AD 618–907) is also considered one of the most prosperous periods in China's history. The Tang emperors, one of whom (Wu Ze Tian) was a woman, appointed foreign scholars as senior officials in the royal court. Literature, the arts, science, technology, and trade all thrived during the Tang Dynasty. China's capital during this time, Chang'an (now Xi'an), was the most populous city in the world and hosted many foreign students and merchants.

Some of the Chinese dynasties were formed by native Han (such as the Ming Dynasty, 1368–1644), and others were established after nomadic tribes from the north conquered China proper (as did the Qing Dynasty, 1644–1911). Nomadic tribes were eventually absorbed into Chinese culture.

Revolution and Communism

A revolution inspired by Sun Yat-sen overthrew the Qing Dynasty in 1911. In 1912, with the country fragmented by

opposing warlords, Sun Yat-sen established the Kuomintang (KMT) party in an effort to unify China.

After Sun's death in 1925, Chiang Kai-shek took control (1927) and ousted the once-allied Communist Party. The Communists, led by Mao Zedong, struggled with the KMT for control of China while both groups fought Japan in World War II. After the Japanese were defeated (1945), the civil war ended with Mao's forces in control and Chiang's army fleeing to Taiwan to regroup. They never returned, and Mao ruled from 1949 to 1976. China still considers Taiwan its 23rd province. In 2009, leaders of China and Taiwan exchanged their first direct messages in more than 60 years.

While the Chinese initially welcomed communism, the Great Leap Forward (1958–61) and the Cultural Revolution (1966–76) had disastrous effects on the country. More than 40 million people starved or were killed during Mao's rule.

Moderate Changes

After Mao died in 1976, Deng Xiaoping came to power and gradually moved away from Maoism. His more moderate policies led to foreign tourism, a more liberal economy, private enterprise, growth, trade, and educational exchanges with other nations. The Tiananmen Square massacre in June 1989 and a subsequent government crackdown derailed these measures for a time. By 1992, China was again focusing on economic reform, and it quickly cultivated one of the world's fastest-growing economies. However, Deng did not favor political liberalization.

Since Deng's death in 1997, his successors have reiterated his policy of a socialist market economy with a strong central government. Hong Kong (a British colony) reverted to Chinese control in 1997, and China was admitted to the World Trade Organization in 2001. The nation also hosted the summer Olympic Games in 2008.

However, China faces several domestic challenges. Ethnic violence occasionally flares in the Xinjiang and Tibet regions. Several food safety scares have come up in recent years. China's population is rapidly aging. Pollution is becoming a major health hazard in major cities. Political corruption is also a pervasive problem in China. Despite these challenges, China continues to rank among the world's leaders in gross domestic product, exports, and receipt of foreign investment.

South China Sea Disputes

Many nations bordering the South China Sea have conflicting claims over the region's waters, motivated in part by fishing rights, access to shipping lanes, and potential oil resources. China's aggressive territory claims violate international law and are the source of disputes with neighbors such as the Philippines, Vietnam, Brunei, and Malaysia.

In 2015, China began building artificial islands on coral reefs in the South China Sea. Some of China's neighbors and the United States criticized the construction of these islands, asserting that they unlawfully expand China's sovereignty in the South China Sea. Later that same year, China promised to stop building new islands, but it continued to place artillery and other military resources on the existing islands. In 2016, a Hague tribunal ruled that China's historic claim to most of the South China Sea was illegal and that Beijing had violated the Philippines' sovereign rights by building artificial islands, a ruling that China rejected.

Recent Events and Trends

- **Corruption trial:** In July 2016, a high-ranking military officer was stripped of his title as general and sentenced to life in prison after being found guilty of accepting bribes. Since 2012, hundreds of thousands of corrupt officials have been investigated and prosecuted as part of President Xi Jinping's anti-corruption campaign. Some believe that the investigations have targeted military officers who have not pledged allegiance to President Xi.
- **Oil tanker disaster:** In January 2018, an Iranian oil tanker sank off the coast of Shanghai after colliding with a Chinese freighter, killing all 32 of the tanker's crew members. The collision is the world's worst tanker spill in the last three decades. The ship was carrying 136,000 tons (about 1 million barrels) of light oil. China coordinated clean-up efforts to reduce the resulting amount of pollution in the East China Sea.
- **Uighur detention camps:** As of August 2018, up to one million ethnic Uighurs and other Turkic-speaking Muslims were being held in camps in the Xinjiang region of China, according to a United Nations report. Many credible reports have said that detainees are forced to renounce their culture and faith and are subjected to political indoctrination. Despite growing international pressure, China maintains the claim that these camps are “training centers” that provide education and vocational skills.

THE PEOPLE

Population

China's population is the world's largest. To reduce growth, the government began sponsoring family-planning programs in the 1970s and offered incentives to families with only one child; penalties were imposed on those with more children, though the policy, which applied mainly to the Han Chinese (92 percent of the population), varied according to region. As a result, China's population growth rate dropped significantly. However, the government relaxed the policy in recent years and in 2015 announced that married couples would be allowed to have two children. China is hoping that the new policy will stimulate economic growth and help support the country's aging population.

Of China's 55 minority groups, 18 include more than one million people. These are the Zhuang, Mongolian, Hui, Tibetan, Uighur, Miao, Yi, Buyi, Korean, Manchu, Dong, Yao, Bai, Tujia, Hani, Kazak, Dai, and Li ethnic groups. More than half of all Chinese live in urban areas. Millions of rural migrant laborers move in and out of cities in search of work. Shanghai (23.7 million) and Beijing (20.4 million) are some of the largest cities.

Language

Standard Chinese (*Putonghua*), or Mandarin, is based on the Beijing dialect and is the national language. It is taught in schools, so most Chinese can read, write, and speak Mandarin. Many people also use the dialects or languages of their geographical region. Some of the main dialects spoken are Wu, Min, Yue (Cantonese), Jinyu, and Kejia. Language

variations are found more in the central and southern areas of China.

Written Chinese uses characters to express words, thoughts, or principles. A Romanized alphabet (*pinyin*) is used to help teach Chinese in school and for international communication. While as many as 50,000 characters exist, only about 8,000 are currently in use. Chinese requires a knowledge of between 1,500 to 3,500 characters for basic literacy. While people in different regions might not understand each other's verbal language, they use the same basic set of characters and can communicate in writing.

Chinese is a tonal language, which means a single word may have multiple meanings depending on how it is pronounced. For example, the word *ma* can mean "mother," "linen," "horse," or "scold" depending on the tone used by the speaker.

Religion

China's constitution guarantees freedom of religion, but in practice many religious activities are restricted. The Chinese Communist Party (CCP) is officially atheist and bans its members from holding religious beliefs. Many Buddhists, Taoists, Muslims, and Christians practice their faith in China. Temples, mosques, and churches are open to the public, but public worship is frowned upon. Unauthorized or underground religious activities have led to imprisonment and other restrictions.

Taoism is the only Chinese-born religion. It is generally believed that Lao Zi (571–471 BC) was the founder of Taoism. The principles of Taoism stress peace, calm, nature, and harmony between human and universe; its symbols are *yin* and *yang* and eight trigrams (*ba gua*). Unique local religions can flourish in small towns, especially in the east; they may focus on one god or form of worship, and they often include elements of Taoism, Buddhism, and ancestor veneration.

General Attitudes

The Chinese are generally noted for hospitality and reserve. Confucianism, the ancient philosophy of social order, influences attitudes and encourages a group consciousness—especially in rural areas. Most Chinese are very proud of their nation's long history and of past Chinese achievements. They do not appreciate external criticism. The attitudes of people in larger eastern cities tend to be more cosmopolitan than those in the more traditional rural areas.

The central government emphasizes respect for and obedience to authority. Over time, people have lost respect for some local and national leaders. The change is slowly forcing local officials to be more accountable.

The principle of *guanxi* commits friends and associates to do what they can for each other when called upon. To violate *guanxi* is to lose reputation or honor. Children are expected to uphold the family's social standing. This has had different meanings in different eras. For today's urban children, it means being well educated and well dressed, earning money, and practicing traditional values such as loyalty and kindness. For rural Chinese, it means putting the needs of the group (family, community) above oneself. An admired person is one

who brings the greatest honor to the family while being the most humble about personal accomplishments.

As more urban Chinese are becoming wealthy in an expanding economy, the gap between rich and poor is growing. Some areas are experiencing unrest because people are losing their jobs and the traditional cradle-to-grave benefits of the *danwei* (work group) system. For the average person, having food, shelter, and clothing is more desirable and understandable than the relatively abstract concept of political freedom.

Personal Appearance

Chinese generally value a neat, clean-cut, and simple personal appearance. Today, many Chinese have adopted Western fashion trends and wear brand-name clothing, especially in urban areas. Rural styles are not always so modern, and some rural elderly Chinese continue to wear the Mao-era pantsuit. Ethnic minorities wear clothing reflective of their cultural past and the climate in which they live.

Most Chinese like to dress up for special occasions or social outings. For some formal occasions and traditional festivals, Chinese people wear traditional attire. The traditional dress for women is the *cheongsam* (a slim, one-piece dress). The traditional dress for men is the *chang-pao* (a long dress with four slits on the lower sides) and mandarin jacket.

CUSTOMS AND COURTESIES

Greetings

The Chinese nod politely or bow slightly when greeting. A handshake is also acceptable, especially in formal situations or to show respect. Greetings vary, as they are given in the local dialect. *Ni hao ma?* (How do you do?) is somewhat formal. Informally, people might greet with *Zao* (Morning), *Wan'an* (Evening), or *Zenmoyang?* (How's it going?). Two acquaintances who have not seen each other for some time might say *Hao jiu bu jian le* (Long time no see) or *Zui jin mang ma?* (Have you been busy lately?). Shopkeepers might greet passersby with *Huan ying* (Welcome). Many people start a conversation with a considerate *Ni chi fan le ma?* (Have you eaten yet?), to which it is proper to respond affirmatively, even if the respondent has not eaten.

The Chinese prefer formal introductions; they use full titles for their guests but are less precise in identifying themselves. Chinese names usually consist of a one-character family name, followed by a one- or two-character given name. A person is addressed either by full name or by title and family name. In lieu of professional titles, the Chinese equivalents of "Mr.," "Ms.," and "Mrs." are used. Thus, Wang Jian-Jun can also be called *Mr. Wang*, but never simply *Wang* and rarely ever *Jian-Jun*. To show special respect, friends might use the terms *Lao* (old) and *Xiao* (young) with or instead of titles.

Gestures

Chinese do not like to be touched by people they do not know. However, close friends of the same gender may sit or

stand close or walk arm in arm. Respectful distance is best when dealing with older people or those in important positions. Chinese do not punctuate conversations with gestures nearly as much as Westerners do. Out of respect, Chinese usually receive items with both hands from their seniors. To beckon, they wave all fingers with the palm of the hand facing down. Chinese point with an open hand rather than one finger. In some regions of rural China, it is common for people to spit in public after clearing their throat, an action that continues despite government fines.

Visiting

Invitations usually are extended for formal events; otherwise people often drop by unannounced. When invited, Chinese are generally prompt; being more than a few minutes late is impolite. Guests conduct themselves with restraint and refrain from loud, boisterous speech and actions. Invited friends often bring gifts such as tea, cigarettes, fruit, chocolates, cakes, or wine when they visit to show their *xin yi* (good intentions or blessings) toward the host. One also might take a small gift when visiting an older person. Hosts rarely open wrapped gifts before visitors leave. They usually offer such refreshments as fruit, nuts, or seeds. If guests decline the offer, hosts probably will insist several times before accepting the refusal.

Eating

Among family, friends, and business associates, eating is an important way of socializing and building relationships in China. The Chinese use chopsticks for all meals. Food is placed at the center of the table and may include more than one type of main dish to be eaten with rice. A small tray is offered for every diner, and diners can put food in their rice bowls or on these trays. When finished, a person places the chopsticks neatly on the table, not in the rice bowl. Spoons are used for soup, which may be eaten at the beginning or end of a meal, depending on preference. In some areas, slurping is not considered impolite; in informal situations, it is a compliment to the host.

At restaurants, diners may choose from several dishes on a revolving tray at the center of the table. Hosts may give a short welcome speech, and guests respond with complimentary toasts. At formal banquets, cold dishes are offered first as appetizers. Rice or noodles are served next to accompany the main, hot dishes. Fruit is served last. Hosts, not guests, turn the revolving tray, and people leave soon after the meal ends. In general, waiters or waitresses serve tea or wine to everyone. On occasion, the host will serve the guests tea. It is also common for guests to serve the host in a gesture of respect and gratitude. Tipping in restaurants traditionally has been an insult—something a superior does for an inferior—but with economic change, it is now popular in Guangdong and Fujian provinces and is spreading to other parts of the country.

LIFESTYLE

Family

Structure

In China's group-oriented society, the family is considered more important than the individual. Family ties survived the upheavals of the Cultural Revolution, and loyalty to family is still a hallmark of society.

The elderly are highly respected in Chinese society. In most regions of China, the entire family is expected to listen to the family elders and consult them about big decisions.

Though in 2013 China began softening its one-child policy and then ended it altogether in 2015, most families still only have one child, reflecting the restriction on multiple children that had been in place since the 1970s. Consequently, Chinese children typically receive considerable attention from parents and grandparents.

Parents and Children

Children may start to help with household chores at age six, but in some wealthy families, the kids are called “little emperors” and are not expected to work around the house. Boys are prized as heirs to the family name. Having children is considered a duty to the family; parents are completely responsible for their children, and children are expected to care for aging parents. Sending elderly parents away from home to receive care is considered shameful.

Gender Roles

Chinese society is traditionally patriarchal. Men are considered the heads of the family, often acting as the main decision makers and breadwinners. Traditionally, a woman stayed at home as a full-time housewife. It was her duty to raise the children, take care of the parents or parents-in-law, and do the housework. Today, women are still responsible for these traditional roles, but an increasing number of women obtain college degrees and also work, especially in urban areas. A growing number of women serve as government leaders or in managerial positions. During Mao's rule, women gained greater rights in marriage, divorce, and property ownership. Despite laws guaranteeing gender equality, many women face discrimination in work and education.

Housing

Urban

Urban housing was once supplied by a person's work unit. Now, the government encourages people to buy their own homes or apartments. City dwellers typically live in apartment buildings of six or seven storeys. Most apartments are small, some as small as 480 square feet (45 square meters). To save space, the kitchen is often located on an enclosed balcony. New high-rise apartment buildings (sometimes 20 to 30 storeys high) are replacing more traditional neighborhoods in many cities, offering more spacious and luxurious apartments for those who can afford them.

A new trend in urban housing is community facilities. Companies build several apartment buildings close to each other and provide green spaces, security services, medical facilities, supermarkets, and schools. These buildings are colorful on the outside, and their apartments are relatively big. However, only the well-off can afford them.

Rural

Rural homes are often larger than urban apartments, though

they may lack running water and other amenities. Central heating is typically available only in cold climates (north of the Yangtze River); in the south, people more often rely on electric heaters and coal stoves. Farmers lease their land from the government for fifty or one hundred years.

Dating and Marriage

Dating and Courtship

Young people like to go to parks, dances, or parties at friends' houses. Intimate relations and public displays of affection are discouraged throughout the country but are increasingly common in cities. Online dating and matchmaking is becoming more common. Dating indicates a serious commitment between two people and is uncommon before one of the partners is over age 20 or has graduated from college.

Marriage in Society

Most Chinese expect to get married, because family is considered the most important thing in a person's life. Marriage is often considered a step toward reaching adulthood. The minimum sanctioned age for marriage is 22 for men and 20 for women. Those who marry before that age are not eligible for certain benefits. Until recently, college students were forbidden to marry until after graduation. Most urban people do not marry until their late twenties. Same-sex marriage is not legally recognized in China. Many young people practice cohabitation but usually hide it from their more traditional parents. Socioeconomic status is still considered important when choosing a spouse. Divorce is becoming increasingly common, but it is sometimes difficult for women with children to marry again.

Weddings

After deciding to wed, a couple must apply for permission from the local government, and a legal contract is signed and recorded. The bride retains her maiden name, but the couple's children will take on their father's surname. A couple is considered truly married after they celebrate their union with family and friends.

In rural areas, wedding festivities last for two days. Brides wear red, which represents happiness and good luck. In some weddings, the bride may wear red in the morning when the groom arrives to pick her up and change into a white dress for the main banquet.

Urban wedding dinner parties combine traditional customs with Western customs. Wedding rings are becoming more common. If the couple is religious, the wedding ceremony may be held in a church. In urban areas, wedding banquets are held in hotels, while rural celebrations may take place at the groom's ancestral home in the village. If couples are from different cities and budgets allow for it, the bride's family often holds another wedding in their hometown so that more friends and family from the bride's side can celebrate.

Traditionally, the groom's family pays for the wedding and may give some money to the bride's family as a gift during the engagement. The bride's family usually buys household appliances for the couple, and the mother of the bride makes quilts for them.

Life Cycle

Birth

The mother and mother-in-law of an expecting mother usually come to stay with her before the baby is born. Ultrasounds to determine the gender of a baby are illegal because discrimination against female children has often caused parents to abort or abandon them. Many taboos surround the birth of a child. For example, expecting mothers are not allowed to eat rabbit meat because it is believed that this may cause the baby to have a harelip. Pregnant women are also encouraged to stay away from construction and are discouraged from touching things like nails or scissors for fear that these items may injure the child. Chinese women generally do not receive epidurals while in labor because of fears for the health of the baby's brain.

Chinese celebrate the arrival of a newborn one month after its birth at a *Man Yue Jiu* (30 days) dinner party. Family and friends attend, bringing red envelopes of money for the baby. The parents will also hold a party when the baby is 100 days old; relatives and friends are invited to a meal to celebrate. Children are named according to family history or a trend at the time. For example, people who were born in the 1950s or '60s usually have the Chinese character *Guo* (country) in their name, reflecting the nationalistic attitude of that time period. Though the child's name may not always be decided on at birth, infants are always given nicknames.

Death

When a person dies, family members wear black bands around their upper arms for a month or two. At the funeral, an enlarged picture (usually drawn) of the deceased is displayed. Black and white are the colors for the dead, and people wear white clothes to a funeral and bring presents of white and black cloth or of money. Family members burn incense and yellow paper. The yellow paper is considered money for the dead. Family members burn yellow paper on every anniversary of the person's death.

Funerals differ in different regions; the Han usually cremate deceased bodies, and celestial burial (in which deceased bodies are ritually dissected and left to decompose or for birds of prey to consume) is practiced in Tibet. Buddhism's influence has brought belief in reincarnation into Chinese culture.

Diet

Except in larger cities, a wide variety of food is unavailable to the average person. What people eat largely depends on what is produced in the region where they live. Dishes with rice, potatoes, cornmeal, tofu, and various grains are staples. Noodles are very common. Dishes made with pork, beef, chicken, or fish (a symbol of abundance) are popular but expensive. Specialties vary from region to region, from duck in Beijing to spicy dishes in the Sichuan province. Fruits and vegetables are eaten in season; few dairy products are available. Sauces are mixed with vegetables and meats and eaten with rice or noodles. *Man tou* (steamed bread) is a staple in northern China. Chinese dumplings (*jiaozi*) are popular in many parts of the country. Seeds (sunflower, pumpkin, winter melon, etc.) and nuts are favorite snacks, and fruit is a preferred dessert. People may eat frequently at local restaurants.

Recreation

Sports

Most cities have sports facilities. The country's favorite sports include soccer, table tennis, swimming, and badminton. Basketball, dancing, jogging, and walking are also popular. Those who are wealthy often play tennis or golf.

Parks and courtyards are often filled in the morning by those practicing *taijiquan*, a traditional form of shadowboxing that provides exercise and therapy. Tai chi, a slow-moving martial art, is popular in Shanghai.

Leisure

Favorite pastimes include eating out, singing karaoke, and watching imported movies. However, going to the cinemas is becoming more expensive, so many people watch movies online at home instead.

People enjoy gathering for conversation or card and table games, which the Chinese play in homes and parks. *Majiang* is the most popular table game; most Chinese know how to play it. The rules for *majiang* are slightly different from place to place. *Wei qi* is a strategy game played in more educated circles. Chinese chess is another favorite. Playing pool is popular among boys. Many children play video games at internet cafés, especially if their parents will not allow video games at home; these games are more popular with boys than with girls.

Vacation

As incomes have increased in recent years, traveling to other parts of China to see places like the Great Wall, the terra-cotta warriors, and other scenic sites has become popular. Traveling takes place during holidays like May Day, National Day, and Chinese New Year, and many join tour groups for their travels. It is becoming more common for people to have private cars, which enables them to travel easily. Many middle-aged people take their elderly parents to visit places in China or overseas. Shopping overseas is popular because brand-name items are less expensive in other countries than in China.

The Arts

Traditional Chinese arts include poetry, calligraphy, paper cutting, shadow puppetry, painting, pottery, and jade carving. Calligraphy is thought to enrich a person's life by teaching self-mastery. Like calligraphers, painters strive for beautiful lines. Many contemporary painters incorporate this tradition with other styles.

Chinese music is distinct in tone and rhythm and is based on a five-tone scale. Traditional instruments include percussion instruments like cymbals, drums, and gongs; stringed instruments like the *guzheng*; and wind instruments like the Chinese flute. Chinese opera is popular and depicts folktales or significant events. Theaters, ballets, and films are well attended in urban areas. Traveling cultural groups perform operas in rural areas. In some regions, families will invite opera troupes to perform at big events.

Holidays

Official public holidays are New Year's Day (1 January), Labor Day (1 May), and National Day (1–7 October). Other

public holidays, set according to the lunar calendar, include Tomb-Sweeping Day, the Dragon Boat Festival, the Mid-autumn Festival (also called Moon Festival), and Chinese New Year (also called Spring Festival). Students have extended vacations at these times.

Spring Festival (Chinese New Year)

As the most important holiday of the year, the Spring Festival is marked by banquets, family gatherings, carnivals, dragon dances, and fireworks. It begins on the first day of the first lunar month and usually occurs about one month after the Gregorian calendar's New Year. It lasts for fifteen days; the first five days are the most important, and the Lantern Festival, which is the last of the fifteen days, is also important. On the day of the Lantern Festival, parks are filled with games, performances, beautiful lanterns, and firework displays. Families gather and eat sweet rice dumplings. On Chinese New Year's Eve, families have a big dinner and children receive money in a red envelope. Those who were born in a year with the same animal as that year receive red presents to bring them good luck.

Tomb-Sweeping Day

Tomb-Sweeping Day is also known as the *Qing Ming* (Pure Brightness) Festival and is held each year in early April. People come to the cemeteries to sweep tombs and offer sacrifices of food and flowers to the dead. They burn incense and paper money and bow before the tombstones. Those who cannot visit cemeteries where their families are buried usually burn some paper money at night on city streets.

Dragon Boat Festival

The Dragon Boat Festival is held on the fifth day of the fifth lunar month. This festival is said to have been started to commemorate the death of Qu Yuan (340–278 BC), a minister of the State of Chu and one of China's earliest poets. People eat *zong zi* (pyramid-shaped, sticky rice dumplings wrapped in reed or bamboo leaves) and drink *xionghuang jiu* (a kind of liquor believed to prevent illness). Dragon boat races are held mainly in the southern part of the country. As the gun is fired, racers in dragon-shaped canoes row to the rapid beat of drums.

Other Festivals

Other festivals are held throughout the year but are not public holidays. The Double Seventh Festival, for example, is held on the seventh day of the seventh lunar month and is called the Chinese Valentine's Day. It honors a legend of two star-crossed lovers who were separated by the Milky Way. They could only cross the sky on a bridge of magpies (a type of bird) to meet once a year on this date.

SOCIETY

Government

Structure

The president of China is head of state and is formally elected by the 2,987 members of the National People's Congress, the country's legislature. In the People's Republic of China, the office of president is mostly symbolic, with the president's real power deriving from also holding the positions of General Secretary of the Chinese Communist Party (usually

considered the government's most powerful position), Chairman of the Central Military Commission, and first member of the Politburo Standing Committee. The president serves for a five-year term, and there are no term limits. The premier is head of government and is nominated by the president and confirmed by Congress. Members of Congress are indirectly elected at local levels or through the military to serve five-year terms. In about half of all villages, local leaders are elected rather than appointed.

Political Landscape

National policy is determined by a 25-member Politburo of the ruling Chinese Communist Party (CCP) and, more importantly, its 7-member Standing Committee, which is believed to make decisions based on consensus. Many party members hold powerful positions in the public and private sector. The CCP also controls eight other smaller parties. No significant opposition group exists in China. There have been conflicts recently within the CCP regarding the direction the country needs to be taken. There is also reportedly some conflict between younger members of the CCP, who do not have strong memories of life before China's economic success, and older members of the party, who do.

Government and the People

The Chinese government is generally thought to be repressive, and freedoms of speech, assembly, religion, and press are not well respected. China is considered by many to have a poor record respecting human rights. Reports of widespread corruption are also common. Despite these concerns, some hope for at least some political reform. For government posts that are filled through elections, the voting age is 18. Only members of the CCP or candidates that the CCP approves are elected.

Economy

China's large economy is offset by its population, meaning the real gross domestic product (GDP) per capita is at the level of a developing country. While overall income is rising, wealth is not equally distributed. In a state accustomed to equal wages for all, this has been a source of contention among average people. Still, successful and honest entrepreneurs are well respected, even in rural areas. The government applauds the vibrant and growing private sector, even as it struggles to control it. Leaders contend that communism is not synonymous with poverty. Urban areas have a growing middle class. For villagers, the growing economy means better diets, but it also draws labor away from the fields and into the cities.

About 28 percent of the population is employed in agriculture. Future agricultural production may require greater mechanization and better seed and fertilizer. China is a world leader in producing rice, wheat, corn, barley, and peanuts. Tea, eggs, pork, fish, and potatoes are also important products. China produces manufactured goods, oil, minerals, coal, and steel.

The economy grew rapidly in the 1990s. The 2008 global economic crisis led to a sharp decline in world demand for China's exports, a contributing factor to the economy's recession. With past growth, the government has invested heavily in public infrastructure. Pollution, corruption, crime,

and rising unemployment are serious problems. A large deficit threatens the social security network and other institutions. The currency is the *renminbi*; the standard unit is the *yuan* (CNY).

Transportation and Communications

Individuals travel by foot, bicycle, motorcycle, train, bus, pedicab (or rickshaw), or private minibus. But a growing number of people now have their own cars. Domestic air travel is expensive. In some areas, people travel by river barge or ferry. The government has undertaken a massive road construction project to create a north-south and an east-west freeway to link with intercity highways. In 2012, China opened the world's longest high-speed rail route between Beijing and Guangzhou. Public transportation, including buses and subways, is becoming more common.

China's government television station (CCTV) has 24 channels. All local channels and radio stations are under the control of the government or the Communist Party, and all programming must be approved. There is no independent press, and the government censors the internet. Most people have televisions. The telephone system is expanding, and the internet reaches into most cities and a growing number of rural areas. Cellular phone use is common and growing.

Education

Structure

Education is very important to the Chinese, and parents do everything they can to help their children finish school and obtain a good education. China seeks to provide an elementary education to every citizen, and nine years of education are compulsory. Nearly 100 percent of first-grade-age children are enrolled, and most finish elementary school. Rural girls are least likely to be enrolled because they are needed at home.

Access

Most primary schools are public and free. The selection exam for going to high school is very difficult, and it is hard to get into the most prestigious high schools, which guarantee the best education and give better chances for getting into good universities.

High schools and universities require tuition, which is paid for by the students' parents. University students may also sign a contract with a state company that will sponsor them in return for a few years of work after graduation.

China's literacy rate (the percentage of people over age fifteen who can read and write) is above 95 percent. To increase adult literacy, universities offer instruction over radio and television.

School Life

Students attend school five or six days a week for several hours, depending on the region. Chinese, English, and math are usually the most emphasized subjects in primary schools. Learning is done largely by memorization, although discussions are becoming more common in class. Computer-aided teaching is also increasingly common. Students spend a large amount of time on homework outside of class: roughly two hours for primary students, four hours for middle school students, and four to five hours for high

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school students. The better the school is, the more time students spend on homework. Rural schools are not as good as urban schools. Cheating is forbidden and is considered shameful.

Higher Education

When students finish their courses in high school, they take the college entrance exam to universities. High scores will allow students to go to the most prestigious universities. Students who do poorly will usually go to vocational training schools. There are over 1,500 universities in China.

Health

China has an insurance-based public healthcare system where patients are required to pay for part of their care. Even with insurance, health care can be expensive. Unlike many developing countries, Chinese health care concentrates on prevention. An extensive network of programs emphasizes immunizations, prenatal care, pediatrics, and sanitation, though access in rural areas is sometimes limited. Facilities are simple, but the system has greatly improved basic health—especially in urban areas. Still, water is usually not potable and open sewers are common. Increased pollution in recent years is becoming a major public health problem in most urban areas. Urban Chinese tend to have better access to quality medical care than rural residents. Traditional Chinese medicine (use of medicinal herbs and acupuncture, among other things) is combined with Western medical techniques in treating illness and injury.

AT A GLANCE

Contact Information

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Country and Development Data

Capital	Beijing
Population	1,384,688,986 (rank=1)
Area (sq. mi.)	3,705,405 (rank=4)
Area (sq. km.)	9,596,960
Human Development Index	86 of 188 countries
Gender Inequality Index	37 of 188 countries
GDP (PPP) per capita	\$16,700
Adult Literacy	98% (male); 95% (female)
Infant Mortality	12 per 1,000 births
Life Expectancy	75 (male); 78 (female)
Currency	Renminbiyuan

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China

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China country profile



China is the world's most populous country. It has a continuous culture stretching back nearly 4,000 years and originated many of the foundations of the modern world.

The People's Republic of China was founded in 1949 after the Communist Party defeated the nationalist Kuomintang, who retreated to Taiwan, creating two rival Chinese states - the People's Republic on the mainland and the Republic of China based on Taiwan.

After stagnating for decades under the rigid totalitarian socialism of founder Mao Zedong, China reformed its economy along partly capitalist lines to make it one of the world's fastest-growing, as well its leading exporter. China is now a major overseas investor, and is pursuing an increasingly assertive foreign and defence policy.

But economic change has not been matched by political reform, and the Communist Party retains a tight grip on political life and much of wider society.

- See **more country profiles** - Profiles compiled by **BBC Monitoring**

FACTS

People's Republic of China

Capital: Beijing

- **Population** 1.4 billion
- **Area** 9.6 million sq km (3.7 million sq miles)
- **Major language** Mandarin Chinese
- **Major religions** Buddhism, Christianity, Islam, Taoism
- **Life expectancy** 75 years (men), 78 years (women)
- **Currency** Renminbi (yuan)

UN, World Bank

Getty Images

LEADERS

President: Xi Jinping



Xi Jinping came to power in 2012-3 as the hand-picked heir of predecessor Hu Jintao, and is expected to lead China for the next decade.

Since taking over, he has concentrated power in his hands, in a move seen as a turning away from the traditional system of collective leadership, and has sought to present a modern face to China and the world.

His position as the most powerful Chinese leader since Mao Zedong was cemented in 2017 when his name and political philosophy was written into the Communist Party constitution by the National Congress.

In early 2018 the party also moved to allow him to remain in office indefinitely by abolishing the conventional two-term presidential limit.

The main themes of his leadership have been economic reform to boost market forces, as well as an anti-corruption campaign.

Mr Xi rejects Western ideas of constitutional democracy and human rights as models for China, and his government moved to silence voices critical of one-party rule, especially on social media.

MEDIA



China has the world's biggest internet audience, but content is tightly controlled

China is the largest media market in the world.

Outlets operate under tight Communist Party control. The opening-up of the industry has extended to distribution and advertising, but not necessarily to editorial content.

Beijing tries to limit access to foreign news by restricting rebroadcasting and the reach of satellite TV, and by blocking websites using an extensive filtering system known as the "Great Firewall".

With 772 million users, China has the world's largest online population. Three powerful companies - Baidu, Alibaba and Tencent - dominate the market.

Tencent's WeChat messenger has more than 900 million users worldwide.

- Read **full media profile**

TIMELINE



The Great Wall of China was built in the 14th century as a barrier against the nomadic peoples of the north

ca 1700-1046 BC - Shang Dynasty rules northern China - the first Chinese state for which clear written records remain.

221-206 BC - The Chinese heartland is united for the first time under the first emperor, Qin Shihuangdi.

1644 - A Manchu invasion from the north establishes the Qing Dynasty.

1911-12 - Military revolts lead to the proclamation of Republic of China under Sun Yat-sen and the abdication of the last Manchu emperor, but much of the country is taken over by unruly warlords.

1931-45 - Japan invades and establishes a brutal regime of occupation across large parts of China.

1949 1 October - Communist leader Mao Zedong proclaims the founding of the People's Republic of China after defeat of the nationalist Kuomintang in a civil war.

1950 - China sends People's Liberation Army (PLA) troops into Tibet, enforcing a longstanding claim.

1958-60 - Mao's "Great Leap Forward" disrupts agriculture, producing an economic breakdown, and is quickly abandoned after the loss of millions of lives.

1966-76 - Mao's "Cultural Revolution" produces massive social, economic and political upheaval.

1976 - Mao dies. From 1977 pragmatist Deng Xiaoping emerges as the dominant figure and undertakes far-reaching economic reforms.

1989 - Troops open fire on pro-democracy protesters in Beijing's Tiananmen Square, killing hundreds of people.

2010 - China becomes the world's second-largest economy after the United States, when Japan's economy shrank in the final months of the year.

- Read **full timeline**



Bright lights: Booming Shanghai is China's largest city

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Country Report

China

Generated on June 26th 2019

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The Economist Intelligence Unit

The Economist Intelligence Unit is a specialist publisher serving companies establishing and managing operations across national borders. For 60 years it has been a source of information on business developments, economic and political trends, government regulations and corporate practice worldwide. The Economist Intelligence Unit delivers its information in four ways: through its digital portfolio, where the latest analysis is updated daily; through printed subscription products ranging from newsletters to annual reference works; through research reports; and by organising seminars and presentations. The firm is a member of The Economist Group.

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Symbols for tables

"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

China

Summary

- 2 [Briefing sheet](#)

Outlook for 2019-23

- 4 [Political stability](#)
- 5 [Election watch](#)
- 5 [International relations](#)
- 6 [Policy trends](#)
- 6 [Fiscal policy](#)
- 7 [Monetary policy](#)
- 7 [International assumptions](#)
- 8 [Economic growth](#)
- 8 [Inflation](#)
- 9 [Exchange rates](#)
- 9 [External sector](#)
- 9 [Forecast summary](#)
- 10 [Quarterly forecasts](#)

Data and charts

- 11 [Annual data and forecast](#)
- 12 [Quarterly data](#)
- 12 [Monthly data](#)
- 14 [Annual trends charts](#)
- 15 [Quarterly trends charts](#)
- 16 [Monthly trends charts](#)
- 17 [Comparative economic indicators](#)

Summary

- 17 [Basic data](#)
- 19 [Political structure](#)

Recent analysis

Politics

- 22 [Forecast updates](#)
- 25 [Analysis](#)

Economy

- 34 [Forecast updates](#)
- 45 [Analysis](#)

Briefing sheet

Editor: **Nick Marro**

Forecast Closing Date: **May 28, 2019**

Political and economic outlook

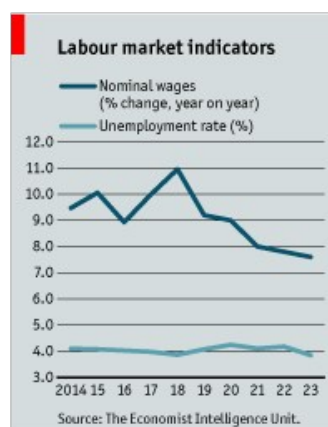
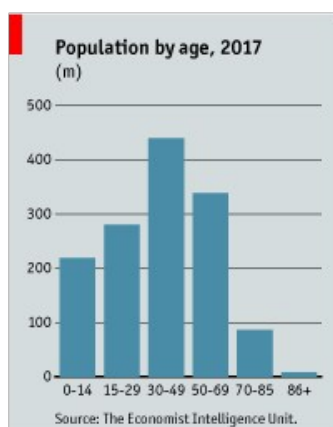
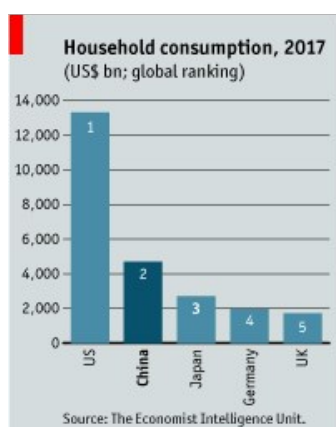
- The president, Xi Jinping, will see through his plans to stay in office beyond 2023. However, economic challenges generated by the US-China trade war will result in mild shifts in China's approach to domestic and foreign policy.
- Relations between the US and China will be frayed in 2019-23. Although we still expect the US and China to agree to avoid further tariff escalation, the risk of a "no-deal" scenario in the US-China trade war has risen. Bilateral friction will persist in 2019-23.
- The authorities will gradually step back from the looser monetary and fiscal policy they outlined in 2019 to offset downward pressure on economic growth. We expect policy tightening after 2020 as addressing structural economic challenges is prioritised again.
- We forecast that real GDP will grow by 6.2% per year on average in 2019-20—just above the minimum level required for the government to achieve its 2020 goal of doubling real GDP from its 2010 level. Growth will slow to an annual average of 5.3% in 2021-23.
- Consumer price inflation is forecast to average 2.9% a year in 2019-23, compared with 1.8% in 2014-18. A spike in pork prices, partly attributable to African swine fever, will generate inflationary pressure in the early years of the forecast period.
- China's current-account surplus will erode in 2019-23. We forecast that the current-account balance will stand at the equivalent of 0.2% of GDP in 2019, before slipping into deficit in 2020 as the services trade shortfall widens further.

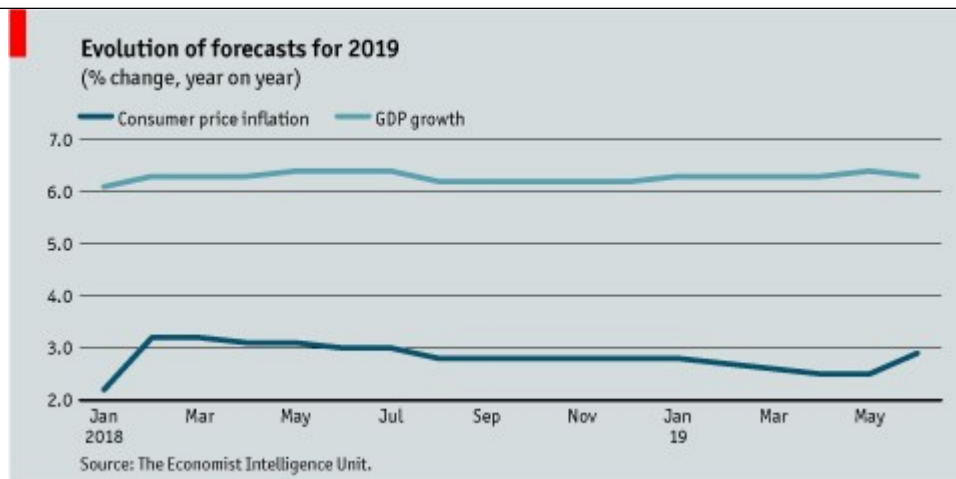
Key indicators

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth (%)	6.6	6.3	6.1	5.6	5.2	5.0
Consumer price inflation (av; %)	1.9	2.9	3.1	2.7	2.9	2.7
Government balance (% of GDP)	-4.2 ^c	-4.5	-4.5	-4.3	-4.1	-4.0
Current-account balance (% of GDP)	0.4 ^c	0.2	-0.3	-0.3	-0.4	-0.4
Money market rate (av; %)	3.0	2.7	2.8	3.1	3.4	3.5
Unemployment rate (%)	3.9 ^c	4.1	4.2	4.1	4.2	3.8
Exchange rate Rmb:US\$ (av)	6.62	6.86	6.90	6.94	7.16	7.03

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Economist Intelligence Unit estimates.

Market opportunities





Key changes since April 30th

- The Economist Intelligence Unit has amended its trade war forecast to expect China and the US to come to an agreement over trade by end-2019. In the interim, we expect both sides to refrain from further tariff escalation, although the risks to this forecast are high.
- As a result of the most recent US and Chinese tariff actions in early May, we have revised down our real GDP forecast for 2019, to 6.3% from 6.4% previously. As part of this revision, we have lowered our forecasts for private consumption, investment and trade growth.
- We have revised up our forecast for consumer price inflation in 2019-20 to an average of 3%, from 2.7% previously, owing to a stronger-than-anticipated shock to consumer prices as a result of the spread of African swine fever.
- As a result of the heightened trade tensions, we have revised down our exchange-rate forecast to an average of Rmb6.86:US\$1 in 2019. Policymakers will defend the Rmb7:US\$1 threshold, but at the cost of dwindling foreign-exchange reserves.

The month ahead

- **June 5-7th—Xi Jinping visits Russia:** The Chinese president will meet his Russian counterpart, Vladimir Putin, in order to shore up bilateral economic ties as China's relations with the US deteriorate.
- **June 10th—May trade data:** We expect the May data on merchandise trade growth to remain weak following the surprise tariff hikes earlier that month. Trade performance will remain subdued over the rest of the year as the trade war erodes business sentiment.
- **June 28-29th—G20 summit:** Mr Xi will meet his US counterpart, Donald Trump, on the sidelines of the G20 meetings. We expect this to result in a postponement of further tariff applications, as in December 2018.

Major risks to our forecast

Scenarios, Q1 2019	Probability	Impact	Intensity
Foreign companies are targeted by regulators owing to international tensions	Very high	Moderate	15
A US-China trade war morphs into a protectionist global trade war	Moderate	Very high	15
China finds itself locked out of global trade deals	Moderate	High	12
Political tightening impairs information technology (IT) functionality for foreign firms	Very high	Low	10
A major regional conflict breaks out over disputed maritime territories	Low	Very high	10

Note: Scenarios and scores are taken from our Risk Briefing product. Risk scenarios are potential developments that might substantially change the business operating environment over the coming two years. Risk intensity is a product of probability and impact, on a 25-point scale.

Source: The Economist Intelligence Unit.

Outlook for 2019-23

Political stability

Risks to the dominant political position of the president, Xi Jinping, will grow in 2019-23. His first five years in power culminated in a political triumph in 2017-18, when he was reappointed to his leadership positions without a designated successor emerging for the handover of power in 2022-23. This will ensure that Mr Xi retains authority during his second term. The revision of the national constitution in March 2018 to remove a two-term limit on the offices of the president and vice-president confirmed Mr Xi's intention to remain in power for more than the usual decade.

Subsequent developments, however, have eroded some of Mr Xi's authority. Escalating US-China tensions over trade, technology and security issues have given rise to domestic criticism over his assertive foreign policy. The president's signature Belt and Road Initiative (BRI) overseas investment programme has encountered problems in implementation, while the financial de-risking campaign launched by Mr Xi's administration in 2016 led to economic pain. In particular, it affected domestic private-sector firms, while economic policymaking tilted in favour of state-owned enterprises (SOEs).

Mr Xi must now navigate more challenging political terrain, although he is still unlikely to face any challenge from within the ruling Chinese Communist Party (CCP). He has installed loyalists across the top ranks of the military, and there is no rival power base within the broader party-state apparatus. Nevertheless, his administration has been prompted to adjust policy in several areas, including in rolling out business-friendly policies towards private enterprises and softening efforts to rein in credit growth. The premier, Li Keqiang, has also assumed a more prominent role after having previously been sidelined.

There remains the possibility that a destabilising event, such as a major US-China military clash or a severe economic slowdown, could pressure Mr Xi into relinquishing his ambition to stay in power beyond 2022-23. However, The Economist Intelligence Unit's core view is that the president will succeed in delaying his retirement. This will ensure political stability, but increases the risk of policy drift the longer that Mr Xi stays in office. Should Mr Xi become incapacitated, political stability and institutional effectiveness could be impaired.

Risks to political stability from social upheaval are likely to prove manageable. There will be labour unrest in parts of the country exposed to US-China trade frictions, as well as among credit-starved private enterprises, but such incidents will prove localised. Problems such as pollution, food and drug safety, house price fluctuations and the quality of public services risk sapping CCP support among the urban middle class. More purposeful policy responses to these issues will prevent widespread protests, as will economic self-interest. The strengthening of already tight security procedures, surveillance and controls on media and the internet will also bolster the CCP's position, but at the expense of long-term social and economic development. The ongoing anti-corruption campaign, however, will risk exacerbating administrative paralysis at the local level.

Separatist movements will remain weak, but instability will occasionally erupt in the ethnic-minority regions of Tibet and Xinjiang. Aggressive security policies targeting Muslim minorities in Xinjiang (including mass internment) will generate widening international criticism, and may dampen support for the BRI among some Muslim nations. The Tibetan separatist movement will grow more violent when the region's ageing, exiled spiritual leader, the 14th Dalai Lama, dies.

Election watch

The government was last reshuffled at the March 2018 meeting of the National People's Congress (the legislature), following that of senior party figures at the 19th CCP national congress in October 2017. Mr Xi was reappointed for another five-year term as state president and chairman of the Central Military Commission; he was named as CCP general secretary and first-ranked member of the top-level seven-member politburo standing committee (PSC) at the earlier meeting. Mr Li received another five-year term as premier, after his earlier reappointment as the second-ranked PSC member. Mr Xi's ally, Wang Qishan, was named as state vice-president, in defiance of an informal rule requiring the retirement of top cadres over the age of 68, and also serves as a de facto eighth PSC member.

The next political reshuffle will begin in late 2022, when the 20th CCP national congress will be held. Mr Xi will retain his leadership of the party, military and state, although other personnel changes are likely. Mr Li will be required by the constitution to step down as premier, after having served two consecutive terms, but at 67 years old he will still be young enough to retain a seat on the PSC. Of the five remaining PSC members, two (Li Zhanshu and Han Zheng) are due to retire. However, the next reshuffle remains uncertain, as the 2017-18 transition overseen by Mr Xi broke several previous orthodoxies.

International relations

We expect China and the US to avoid further tariff escalation across the remainder of bilateral merchandise trade not yet targeted by punitive tariffs, although risks to this forecast are high. This truce will be agreed following the expected meeting between Mr Xi and his US counterpart, Donald Trump, on the sidelines of the G20 in late June. We expect a limited trade deal covering Chinese purchases of US commodities and nominal pledges to reform China's foreign business environment to still be agreed by end-2019, but that existing tariffs, covering roughly US\$360bn of bilateral merchandise goods trade, will remain in place until 2020. Their withdrawal will depend on China's progress in satisfying the US's concerns about intellectual property protection and forced technology transfer, as well as the politics of the 2020 US presidential elections.

Regardless of developments in the tariff dispute, US-China bilateral tensions will intensify in other areas, including investment and technology policy. Much of this will be tied to US policies regarding Huawei—a large Chinese telecommunications equipment firm at the forefront of China's fifth generation (5G) strategy and BRI push—which the US has branded a national security threat. This will exacerbate US-Chinese differences over regional strategic and security issues, including on North Korea, Taiwan and the South China Sea. An outright military clash between the US and China in 2019-23 remains unlikely, but their relationship will become increasingly hostile and competitive.

Under Mr Xi, China will push ahead with the BRI, despite US criticism and some domestic complaints about the programme's largesse. At the second Belt and Road Forum in April 2019, China signalled adjustments in several areas. This included addressing concerns around debt sustainability, to help to ensure the programme continues to attract international participation. Although China's construction and lending activity along the BRI is likely to slow in the forecast period as it adopts a more cautious approach, we expect a more assertive effort by the country to develop BRI-related rules and institutions.

Policy trends

Economic policy loosened from mid-2018 in order to offset a weakening in domestic demand caused by financial de-risking efforts and the risks posed by US trade actions. Stimulus policies have included multiple cuts to banks' reserve requirement ratios, a cut to the manufacturing value-added tax (VAT) rate, reforms to individual income tax (IIT) and additional support for infrastructure spending. While these measures have helped lift business and consumer confidence since the beginning of 2019, renewed trade hostilities with the US may dampen their impact.

As stimulus measures place a floor under economic growth, policy will shift to a neutral stance in early 2020, as the government refocuses on structural challenges facing the economy, not least the high level of debt. The shift will become more pronounced in 2021-22, when the government will have more policy flexibility after reaching its goal of doubling real GDP by 2020 over the level in 2010. The main risk to our forecast is if the 14th five-year economic plan (2021-25) includes a high annual real GDP growth target; 6% or above would imply a worrying attachment to ongoing stimulus.

Downward pressure on economic growth and the US-China trade war have also forced the authorities into backing some market reforms. These include more support for the domestic private sector and increased protection for foreign investors, with the latter due to be formalised when the new foreign investment law (FIL) becomes effective in January 2020. These protections, however, may not be guaranteed for US firms amid "qualitative" retaliation as part of both the trade war and US sanctions on Huawei. In addition, Mr Xi's government is not economically liberal and we do not expect changes that would dramatically reduce the state's role in the economy, including on the key issue of SOE reform.

Fiscal policy

The authorities will lean on fiscal policy in 2019 to ensure that economic growth remains within their targeted range, with the general government cash budget deficit forecast to widen to the equivalent of 4.5% of GDP, from an estimated 4.2% in 2018. The deficit will widen primarily as a result of changes to the IIT and VAT regimes, although the impact will be partially offset by tighter tax enforcement. The authorities will also use other fiscal tools at their disposal, including allowing more local government bond issuance to support infrastructure spending. As economic policy moves to a neutral stance, and later a tighter one, we forecast that the budget deficit will stabilise in 2020, before gradually narrowing in the remaining years of the forecast period to stand at 4% of GDP by 2023.

Central government debt was the equivalent of just 19.3% of GDP in 2018, but is forecast to reach 32.1% by 2023. Besides the budget deficit, the central authorities will have little choice but to bring some local government debt onto their own books, with numerous regional administrations expected to face financing challenges in the forecast period. Their debts—when including off-balance-sheet borrowing—may stand between 60% and 70% of GDP. The central government is also likely to recognise a broader range of implicit debts, such as those associated with SOEs, as part of anticipated restructuring efforts after 2020.

Monetary policy

Monetary policy settings will be relatively loose in the early years of the forecast period. We expect China's benchmark one-year deposit and lending rates—which stand at 1.5% and 4.35% respectively—to remain unchanged in 2019-20, with consumer price inflation nearing the 3% ceiling set by the People's Bank of China (PBC, the central bank). However, money-market interest rates will be guided to a lower level than in 2018, supporting business financing. Although policy will be neutral in 2020, we expect a tightening bias to emerge afterwards, alongside a move away from GDP growth targets and towards addressing structural issues. Benchmark interest rates are forecast to rise by 50 basis points in 2021-23, with market interest rates moving similarly.

Domestic credit issuance will be relatively rapid in 2019-20, at 11.9% a year on average, which will push up the domestic credit-to-GDP ratio to 236.5% by end-2020. Strong growth in credit will give rise to repayment difficulties when liquidity conditions are tightened in the remainder of the forecast period, but the state's penetration of the banking system and enhancements in regulation make an outright financial crisis unlikely. Domestic credit is forecast to stand at 258% of GDP by end-2023.

International assumptions

	2018	2019	2020	2021	2022	2023
Economic growth (%)						
US GDP	2.9	2.2	1.7	1.8	2.0	1.7
OECD GDP	2.2	1.7	1.6	1.8	1.9	1.8
World GDP	2.9	2.6	2.6	2.8	2.9	2.8
World trade	4.4	3.3	2.9	3.9	4.0	4.1
Inflation indicators (% unless otherwise indicated)						
US CPI	2.4	2.2	1.4	2.2	2.1	1.8
OECD CPI	2.5	2.2	1.9	2.1	2.1	2.1
Manufactures (measured in US\$)	4.9	2.1	3.3	3.5	3.2	3.0
Oil (Brent; US\$/b)	71.1	66.5	60.5	69.8	75.6	75.0
Non-oil commodities (measured in US\$)	1.9	-4.4	3.5	3.0	2.0	0.7
Financial variables						
US\$ 3-month commercial paper rate (av; %)	2.0	2.6	2.2	2.1	2.5	2.9
¥ 3-month money market rate (av; %)	0.1	0.1	0.1	0.2	0.2	0.3
¥:US\$ (av)	110.4	110.0	108.7	104.9	100.5	96.1
Rmb:US\$ (av)	6.62	6.86	6.90	6.94	7.16	7.03

Economic growth

Real GDP is forecast to grow by 6.3% in 2019, before slowing to 6.1% in 2020. The most aggressive stimulus efforts will be front-loaded in 2019, and their effects will begin to fade towards the end of the year. The US-China trade war will constrain external sector performance in 2019-20, while also dampening business and consumer sentiment, which will weigh on private consumption and corporate investment. Increased government consumption in response to these shocks, however, will help offset downward pressure.

Our forecast for 2019-20 assumes that the authorities will have satisfied the goal of doubling real GDP by 2020 over the level in 2010, which would require average annual expansion of at least 6.2% in 2019-20. Thereafter, we believe that policymakers will move to a less supportive policy stance, with GDP growth averaging 5.3% per year in 2021-23 as structural economic challenges become a higher priority.

The fastest growth in terms of real GDP components in 2019-23 will be recorded by government consumption, which we expect to increase by an annual average of 9%, reflecting expansionary fiscal policy and strong growth in expenditure on public services. Private consumption will rise by an annual average of 6% and will make the largest contribution to the economy overall, even as growth slows, while investment will rise by 3.6% on average. The external balance will make a marginally positive contribution to economic growth in 2019-23.

Economic growth

%	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
GDP	6.6 ^c	6.3	6.1	5.6	5.2	5.0
Private consumption	7.3	6.7	6.2	6.3	5.7	5.6
Government consumption	12.0	11.2	9.5	9.0	8.0	7.4
Gross fixed investment	4.6	4.6	4.2	3.7	3.3	3.0
Exports of goods & services	6.8	3.0	3.8	4.4	5.2	4.9
Imports of goods & services	8.2	2.7	3.3	4.0	3.9	3.2
Domestic demand	6.9	6.4	5.9	5.5	4.7	4.4
Agriculture	3.5 ^c	3.7	3.4	2.9	3.0	2.0
Industry	5.8 ^c	6.0	5.8	5.2	5.0	5.1
Services	7.6 ^c	7.2	6.9	6.6	5.8	5.3

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts. ^c Actual.

Inflation

An upward cycle in pork prices, exacerbated by supply disruptions caused by African swine fever, will push up consumer price inflation in the early years of the forecast period. The consumer price index (CPI) will rise by 2.9% on average in 2019, representing the highest level since 2013, with the rate exceeding 3% in 2020. This will constrain the PBC's space to loosen monetary policy. With pork prices likely to remain elevated (rather than dropping) and global oil prices forecast to rise in 2021-22, growth in the CPI will average 2.8% a year in 2021-23.

We expect producer price inflation to weaken to 0.7% in 2019-20 amid slowing business activity and softer global commodity prices. An easing in overcapacity cuts will also create downward price pressures from the return of excess supply. We forecast that producer prices will rise by 2.6% per year on average in 2020-23, with stronger oil prices and the re-introduction of capacity cuts supporting price growth later in the forecast period.

Exchange rates

We forecast the renminbi to average Rmb6.86:US\$1 in 2019, compared with Rmb6.62:US\$1 in 2018. This will stem from renewed investor concerns about the health of the economy, rather than deliberate efforts by the PBC. Central bank efforts to defend the currency above the Rmb7:US\$1 threshold will cause foreign-exchange reserves to dip below US\$3trn by year-end.

The renminbi will stabilise against the US dollar in 2020 amid US dollar weakness, but downward pressure will again build on the renminbi in 2021-22, with China's current account moving into deficit and the economic outlook deteriorating. The currency will pass the Rmb7:US\$1 threshold in 2021. Renminbi internationalisation and exchange-rate liberalisation remain policy goals, but these will take a back seat in 2019-23 amid efforts by the PBC to manage capital outflows.

External sector

Goods export growth will slow in 2019, amid the US-China trade war and a slowdown in global consumer electronics demand. This will cause stress for low-end export manufacturing firms, accelerating supply-chain relocation, particularly into South-east Asia. We expect US-China tariffs to remain in place at least until 2020. We forecast that goods exports will rise by an annual average of 5.5% in value terms in 2019-23, with imports increasing by 5.7%.

China's current account will post a surplus equivalent to 0.2% of GDP in 2019, but will then move into the red and average a deficit of 0.3% of GDP in 2020-23. This will mark an important shift in China's global economic relations, and will be driven mainly by a widening deficit in services trade, owing largely to overseas travel by Chinese tourists. While the current-account deficit will prompt authorities to encourage further inbound capital flows to ensure a balance of payments, regulatory restrictions will dampen foreign appetite for portfolio investment. This will be particularly true as authorities adopt a more cautious stance on loosening capital outflow controls.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2018 ^a	2019 ^b	2020 ^b	2021 ^b	2022 ^b	2023 ^b
Real GDP growth	6.6	6.3	6.1	5.6	5.2	5.0
Industrial production growth	6.3	6.1	5.9	5.3	5.1	5.2
Gross agricultural production growth	3.5	3.7	3.4	2.9	3.0	2.0
Unemployment rate (av)	3.9 ^c	4.1	4.2	4.1	4.2	3.8
Consumer price inflation (av)	1.9	2.9	3.1	2.7	2.9	2.7
Consumer price inflation (end-period)	1.8	3.8	2.4	2.7	2.9	2.7
Benchmark lending rate (end-period)	4.4	4.4	4.4	4.6	4.9	4.9
Government balance (% of GDP)	-4.2 ^c	-4.5	-4.5	-4.3	-4.1	-4.0
Exports of goods fob (US\$ bn)	2,417.4 ^c	2,513.8	2,599.5	2,758.8	2,943.2	3,160.6
Imports of goods fob (US\$ bn)	2,022.3 ^c	2,099.3	2,179.9	2,304.7	2,469.7	2,669.3
Current-account balance (US\$ bn)	49.1 ^c	23.6	-43.2	-54.4	-66.0	-69.9
Current-account balance (% of GDP)	0.4 ^c	0.2	-0.3	-0.3	-0.4	-0.4
External debt (end-period; US\$ bn)	1,976.2 ^c	2,073.3	2,272.7	2,481.6	2,723.7	2,934.7
Exchange rate Rmb:US\$ (av)	6.62	6.86	6.90	6.94	7.16	7.03
Exchange rate Rmb:US\$ (end-period)	6.85	6.97	6.79	7.16	7.09	6.97
Exchange rate Rmb:¥100 (av)	5.99	6.23	6.35	6.62	7.13	7.32
Exchange rate Rmb:€ (end-period)	7.85	8.01	8.15	8.77	8.82	8.72

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Economist Intelligence Unit estimates.

Quarterly forecasts

Quarterly forecasts

	2018				2019				2020			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	1.7	1.6	1.5	1.5	1.7	1.5	1.5	1.3	1.8	1.4	1.4	1.3
% change, year on year	6.8	6.7	6.5	6.4	6.4	6.3	6.3	6.1	6.2	6.1	6.1	6.1
Consumer prices												
% change, quarter on quarter	0.5	0.2	0.8	0.6	0.2	1.1	1.3	1.1	0.2	0.8	0.8	0.7
% change, year on year	2.0	1.6	2.1	2.1	1.8	2.7	3.2	3.7	3.7	3.4	2.9	2.5
Producer prices												
% change, quarter on quarter	0.9	0.0	0.9	0.5	-1.4	0.3	2.8	-1.3	-1.8	1.0	3.1	-0.9
% change, year on year	3.8	4.1	4.1	2.2	0.0	0.3	2.1	0.3	-0.1	0.6	0.9	1.4
Exchange rate Rmb:US\$												
Average	6.35	6.38	6.81	6.92	6.75	6.81	6.91	6.97	6.97	6.96	6.88	6.80
End-period	6.28	6.63	6.88	6.85	6.72	6.86	6.94	6.97	6.97	6.92	6.84	6.79
Interest rates (%; av)												
Money market rate	3.2	3.4	2.7	2.9	2.7	2.7	2.8	2.6	2.6	2.7	3.0	3.1

Data and charts

Annual data and forecast

	2014 ^a	2015 ^a	2016 ^a	2017 ^a	2018 ^b	2019 ^c	2020 ^c
GDP							
Nominal GDP (US\$ bn)	10,535	11,226	11,222	12,062	13,508	14,084	15,082
Nominal GDP (Rmb bn)	64,718	69,911	74,563	81,526	89,372	96,599	104,104
Real GDP growth (%)	7.3	6.9	6.7	6.8	6.6 ^a	6.3	6.1
Expenditure on GDP (% real change)							
Private consumption	7.9 ^b	7.2 ^b	8.5 ^b	6.3 ^b	7.3	6.7	6.2
Government consumption	4.0 ^b	9.7 ^b	8.7 ^b	9.8 ^b	12.0	11.2	9.5
Gross fixed investment	6.8 ^b	6.6 ^b	6.3 ^b	4.1 ^b	4.6	4.6	4.2
Exports of goods & services	8.2 ^b	1.8 ^b	5.3 ^b	8.9 ^b	6.8	3.0	3.8
Imports of goods & services	7.2 ^b	2.0 ^b	7.1 ^b	7.0 ^b	8.2	2.7	3.3
Origin of GDP (% real change)							
Agriculture	4.1	3.9	3.3	4.0	3.5 ^a	3.7	3.4
Industry	7.4	6.2	6.3	5.9	5.8 ^a	6.0	5.8
Services	7.8	8.2	7.7	7.9	7.6 ^a	7.2	6.9
Population and income							
Population (m)	1,358 ^b	1,364 ^b	1,371 ^b	1,379 ^b	1,385	1,390	1,395
GDP per head (US\$ at PPP)	13,616 ^b	14,785 ^b	15,677 ^b	16,687 ^b	18,120	19,578	21,090
Fiscal indicators (% of GDP)							
General government revenue	21.7	21.8	21.4	21.2	20.5	21.2	21.5
General government expenditure	23.5	25.1	25.2	24.9	24.7	25.7	26.0
General government balance	-1.8	-3.4	-3.8	-3.8	-4.2	-4.5	-4.5
Net public debt	14.8	15.2	16.1	16.5	19.3	22.3	25.2
Prices and financial indicators							
Exchange rate Rmb:US\$ (end-period)	6.12	6.49	6.95	6.51	6.85 ^a	6.97	6.79
Exchange rate Rmb:€ (end-period)	7.43	7.07	7.33	7.81	7.85 ^a	8.01	8.15
Consumer prices (end-period; %)	1.6	1.7	2.1	1.7	1.8 ^a	3.8	2.4
Producer prices (av; % change) ^d	-1.9	-5.2	-1.4	6.4	3.6 ^a	0.7	0.7
Stock of money M1 (% change)	3.2	15.2	21.4	11.8	1.5 ^a	4.6	5.2
Stock of money M2 (% change)	11.0	13.3	11.3	9.0	8.1 ^a	8.5	8.6
Benchmark lending rate (end-period; %)	5.6	4.4	4.4	4.4	4.4 ^a	4.4	4.4
Current account (US\$ bn)							
Trade balance	435.0	576.2	488.9	475.9	395.2	414.5	419.5
Goods: exports fob	2,243.8	2,142.8	1,989.5	2,216.2	2,417.4	2,513.8	2,599.5
Goods: imports fob	-1,808.7	-1,566.6	-1,500.6	-1,740.3	-2,022.3	-2,099.3	-2,179.9
Services balance	-213.7	-218.3	-233.1	-258.9	-292.2	-327.1	-341.7
Primary income balance	13.3	-41.1	-44.0	-10.0	-51.4	-61.2	-118.4
Secondary income balance	1.4	-12.6	-9.5	-11.9	-2.4	-2.5	-2.7
Current-account balance	236.0	304.2	202.2	195.1	49.1	23.6	-43.2
External debt (US\$ bn)							
Debt stock	1,770.5	1,325.9	1,415.8	1,710.2	1,976.2	2,073.3	2,272.7
Debt service paid	81.3	126.4	165.5	204.2	190.5	231.3	247.4
Principal repayments	38.2	83.9	129.1	142.8	121.9 ^a	145.4	162.3
Interest	43.1	42.5	36.3	61.4	68.6	85.9	85.1
International reserves (US\$ bn)							
Total international reserves	3,869.0	3,406.1	3,097.8	3,235.9	3,168.0	2,978.1	2,890.8

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d Non-seasonally adjusted.

Source: IMF, International Financial Statistics.

Quarterly data

	2017			2018				2019
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Output								
Real GDP (% change, year on year)	6.8	6.7	6.7	6.8	6.7	6.5	6.4	6.4
Industrial production, gross value added (2005 prices; % change, year on year)	6.9	6.3	6.2	6.8	6.6	6.0	5.7	6.4
Electricity production (% change, year on year)	6.6	7.3	4.6	8.7	7.9	6.2	7.2	6.0
Prices								
Consumer prices (2015=100)	103.5	103.9	104.4	104.9	105.1	106.0	106.6	106.8
Consumer prices (% change, year on year)	1.5	1.5	1.6	2.0	1.6	2.1	2.1	1.8
Financial indicators								
Exchange rate Rmb:US\$ (av)	6.86	6.67	6.61	6.35	6.38	6.81	6.92	6.75
Exchange rate Rmb:US\$ (end-period)	6.78	6.65	6.51	6.28	6.63	6.88	6.85	6.72
Deposit rate (end-period; %)	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Prime lending rate (end-period; %)	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Seven-day repurchase rate (av; %)	3.4	3.4	3.6	3.2	3.4	2.7	2.9	2.7
Total loans (% change; year on year)	12.7	12.5	12.1	11.9	12.1	12.8	12.9	13.3
M1 (end-period; Rmb bn)	51,023	51,786	54,379	52,354	54,394	53,857	55,169	54,758
M1 (% change, year on year)	15.0	14.0	11.8	7.1	6.6	4.0	1.5	4.6
M2 (end-period; Rmb bn)	163,128	165,566	169,024	173,986	177,018	180,167	182,674	188,941
M2 (% change, year on year)	9.4	9.2	9.0	8.8	8.5	8.8	8.1	8.6
Shanghai A-share price index (end-period; Feb 21st 1992=100)	3,343	3,507	3,463	3,319	2,982	2,955	2,611	3,237
Shanghai A-share price index (% change, year on year)	9.0	11.5	6.6	-1.7	-10.8	-15.7	-24.6	-2.5
Sectoral trends								
Retail sales, consumer goods (% change, year on year)	10.8	10.3	9.9	5.2	3.7	3.8	3.5	8.3
Foreign trade (US\$ bn)								
Exports fob	561.6	588.1	635.3	543.9	626.1	656.8	659.9	551.1
Imports cif	-444.0	-475.8	-506.1	-499.2	-535.6	-572.8	-528.3	-475.6
Trade balance	117.7	112.3	129.2	44.7	90.5	84.0	131.7	75.6
Capital flows (US\$ bn)								
Foreign direct investment	21.1	32.6	79.3	73.0	52.7	25.2	52.7	n/a
Foreign direct investment (% change, year on year)	-44.1	26.8	13.3	120.8	149.5	-22.7	-33.6	n/a
Reserves excl gold (end-period)	3,077	3,128	3,159	3,162	3,132	3,107	3,092	3,118

Sources: IMF, International Financial Statistics; China Statistical Information Centre; National Bureau of Statistics, China Monthly Economic Indicators; People's Bank of China, Quarterly Statistics Bulletin.

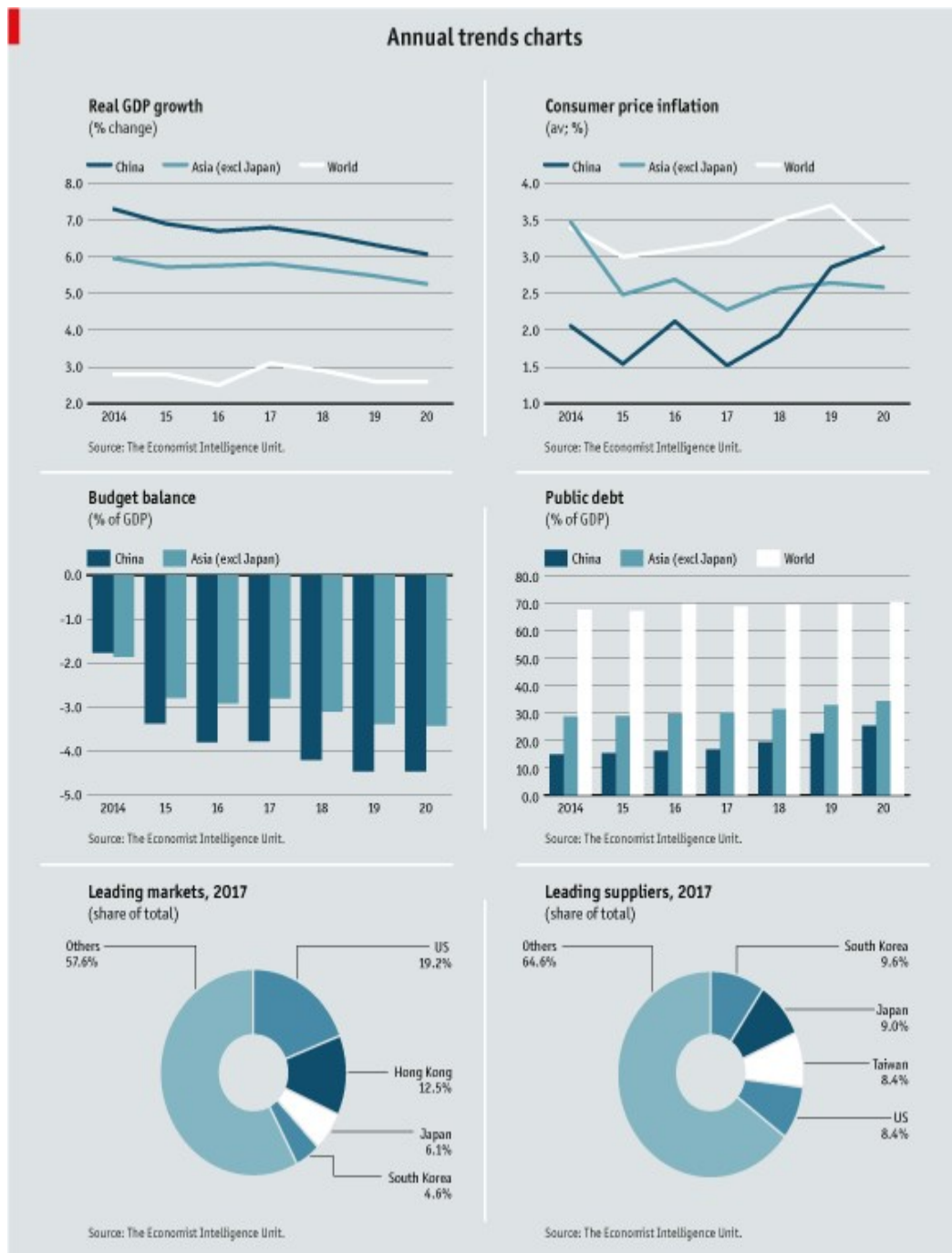
Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate Rmb:US\$ (av)												
2017	6.90	6.87	6.90	6.89	6.89	6.81	6.77	6.67	6.57	6.62	6.63	6.59
2018	6.43	6.31	6.32	6.30	6.37	6.47	6.72	6.85	6.86	6.94	6.94	6.89
2019	6.79	6.74	6.71	6.72	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate Rmb:US\$ (end-period)												
2017	6.88	6.87	6.89	6.90	6.83	6.78	6.73	6.60	6.65	6.63	6.61	6.51
2018	6.30	6.33	6.28	6.34	6.40	6.63	6.83	6.83	6.88	6.97	6.94	6.85
2019	6.71	6.69	6.72	6.74	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Real effective exchange rate (2010=100; CPI basis)												
2017	130.98	128.40	128.25	127.63	127.48	128.26	127.98	128.73	130.13	130.70	130.42	130.14
2018	130.93	132.88	132.28	133.42	134.50	134.00	130.03	128.50	128.79	127.93	127.89	129.21
2019	129.83	130.90	132.24	132.65	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M1 (% change, year on year)												
2017	14.5	21.4	18.8	18.5	17.0	15.0	15.3	14.0	14.0	13.0	12.7	11.8
2018	15.0	8.5	7.1	7.2	6.0	6.6	5.1	3.9	4.0	2.7	1.5	1.5
2019	0.4	2.0	4.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

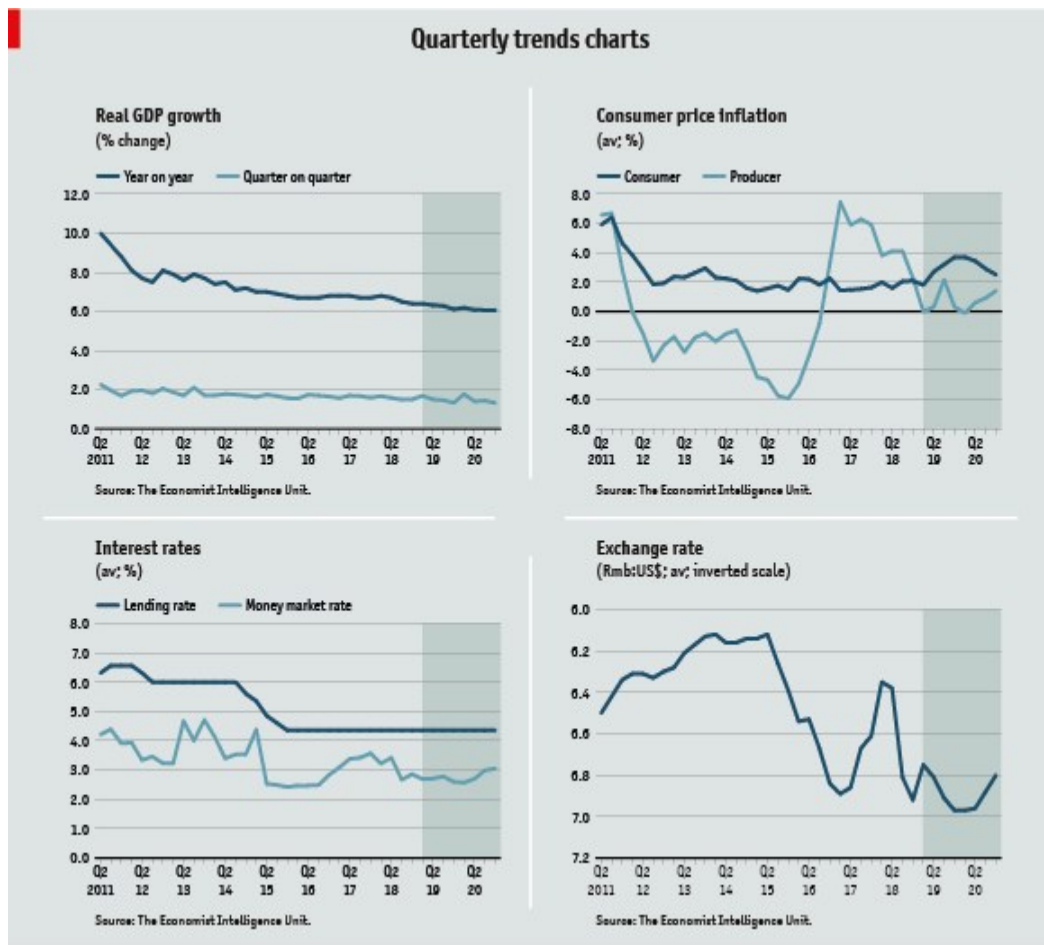
Money supply M2 (% change, year on year)												
2017	11.3	11.1	10.6	10.5	9.6	9.4	9.2	8.9	9.2	8.8	9.1	9.0
2018	9.2	9.2	8.8	8.9	8.8	8.5	9.0	8.7	8.8	8.6	8.6	8.1
2019	8.4	8.0	8.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (end-period; %)												
2017	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
2018	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
2019	1.5	1.5	1.5	1.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Prime lending rate (end-period; %)												
2017	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
2018	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
2019	4.4	4.4	4.4	4.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (% change, year on year)												
2017	6.3	6.3	7.6	6.5	6.5	7.6	6.4	6.0	6.6	6.2	6.1	6.2
2018	7.2	7.2	6.0	7.0	6.8	6.0	6.0	6.1	5.8	5.9	5.4	5.7
2019	5.3	5.3	8.5	5.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Retail sales of consumer goods (% change, year on year)												
2017	9.5	9.5	10.9	10.7	10.7	11.0	10.4	10.1	10.3	10.0	10.2	9.4
2018	5.4	5.4	4.8	4.6	3.1	3.5	3.8	4.0	3.7	3.8	3.4	3.3
2019	8.2	8.2	8.7	7.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Shanghai A-share price index (end-period; Feb 21st 1992=100)												
2017	3,308	3,395	3,375	3,303	3,265	3,343	3,428	3,520	3,507	3,554	3,474	3,463
2018	3,646	3,414	3,319	3,228	3,242	2,982	3,013	2,854	2,955	2,726	2,710	2,611
2019	2,707	3,080	3,237	3,224	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2017	2.0	1.4	0.9	1.2	1.6	1.5	1.4	1.7	1.5	1.7	1.5	1.7
2018	1.9	2.1	1.9	1.6	1.5	1.6	1.8	2.1	2.3	2.4	2.1	1.8
2019	1.5	1.6	2.2	2.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Producer prices (av; % change, year on year)												
2017	6.9	7.9	7.6	6.5	5.6	5.6	5.6	6.4	6.9	6.9	5.8	5.0
2018	4.5	3.7	3.2	3.4	4.2	4.7	4.6	4.1	3.6	3.3	2.6	0.8
2019	-0.1	-0.1	0.2	0.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (US\$ bn)												
2017	180.3	118.8	179.2	177.8	189.1	194.8	192.1	198.0	197.9	187.9	215.8	231.5
2018	199.5	170.6	173.9	198.9	211.6	215.6	214.4	216.9	225.4	214.8	224.3	220.9
2019	218.0	135.2	197.9	193.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (US\$ bn)												
2017	131.6	129.8	156.5	141.3	149.2	153.5	147.3	158.0	170.6	151.0	177.4	177.7
2018	181.1	138.4	179.7	172.7	188.2	174.7	186.9	190.7	195.2	181.8	182.4	164.1
2019	178.7	131.4	165.5	179.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US\$ bn)												
2017	48.7	-10.9	22.7	36.5	39.9	41.2	44.9	40.0	27.4	36.9	38.4	53.9
2018	18.3	32.2	-5.8	26.1	23.4	40.9	27.5	26.3	30.3	33.0	41.9	56.8
2019	39.3	3.8	32.4	13.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ bn)												
2017	3,018	3,025	3,029	3,050	3,073	3,077	3,100	3,111	3,128	3,129	3,139	3,159
2018	3,181	3,154	3,162	3,144	3,129	3,132	3,138	3,129	3,107	3,073	3,081	3,092
2019	3,107	3,109	3,118	3,114	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

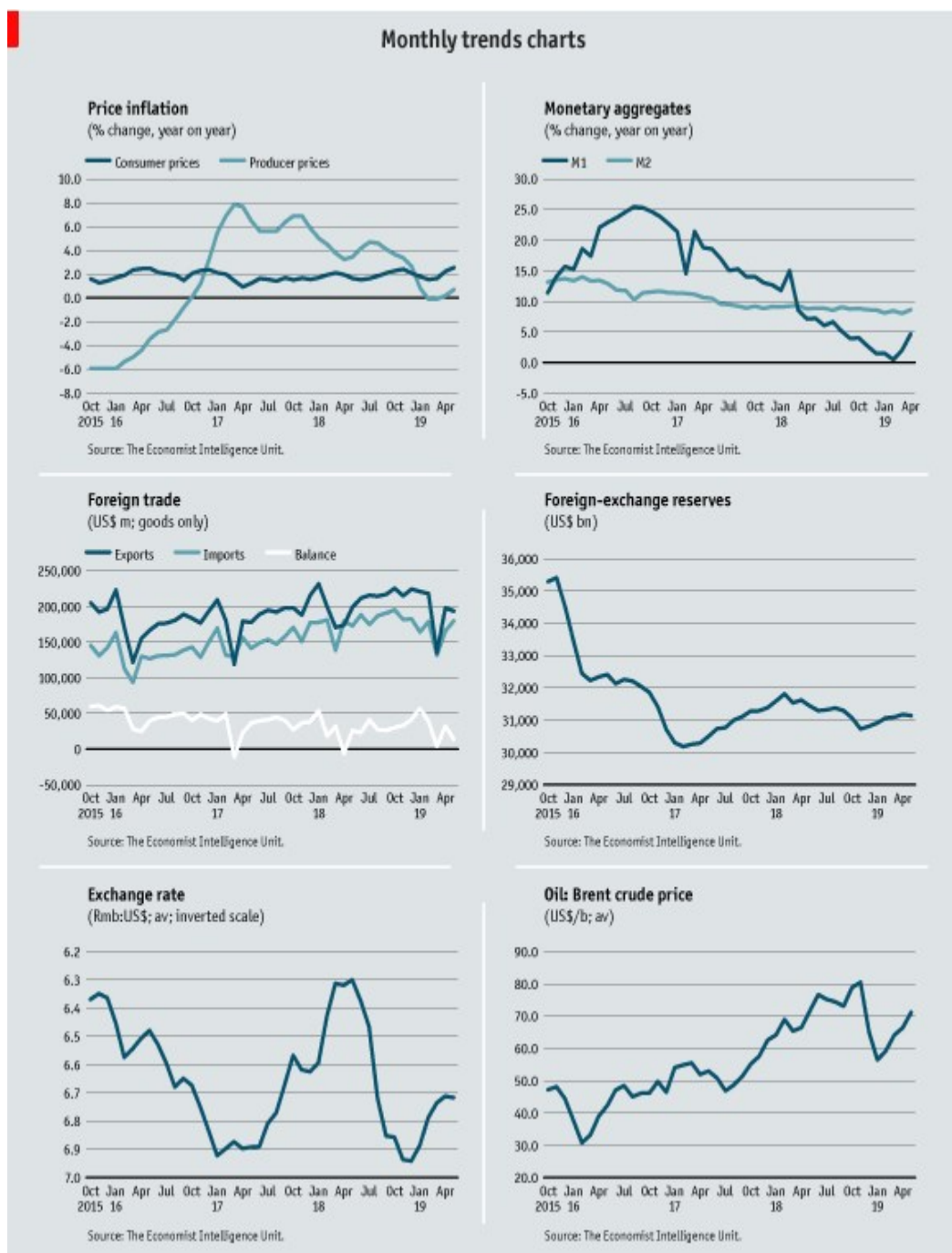
Annual trends charts



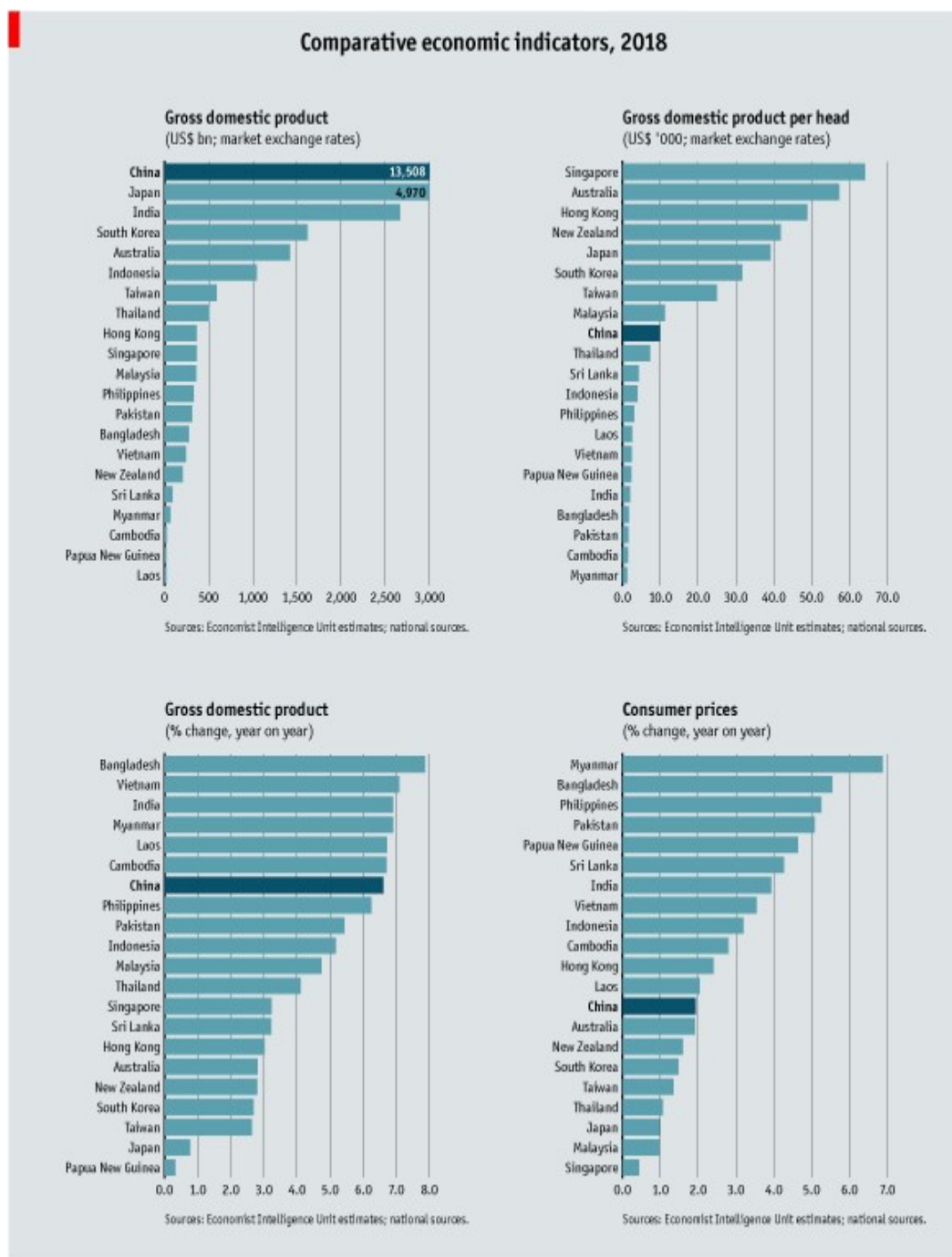
Quarterly trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

9,561,000 sq km

Population

1.4bn (2018; official estimate)

Main towns

Population (millions) of metropolitan areas (2018; Economist Intelligence Unit Access China estimates)

Shanghai: 23.2

Beijing (capital): 20.1

Shenzhen: 12.8

Guangzhou: 11.0

Tianjin: 10.6

Chongqing: 9.7

Dongguan: 9.0

Foshan: 8.4

Wuhan: 8.1

Chengdu: 7.9

Nanjing: 7.0

Shenyang: 6.1

Climate

Continental, with extremes of temperature; subtropical in the south-east

Weather in Shanghai (altitude 4 metres)

Hottest months, July and August, 23-33°C (average daily minimum and maximum); coldest month, January, -1 to 9°C; driest month, September, less than 5 mm average rainfall; wettest month, June, 160-165 mm average rainfall

Language

Mainly putonghua, or Standard Chinese, based on northern Chinese (the Beijing dialect known as Mandarin); local dialects and languages are also used

Measures

The metric system is used alongside certain standard Chinese weights and measures, of which the most common are:

1 jin = 0.5 kg

1 dan = 50 kg

1 mu = 0.0667 ha

2,000 jin = 1 tonne

20 dan = 1 tonne

15 mu = 1 shang = 1 ha

Currency

Renminbi (Rmb), or yuan. Rmb1 = 10 jiao = 100 fen. Average exchange rate in 2018: Rmb6.62:US\$1

Fiscal year

January-December

Time

8 hours ahead of GMT

Public holidays

January 1st (New Year's Day); February 4th-10th (Chinese New Year); April 5th-7th (Qingming Festival); May 1st (Labour Day); June 7th-9th (Dragon Boat Festival); September 13th-15th (Mid-Autumn Festival); October 1st-7th (National Day). All public holidays are in practice one day long, except for Chinese New Year and National Day, with several holiday periods also including weekends. When the holiday covers weekdays in excess of this figure, these are compensated for by working weekends around the holiday



Political structure

Official name

People's Republic of China

Form of government

One-party rule by the Chinese Communist Party (CCP)

The executive

The State Council, membership of which is approved by the legislature; State Council members, including the premier, may serve no more than two consecutive five-year terms

Head of state

The president and vice-president are approved by the legislature. The limit of two five-year terms for these posts was removed in March 2018

National legislature

The unicameral National People's Congress (NPC) has 2,989 delegates selected by provinces, municipalities, autonomous regions and the armed forces. It approves the president and members of the State Council, as well as the membership of the standing committee of the NPC, which meets when the NPC is not in session. All arms of the legislature and the executive, apart from the president and vice-president, serve five-year terms

Regional assemblies and administrations

There are 22 provinces, four municipalities directly under central government control and five autonomous regions. All these different types of regional administration elect local people's congresses and are administered by people's governments

National elections

The party leadership was reshuffled at the 19th CCP national congress, which took place in October 2017. A parallel reshuffle at cabinet level took place in March 2018, with new appointments to key ministerial-level positions in the government

National government

The politburo (political bureau) of the CCP decides policy and controls all administrative, legal and executive appointments; the seven-member politburo standing committee is the focus of power

Main political organisation

The CCP, of which Xi Jinping is the general secretary

Politburo standing committee members

Xi Jinping

Li Keqiang

Li Zhanshu

Wang Yang

Wang Huning

Zhao Leji

Han Zheng

Heads of selected state ministries and commissions

President: Xi Jinping

Vice-president: Wang Qishan

Premier: Li Keqiang

Vice-premiers:

Han Zheng

Sun Chunlan

Hu Chunhua

Liu He

Commerce: Zhong Shan

Finance: Liu Kun

Foreign affairs: Wang Yi

National Development & Reform Commission: He Lifeng

Central bank governor

Recent analysis

Generated on June 26th 2019

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

Politics

Forecast updates

Trump threatens fresh tariffs on Chinese trade

May 6, 2019: International relations

Event

On May 5th the US president, Donald Trump, threatened on Twitter to raise existing tariff duties on US\$200bn-worth of Chinese imports to 25%, from 10% currently, as part of the US-China trade war. He also threatened to apply tariffs on the remaining Chinese goods not currently targeted in the dispute.

Analysis

Mr Trump specified that he would escalate existing tariff rates to 25% by May 10th. He had initially made this threat in September 2018, but [rescinded it](#) in late February owing to "substantial progress" in trade negotiations. His shift in position was therefore unexpected given recent reports that both sides were [nearing a deal](#).

Mr Trump said that he was prompted to issue his threat following Chinese attempts to "renegotiate" the bilateral deal that has taken shape. This is surprising given China's recent reforms aimed at laying the grounds for the deal, including stronger steps to [strengthen](#) intellectual property protection and widen market access for foreign firms. If Mr Trump's comments are accurate, they hint at a lack of consensus on the Chinese side, or a sign of China's overconfidence in walking back its already-agreed-upon pledges.

China's Ministry of Foreign Affairs confirmed on May 6th that a delegation was still planning to visit the US for the 11th round of trade talks, suggesting that the trade deal remains alive. However, it is not clear whether China's chief negotiator, the vice-premier, Liu He, will join, given the difficult optics of the visit.

Although the risk of negotiations breaking down is now alarmingly high, we still think that a deal remains possible. The talks are already well advanced and fresh volatility in financial markets will encourage both parties to step back from escalation, as they have in the past.

However, if Mr Trump proceeds with his threat, the implications will be significant. It would certainly scupper a trade agreement and likely prompt countermeasures by China. Increasing the tariff rate from 10% to 25% would pull down China's real GDP growth down by 0.2-0.3 percentage points, in our view, and expanding tariffs to all Chinese goods would reduce the growth by around 0.5 percentage points.

Impact on the forecast

We retain our view that a US-China "stop-gap" trade deal will be reached, but it may not be finalised within the first half of this year as we currently assume. Risks to this forecast have risen, with much dependent on the progress of trade talks this week.

US proposes tariffs on all Chinese trade

May 15, 2019: International relations

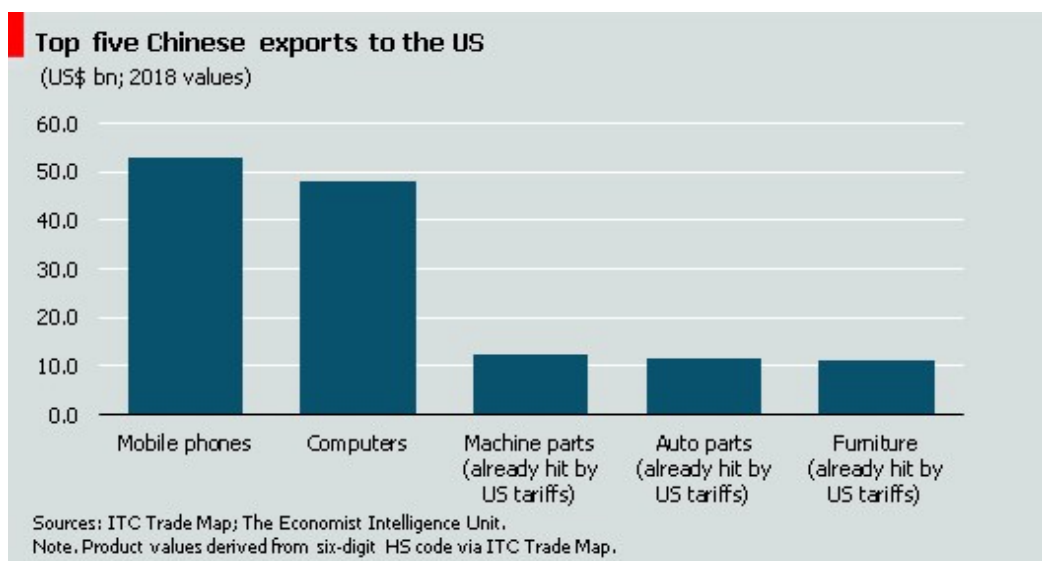
Event

On May 13th the Office of the US Trade Representative (USTR) proposed new tariffs of 25% on Chinese merchandise imports worth around US\$300bn. The latest measures target goods that were not covered by the punitive US duties introduced in 2018.

Analysis

The action followed an announcement by China that it would increase [existing tariff rates](#) on US\$60bn worth of US goods imports, as per our expectations, in response to the recent [US tariff escalation](#). China's tariff rises will take effect on June 1st, reflecting the de facto timeline of the US tariffs. This leaves a small window for negotiation.

However, the latest escalation further squeezes the space for compromise. The USTR has set a deadline of June 17th for written comments and scheduled a public hearing for the same day. The newest duties affect consumer electronics, such as mobile phones and computers (the two largest Chinese exports to the US), which had previously been spared.



China will probably respond by outlining plans for tariffs across all of its US merchandise imports; around 80% are currently covered by additional tariffs. It will also probably end goodwill purchases of US soybeans. Since the latest flare-up, Chinese state media have projected an image of economic resilience; calls to fight US trade aggression "to the end" have generated support on social media.

We still assume, however, that [a deal](#) will be reached by June, when the two presidents are scheduled to meet on the sidelines of the G-20 summit. (Alternatively, the US could again delay the imposition of tariffs). The US tariff timeline will probably extend into July or August, and so a June meeting will be early enough to prevent escalation to the additional US\$300bn worth of Chinese goods.

An agreement will continue to be driven by the calculations of the US president, Donald Trump, in order to minimise economic disruption before the presidential election in 2020. In addition, the targeting of consumer goods will engender considerable domestic US opposition to the proposed duties, which will constrain US action. Nevertheless, growing nationalist sentiment will complicate negotiations, and the risk of a "no deal" outcome is very high.

Impact on the forecast

We plan to moderately downgrade our forecast that China's real GDP will grow by 6.4% in 2019, based on the earlier bilateral tariff increases, but maintain our forecast that a US-China deal will prevent further escalation in trade hostilities.

China nets another tiger

May 21, 2019: Political stability

Event

On May 19th Chinese media announced that Liu Shiyu, the ex-chairman of the China Securities Regulatory Commission (CSRC), had turned himself in for investigation of "suspected violations of party discipline and laws," a term often used as a euphemism for graft.

Analysis

The announcement was made by both the Central Commission for Discipline Inspection (CCDI), which serves as the Chinese Communist Party's internal watchdog, as well as the [National Supervisory Commission](#) (NSC), which monitors corruption among all levels of the Chinese government. Mr Liu had served as head of the CSRC from 2016 until January 2019, when he was reappointed as the deputy party secretary for the All-China Federation of Supply and Marketing Co-operatives, a more junior position that signalled his fall from grace. He was [succeeded](#) at the CSRC by Yi Huiman, the former head of the Industrial and Commercial Bank of China. Mr Liu is the most high-profile "tiger" netted by the anti-corruption campaign this year, although the NSC and CCDI also announced the detention and investigation of Qin Guangrong, a former party secretary of Yunnan province, earlier in May.

Neither China's state-owned media nor the government have specified the nature of Mr Liu's violations. Some reports have suggested that his detention could be tied to his policy missteps rather than corruption. These include the failure to launch the London-Shanghai stock connect, and backtracking on the issuance of Chinese Depositary Receipts (CDRs), which had been expected to help to drive Chinese technology listings on local bourses. The decision by Xiaomi, a local phone manufacturer, to scrap its CDR listing in June 2018 was seen as a particular embarrassment.

Nevertheless, the CCDI does not usually step in over policy failures by senior party members. If disciplinary agencies are now also intervening over this issue, it will further exacerbate the danger of administrative paralysis, as officials will increasingly avoid taking responsibility for potentially risky policies.

Impact on the forecast

The latest developments reinforce our forecast that the anti-corruption campaign will increase the likelihood of policy paralysis in 2019-23.

China threatens to play the rare-earths card

May 29, 2019: International relations

Event

In an interview with the Chinese Communist Party flagship newspaper *People's Daily*, published on May 28th, an unnamed spokesman from the National Development and Reform Commission (China's top economic planning body) suggested that China might use rare earths as a "counter-weapon" against US trade policy.

Analysis

The interview is best interpreted as economic sabre-rattling, but it highlights the possibility (as we had [previously noted](#)) that China could use rare earths as leverage in its trade dispute with the US. The comments followed a visit on May 20th by China's president, Xi Jinping, to a rare-earths company in Ganzhou during a tour of Jiangxi province.

China produced 70.6% of the global supply of rare earths in 2018, according to the US Geological Survey (USGS). They comprise a group of 17 metals that, when combined with other materials, are essential in a range of high-technology industry fields, such as magnetic materials, display panels, hydrogen storage and petroleum processing. The USGS notes that China is the source for around 80% of US imports of rare-earth compounds and minerals in volume terms. Rare earths were among only a few goods excluded from the expanded [tariff list published](#) in May by the US Trade Representative, suggesting that the US government recognises the extent of the country's reliance on Chinese supplies.

Nonetheless, there would be drawbacks for China if it imposed restrictions on exports of raw rare earths or related intermediate products to the US or more broadly. Most importantly, it would undermine efforts to develop the local industry by calling into question its reliability as a supplier. Most production is for export, and China has been trying to move the industry up the value chain, beyond the mining of raw elements. The economic impact for China of export controls would be negligible at the macro level and localised within Jiangxi, where rare-earth mining is concentrated. However, the CCP is highly sensitive to labour market stability issues at present.

Impact on the forecast

Potential disruption to rare-earths trade is one factor likely to encourage the US and China to reach a temporary trade truce in the coming weeks. Our baseline forecast is for a broader trade agreement to be reached by end-2019, although risks to this call are very high.

Analysis

Hoping for the best

May 16, 2019

US-China trade relations have become embroiled in fresh uncertainty. However, we still believe that further escalation will be too politically costly for the US president, Donald Trump, before the presidential election in 2020, and this makes it likely that a bilateral agreement will eventually be reached this year. However, the risk of a "no deal" outcome is very high and ought to be prepared for.

On May 10th the US increased existing tariffs of 10% on US\$200bn worth of Chinese merchandise imports to duty rates of 25%, in the first salvo of a resumption of trade hostilities. China responded by raising its import tariffs on around US\$60bn of US goods. The stakes were raised again on May 13th with a US proposal to apply additional tariffs across Chinese merchandise imports not yet covered by punitive tariffs, worth around US\$300bn (at 2018 values). China has not outlined its response, but it would no doubt include widening its own tariffs across all US goods.

The application of tariffs across the entirety of bilateral merchandise trade would have dire wider consequences for the global economy by disrupting supply chains, as well as inducing volatility

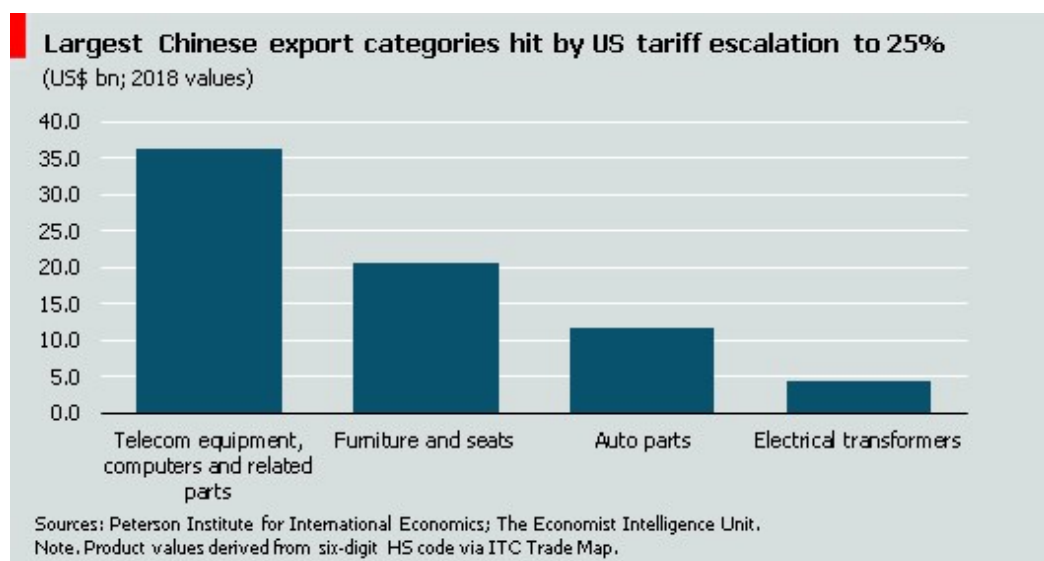
in financial markets, raising costs for consumers and curtailing business investment. Partly because of what is at stake economically, The Economist Intelligence Unit continues to expect the US and China to [come to an agreement](#) to prevent further tariff escalation. The timing to watch will be late June, when Mr Trump is expected to meet his Chinese counterpart, Xi Jinping, on the sidelines of G20 meetings in Japan.

De-escalation will come from the US

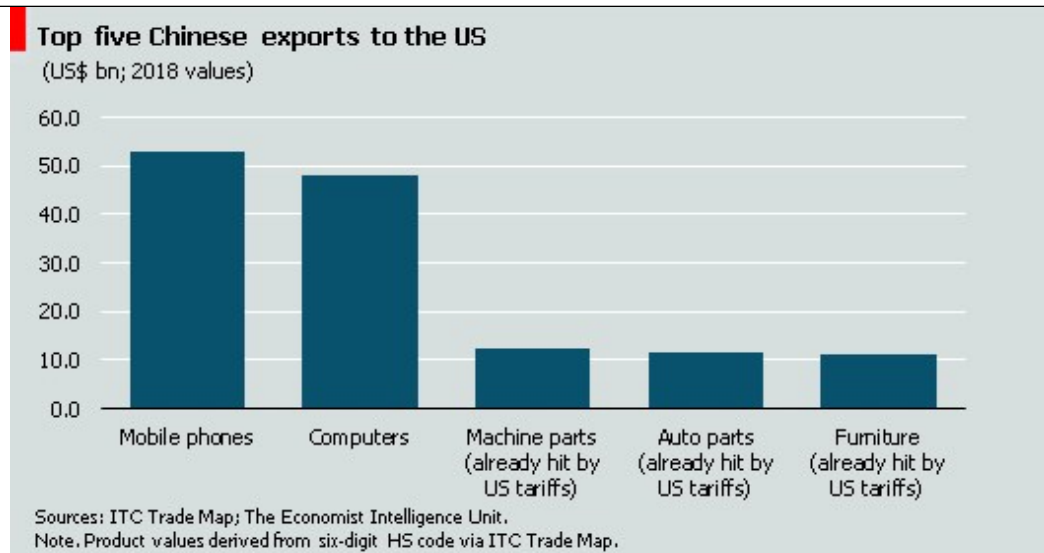
According to Mr Trump and the US Trade Representative, Robert Lighthizer, [the recent breakdown](#) in trade negotiations was caused by China's sudden backtracking on elements of the trade agreement that had taken shape over ten rounds of negotiation. If taken at face value—and there are reasons to treat the information with caution—it suggests that Mr Xi came under pressure from domestic interest groups not to submit to an "unequal treaty" with the US. This pressure may have materialised once the text of the outline agreement was translated into Chinese—reportedly at a surprisingly late stage—and circulated internally. Mr Xi had previously signalled cautious support for a deal and must have been aware of its content, given his close relationship with the chief Chinese negotiator, Liu He (a vice-premier).

While the reasons for China's about-turn are not transparent, it is clear that its negotiating position has hardened. Commentary in state media has adopted a belligerent tone, stressing China's economic "resilience" and signaling a willingness to fight US trade aggression "to the end". Across broader social media, there has been a rise in patriotic postings and a crowding-out of liberal voices that have supported a trade deal with the US. Stoking domestic sentiment in this way suggests that China is not preparing to reverse its recent backtrack or to fulfil other outstanding US demands, even if this results in economic pain.

As a result, our view that a cessation in bilateral trade hostilities will be formalised in June rests on the assumption that de-escalation will be driven by the US. This will come from Mr Trump's political calculations in advance of the US presidential election in 2020. The most recent US tariff escalation from 10% to 25% was controversial, although the overwhelming majority of the goods targeted (within the US\$200bn tranche) are intermediate components, which will primarily squeeze US businesses.



However, the proposed tariff application on the remainder of Chinese merchandise imports not yet hit by US duties would target major finished consumer goods, such as mobile phones and computers. These actions, which would cover goods worth around US\$300bn (at 2018 values), would put direct pressure on US consumers. Expected Chinese retaliation would also be likely to result in a suspension of goodwill purchases of US soybeans and an intensification of ["qualitative" measures](#) targeting US companies in China, such as increased licensing and administrative procedures.



The political cost of tariff troubles

Given these coming economic challenges, there are signs that support for Mr Trump is already starting to erode among US farmers—a key Republican constituency—as a result of his trade agenda. US businesses and consumer groups have also already come out in strong opposition to the new tariffs. Meanwhile, volatility has picked up in the US financial market, which has in the past made Mr Trump nervous.

We therefore believe Mr Trump will judge that extending the trade war to the entirety of Chinese merchandise trade will both split the Republican Party and introduce unnecessary economic harm before the presidential election. There still seems to be appetite for a trade deal among other parts of the US administration, as well: the US Treasury secretary, Steven Mnuchin, reportedly plans to return to China to continue trade negotiations, although a specific timeline has not yet been announced.

Meetings between the presidents have previously allowed both sides to [walk back from the brink](#). At the least, the US could agree to delay the imposition of tariffs at the planned G20 summit. Precedent suggests that the timeline for new tariff application will be around two months, so the meeting will come early enough to prevent tariff escalation in July or August. As a result, we expect these meetings to ultimately prevent further escalation over the remaining US\$300bn worth of Chinese merchandise imports—and, in turn, China's retaliation over the entirety of US merchandise imports into its own market.

There is, nevertheless, a high level of risk to this forecast. It is unclear whether Mr Lighthizer—who has led the charge for the resumption of tariff hostilities—will continue to accompany Mr Mnuchin in future talks with China. Mr Lighthizer's influence over Mr Trump is key, and his view that China reneged on its previously agreed-upon commitments will have vindicated his suspicions of China's commitment to enforcing a trade deal.

In addition, Mr Trump himself remains convinced that strong first-quarter GDP growth in the US was underpinned primarily by the trade war. It is also possible that he could see a weak deal with China as more politically damaging in advance of the presidential vote than no deal at all.

What happens without a deal?

A "no deal" scenario that sees tariffs extended across all bilateral trade would inflict significant economic pain on China. While the direct impact on GDP growth via external trade would be manageable, at around 0.5 percentage points, the indirect impact on consumer and business confidence could be more substantive, potentially pulling down GDP expansion by a further 0.5-1 percentage points. The government would implement stimulus measures to cushion the impact of trade hostilities on domestic demand, but these would disrupt policy efforts made in recent years to contain risks tied to high levels of debt, pointing to a poorer long-term economic outlook.

The US economy is less trade-reliant than China's, and we would expect the US government to continue to provide stimulus to the agriculture sector—one of the sectors that would suffer the most from the loss of export competitiveness. However, rising prices and narrowing business margins would push down growth in both household spending and business investment. Under our initial projections, we expect this to knock 0.2-0.3 percentage points off our current GDP growth forecast of 2.2% for 2019.



With or without a deal, lingering friction between the US and China—particularly in the realm of trade—will weigh on global trade sentiment, particularly in the electronics sector. East Asian trade growth is already under pressure owing to a slowdown in global demand for consumer electronics. This has been exacerbated by both the tariffs themselves and uncertainty tied to the trade war.

An escalation in the dispute could further raise the risk of this conflict morphing into a global trade war—which The Economist Intelligence Unit has identified as [the top risk to the global economy](#) in 2019—as Chinese exporters redirect their shipments to the EU and other countries to offset US tariff pain. This would inflame tensions in those third countries and could prompt retaliatory duties against Chinese goods in those markets. Regardless of how the dispute pans out, trade uncertainty will inevitably weigh on investor and trade sentiment, creating consequences for the entire global economy.

The wild cards for a trade deal

May 22, 2019

The Economist Intelligence Unit still expects the US and China to [avoid tariff escalation](#) on the remaining amount of bilateral merchandise trade by concluding a limited trade deal, possibly in late June. However, this is a finely balanced call. Both sides retain an arsenal of additional tools, ranging from US restrictions on technology exports to China's weaponising of its currency or dumping of holdings of US Treasury bills. Each of these potential moves, however, would come with a steep cost, particularly as the trade war increasingly spills into other areas of contention.

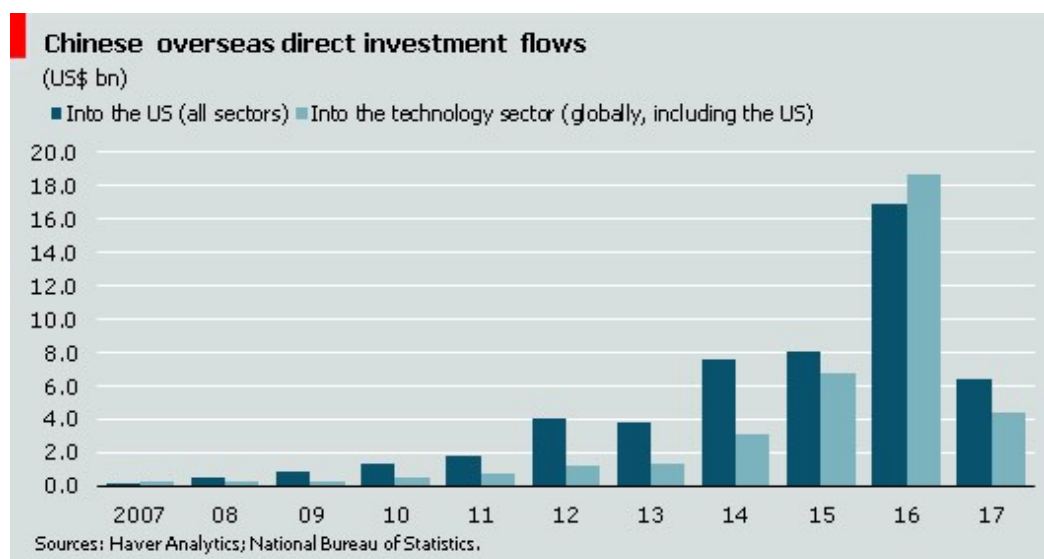
The US and China each have options through which they could inflict economic pain on the other, quite apart from merchandise trade tariffs (both existing and threatened). We have previously explored some of the [qualitative measures](#) that China could impose on US firms in an attempt to bring about a de-escalation of the trade war. Following the recent tariff rise, there is now an increasing likelihood that policymakers on both sides of the Pacific will consider other non-tariff actions in a bid to facilitate some type of trade agreement.

Troubles around technology

Technology is the most obvious area of disagreement between the two countries. The US has

justified its existing tariff actions, [based on allegations](#) of forced technology transfer to China and Chinese theft of related US intellectual property. The Economist Intelligence Unit has long expected bilateral economic frictions to spill over into policies targeting technology investment, which will impact firms on both sides of the Pacific.

Most of this pressure, so far, has come from the US. Regulatory scrutiny of Chinese investment in the US was first tightened in 2015 and has become tougher still since the current US president, Donald Trump, assumed office in early 2017. Such moves are largely a response to the [Made in China 2025 programme](#), which has aligned outbound investment activity with technology procurement goals. Increased scrutiny caused Chinese investment activity in the US to fall in 2017 (in absolute US dollar value terms), according to official Chinese government statistics. This has mirrored a fall in total Chinese outbound investment into the global technology sector, highlighting the importance of the US market in this sphere.



Outbound technology investment is likely to fall further in 2019-23, as US pressure on Chinese technology intensifies. Since late 2018 Huawei, a major Chinese telecommunications and network equipment manufacturer, has found itself at the centre of these tensions. In addition to its global campaign against Huawei's construction of fifth-generation (5G) network infrastructure, the US on May 15th imposed an export ban on Huawei on the grounds of alleged violations of US sanctions against Iran (allegations that the company has denied). The US Department of Commerce subsequently allowed a temporary 90-day relief period for consumers and supply chains to adjust to this ban, but the US is unlikely to reverse these measures completely.

Much ado about Huawei

The US-imposed export controls on Huawei are probably only the first of many such restrictions. The Department of Commerce has also drafted separate controls on US technology exports to China in sectors including artificial intelligence, biotechnology, microprocessors and robotics. These measures would severely hinder Chinese technological development in these industries, which remains heavily dependent on both US technology and research co-operation. Their broad scope, however, also risks disrupting the operations of US firms in China, for example by restricting the types of technology or equipment required for routine business activities in the Chinese market. It is likely that these draft measures, which have remained dormant since late 2018, will resurface later in 2019.

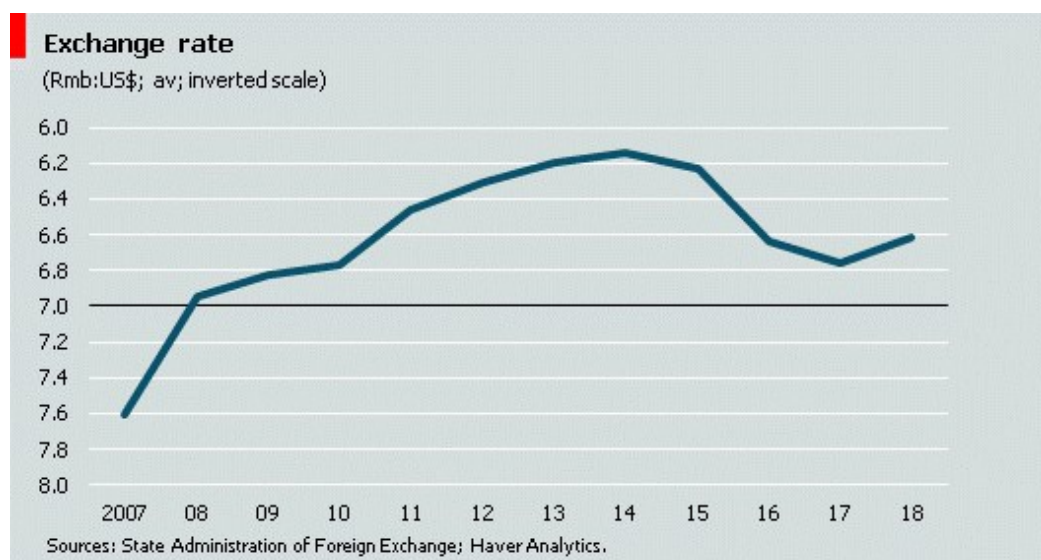
The targeting of one of China's most important companies, as well as the country's broader strategic policy designs for the next decade, hints at US attempts to force China into a trade deal. This is unlikely, however, to lead to Chinese concessions. The targeting of Huawei has roused Chinese nationalist sentiment, making it politically difficult for China's trade negotiators to compromise, for fear of looking weak.

In addition, the US targeting of China's supply-chain vulnerabilities will prompt China to double down on its existing [indigenous innovation policies](#), and risks prompting a reciprocal Chinese ban on rare-earth exports to the US. This would have consequences for the US automotive,

technology and defence industries (in 2018 China was the source of 60%, by volume, of US raw-earth imports, according to international trade statistics). In addition to disrupting China's [technology development plans](#), this would encourage a shift away from US companies in Chinese supply chains in the longer term. It could also invite retaliation against US technology companies, as sanctioned by China's [new foreign investment law](#). Unfortunately, the US appears likely to commit to this course of action, despite these risks, which will have market access consequences for US firms in China and could derail the planned global rollout of 5G technology (within which Huawei plays a leading role).

Weaponising the Chinese currency

China could respond to US trade pressure by allowing the steady depreciation of the renminbi against the US dollar. Critics of China's currency policy blame the undervaluation of the renminbi for helping China to accumulate a large trade surplus during the past decade, while keeping Chinese goods price-competitive on international markets; this has eroded US manufacturing competitiveness (with an associated loss of US jobs).



China could allow the renminbi to fall further against the US dollar in 2019, following its dramatic decline in the wake of the tariff escalation in early May. A lower renminbi would enable Chinese exporters to absorb much of the impact of the recent tariff rise, allowing them to remain competitive in the US market.

The shifts in the structure of China's economy over the past ten years, however, suggest that weaponisation of the currency is unlikely. Since the renminbi first came under pressure in mid-2018, Chinese policymakers' efforts have been directed more towards putting a floor under its value, rather than guiding its further depreciation against other major currencies. Policymakers' strategy has included restrictions on foreign-exchange futures trading, which were implemented in August 2018 on top of existing strong capital controls aimed at preventing uncontrolled capital outflows. In addition, US\$672.1bn in US dollar-denominated bonds were outstanding by end-April. Although only a small fraction of China's total outstanding debt, these bonds have been disproportionately issued by Chinese property developers. A weaker currency would raise domestic debt-servicing costs, with a negative impact on China's property market; if severely disrupted, this would have consequences for the overall economy.

Dumping US Treasury bills: China's nuclear option

There is growing concern that China could also move to offload all or part of its vast holdings of US Treasury notes, bills and bonds. Fears have grown following the release on May 15th of data showing that Chinese holdings of US Treasuries fell by US\$20.5bn in March, the biggest offloading for two years.

Aggressive offloading would push up US interest rates and increase borrowing costs for US firms, compounding downward pressure on the US economy as businesses and consumers struggle with higher tariffs. This could translate into stronger political pressure on Mr Trump to

cut a deal with China to bolster his electoral chances in advance of the US presidential contest in 2020.



These fears are unwarranted. China's holdings of US Treasuries remain vast, at around US\$1.12trn at end-April, according to US government data. Moreover, China's appetite for their purchase remains large, owing to their status as a safe, positive-yield asset (as opposed to Japanese or German bonds). Further sales are still likely, given the desire to defend against further depreciation of the renminbi against the US dollar, but these will be controlled in order to prevent international financial instability from rippling back to China's shores. Any large-scale sell-off would further erode China's own foreign-exchange reserves, which would complicate separate policy designs aimed at stabilising the currency. As a result, this option is likely to remain off the table, even if the trade dispute intensifies.

Belt and Road Quarterly: Q2 2019

May 31, 2019

In this edition of the Belt and Road Initiative (BRI) Quarterly, The Economist Intelligence Unit highlights recent efforts by China to rebrand and reboot the initiative as more sustainable, in terms of its lending practices and investment feasibility. The successful renegotiation of important BRI flagship projects, as well as a rebound in BRI-related construction contracts, points to growth in BRI-related investment in 2019—particularly as increased regulatory scrutiny in the US and EU squeezes Chinese investor activity in those markets.

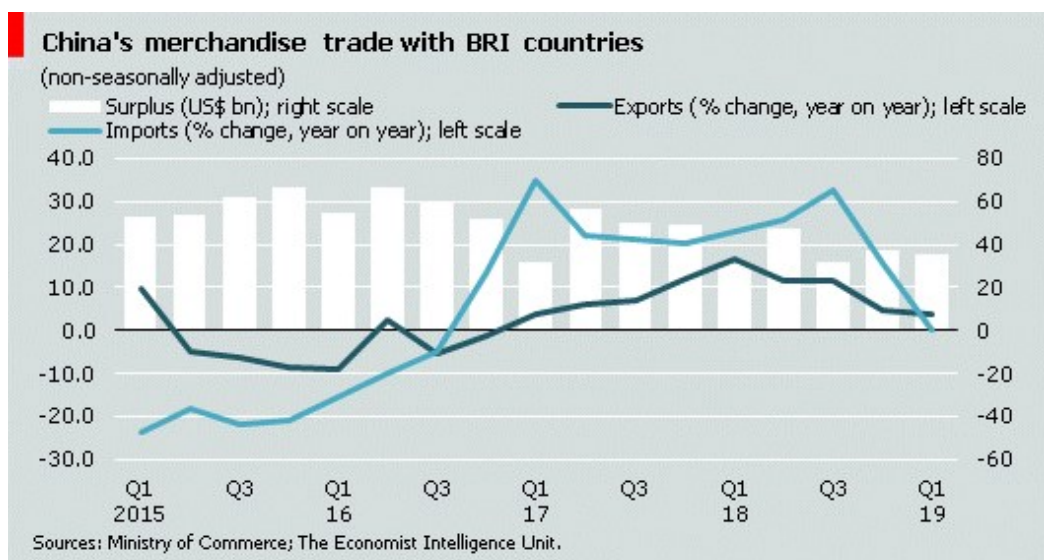
In our [previous BRI Quarterly](#), we examined the steps taken by Chinese policymakers to improve the quality and standards relating to BRI projects, in order to address recent criticisms. The [reboot of the initiative](#) in late April at China's second Belt and Road Forum (BRF) further pointed to efforts to enhance project sustainability and ensure future international interest in BRI co-operation.

Trade, investment and lending

Merchandise trade growth along the BRI continued to decelerate during the first quarter of 2019, with expansion in two-way flows easing to 2.1% year on year across the 65 "core" countries we classify as belonging to the project (the Chinese government claims that around 130 countries have signed BRI agreements). This was down from the 9.4% growth registered in the fourth quarter of 2018. China's merchandise exports to BRI countries rose during the quarter by 3.6% to US\$165bn, while goods imports inched up by only 0.3% to just under US\$129bn.

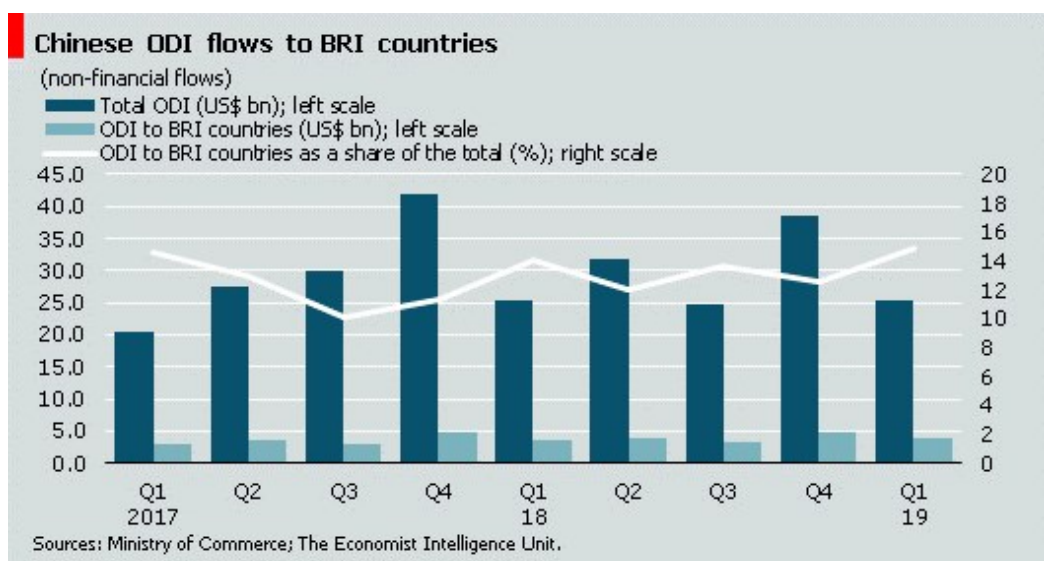
The resulting US\$36bn surplus in China's trade with BRI countries in January-March represented a 4.5% fall from the surplus recorded in October-December 2018. This figure accounted for 47.2% of China's global trade surplus in the first quarter, however—a steep increase from 27.4% in the previous three-month period. The shift was caused primarily by the fact that import growth from BRI countries slowed at a faster pace than that from non-BRI countries. BRI imports to China are dominated by commodities, so this reflects softer Chinese demand for such materials. This will

have repercussions for the external performance of countries such as Russia, Saudi Arabia and Iraq. Chinese exports to BRI countries have remained more stable, with growth in shipments to South-east Asian countries still relatively positive. A strong expansion of merchandise exports of electronics and machinery from Vietnam to the US suggests that some Chinese firms are rerouting shipments and production through third countries, in order to avoid the impact of the [US-China trade war](#).



Other indicators show that Chinese business activity in core BRI countries was mixed during the first quarter. Growth in non-financial overseas direct investment (ODI) flows to BRI countries softened to 4.4% in January-March 2019, to a total of US\$3.8bn, compared with 8.9% growth in full-year 2018. Singapore, the UAE, Pakistan, Vietnam, Thailand and Malaysia attracted the most investment in January-March. Flows to BRI countries were stronger than to other countries, however. Overall Chinese ODI contracted during the first quarter, owing primarily to increasing regulatory scrutiny of Chinese investments in developed markets. BRI flows still represent only about 15% of China's total ODI flows, but we expect this proportion to continue to increase as regulatory barriers in the US and the EU to inbound Chinese investment continue to harden.

Nevertheless, the value of newly signed BRI construction contracts by Chinese firms increased by 47.7% year on year in January-March, reversing a 12.8% contraction in 2018. The rebound in contract values suggests that business tied to the BRI may be gathering steam again, despite past reports of project pushback. Construction contracts are highly correlated with China's overseas lending, especially in poorer countries.



Policy updates

The most significant policy updates tied to the BRI were unveiled at the BRF in April by the Ministry of Finance. These guidelines, announced by China's finance minister, Liu Kun, aim to create a "debt sustainability framework" to improve assessment of financial risk. The guidelines build upon regulations released in late 2018 that seek to enhance BRI project standards and quality, as well as discussions that have been ongoing since mid-2018 between Chinese policy banks and international financial institutions—such as the European Bank for Reconstruction and Development, as well as the World Bank and the Asian Development Bank—on improving financial governance. Although China released these measures partly to rebut global criticisms that the BRI is a form of "debt-trap diplomacy," they are also the latest in a genuine domestic effort to strengthen the institutional underpinnings of the initiative.

Beyond financial governance, China's standards-setting agencies have also attached renewed importance to the BRI. In March the Standardisation Administration released its policy priorities for the year, which include objectives to enhance standards co-operation and integration with BRI countries. Much of this work will be focused in areas such as intelligent manufacturing and other emerging industries. Significantly, however, the work plan omits its former emphasis on standards integration (primarily in technology sectors) between China, the US and the EU—reflecting the greater priority now placed on promoting the "digital Silk Road" as an alternative for Chinese investors to the US and EU markets, as well as the fracturing of the global technology landscape amid the backdrop of the US-China trade war.

Project updates

Despite accusations that the BRI is a debt trap, it has gained new momentum since early 2019. In March [Italy became](#) the first G7 country to sign a Memorandum of Understanding (MoU) with China on the BRI; this paved the way for MoUs with Luxembourg and Switzerland later in that month. The willingness of Western countries to sign up to the initiative suggests that some international critics are accepting Chinese pledges to improve BRI project sustainability, transparency and lending standards at face value, besides the promise of Chinese funds and investment. BRI projects are also expanding into new territories; in April China Machinery Engineering Corporation signed a US\$135m contract to upgrade Bulgaria's Varna Port, China's first port construction project on the Black Sea.

China also scored a modest diplomatic victory in April by convincing Malaysia to resume work on the [East Coast Rail Link](#) (ECRL). The project had been suspended for almost a year. Although the ECRL's cost was revised down by one-third, Malaysia also revived the US\$34bn China-backed Bandar Malaysia development project, which had been cancelled in 2017. The resolution of disagreements over the ECRL ensured that China avoided a diplomatic embarrassment before the BRF and also helped it to secure the attendance at the event of Malaysia's prime minister, Mahathir Mohamad. Dr Mahathir later stated his "full support" for the BRI, a sharp contrast to his earlier criticism. Moreover, while at the BRF, he oversaw the signing of a Malaysian-Chinese deal to develop a US\$500m artificial intelligence park in Malaysia.

Growing pressure on Chinese technology firms, as part of the US-China trade war, has prompted them to focus their overseas expansion efforts on the digital Silk Road. Huawei, which has been caught at the centre of the US-China trade war, has sought new markets for its rollout of fifth-generation (5G) cellular network technology since being blocked in the US and Australia (the company's fate remains uncertain in the EU). Since February Huawei has signed 5G-related agreements with Bahrain, Saudi Arabia and Indonesia, and has launched a 5G test-bed in Thailand. Nevertheless, the recent US export ban on Huawei will deprive it of access to critical US-manufactured components—such as US semiconductor devices—which could derail these plans (and potentially damage the operations of the company at large. As a result of Huawei's leading role in China's 5G push overseas, these actions could delay the planned 5G rollout in these countries.

Economy

Forecast updates

Liquidity conditions stay flat in April

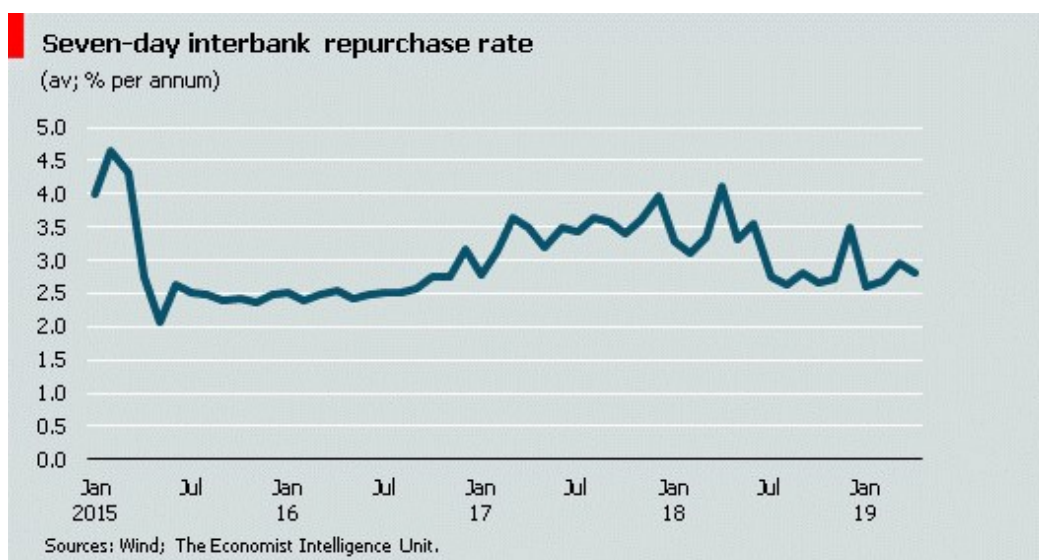
May 6, 2019: Monetary policy outlook

Event

The seven-day interbank repurchase (repo) rate decreased to an average of 2.8% in April, from 2.9% in [March](#). Meanwhile, the bond yield curve steepened, with the spread between one- and ten-year Chinese government bonds widening to 98 basis points by end-April 2019, from 63 basis points a month earlier.

Analysis

Liquidity conditions were relatively unchanged in April compared with the previous month, although the scope for further monetary policy easing looks more limited following the publication of strong [first-quarter GDP](#) data. In April the interbank seven-day repo rate was broadly unchanged from the level in March. Although the People's Bank of China (the central bank) tightened money issuance through its open-market operations, it also injected additional liquidity via its medium- and long-term lending facility when the repo rate neared 3%. This suggests an enduring willingness to ensure a relatively ample money supply.



The fixed-income market experienced a correction in April, with government bond yields of all durations increasing. The better than expected first-quarter GDP expansion surprised investors, causing them to dump safe assets and shift to equities. The steepening in the yield curve implies a strengthening short-term outlook for economic growth and inflation.

In terms of the local government bond market, issuance volume reached Rmb624.5bn (US\$91.4bn) in March (latest available data), taking year-to-date issuance to Rmb1.41trn (US\$206.4bn)—a substantial jump over the level in the year-earlier period. The front-loading of bond issuance, however, is likely to mean less support for infrastructure spending in the second half of the year.

Impact on the forecast

As we noted following the release of first-quarter GDP data, stimulus actions are likely to soften, with economic growth falling comfortably within the government's targeted range. We therefore plan to adjust upwards our forecast that the seven-day repo rate will stand at 2.5% at end-2019.

Foreign-exchange reserves fall slightly in April

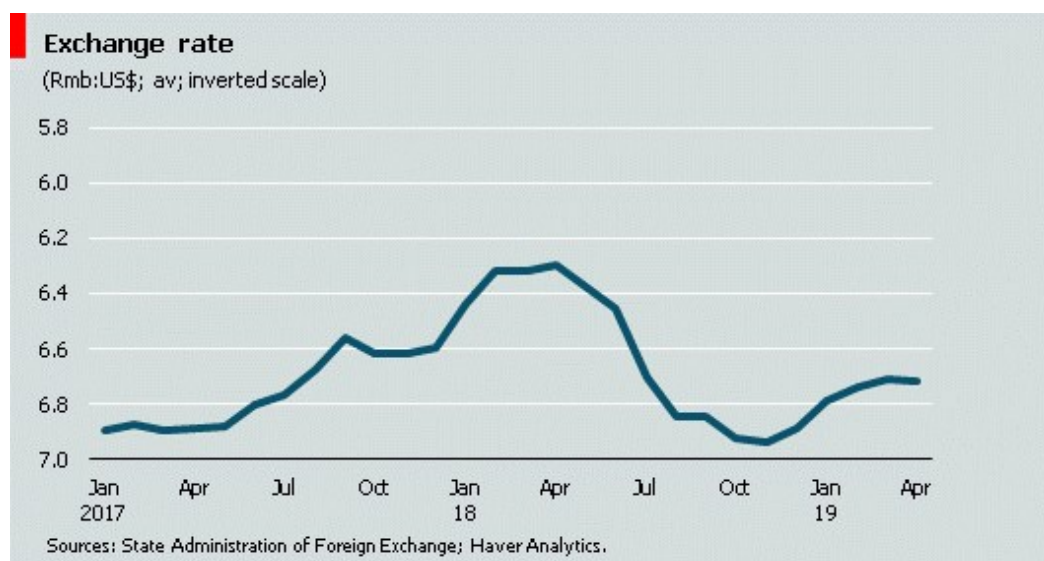
May 8, 2019: Exchange rates

Event

Foreign-exchange reserves fell by US\$3.8bn in April, compared with an increase of US\$8.6bn in [March](#), according to data released on May 7th by the People's Bank of China (PBC, the central bank).

Analysis

The modest—yet unexpected—decline in reserves was mainly due to flat asset valuation and a strengthening in the US dollar. The US dollar index went up by 0.2% in April, which in turn negatively affected the valuation of non-dollar assets. This was offset to a degree by continuous foreign inflows into China's bond and stock markets in April, which helped to buoy foreign-exchange reserves over that month. In addition, tight capital controls and better than expected [economic performance](#) over the first quarter have also kept the risks of capital flight in check.



China's renminbi fell by 0.3% against the dollar on average in April, amid the PBC's increasing tolerance of exchange-rate movements. The sharp depreciation in the renminbi following [fresh tariff threats](#) by the US president, Donald Trump, nonetheless indicates the currency's vulnerability to uncertainties in US-China trade negotiations. A breakdown in trade talks and an escalation in tariff rates on May 10th, as threatened by the US, would inevitably cause the renminbi to lose more of its value against the US dollar, although this scenario remains outside our current forecast.

We expect the current account to maintain a small surplus in 2019, constraining currency volatility to a degree, although this situation may change in 2020 as the current account moves into deficit in that year. However, worsening US-China bilateral tensions—which we expect to occur irrespective of a final trade agreement—will reintroduce depreciatory pressure on the currency later this year.

Impact on the forecast

Although we continue to expect a US-China trade deal, Mr Trump's latest tariff threat has substantially raised the downside risks to this call. As a result, although we expect the local currency to trend on average against the dollar at Rmb6.78:US\$1 in 2019, potential volatility tied to the trade negotiations means that there are similar downside risks to this view. We maintain our forecast that China's foreign reserves will remain at US\$3.1trn by end-2019.

Exports fall back to earth in April

May 8, 2019: External sector

Event

Data released by the General Administration of Customs on May 8th show that goods exports fell by 2.7% year on year in US dollar terms in April, compared with a revised increase of 13.8% in [March](#). Imports rose by 4%, following a revised 7.9% drop the previous month. The trade surplus was US\$13.8bn, compared with US\$32.4bn in March.

Analysis

With the distortions caused by the timing of the Lunar New Year holiday fully washed out, the underlying trade picture has become clearer; it suggests that tepid global demand is providing little support to the Chinese economy. Exports under the processed trade category, such as electronics, rose by just 2.9% year on year in April, while growth in shipments of mechanical and electrical products—a category vulnerable to the [US-China trade war](#)—fell by 3.7%.



The increase in imports—the first in five months—was partly due to rising commodity prices over the same period. The data do suggest, however, that government stimulus over the past few months may be starting to feed through to domestic demand. The category of general imports rose by 3.4% year on year in April, compared with a drop of 12.3% in March. That said, iron ore imports fell in volume terms, although that may be due more to supply problems in Brazil than weak demand.

Trade with the US continued to slump amid the tariff war, with exports falling by 13.1% and imports dropping by 25.7%. On May 5th the US president, Donald Trump, [threatened to escalate](#) existing tariffs and to impose additional duties across all Chinese imports. However, the weak April trade data will give Chinese negotiators added urgency to find a settlement to prevent the trade war from worsening, so this scenario presently remains outside of our forecast. Nevertheless, the risks of further US tariffs being imposed are high, and such an outcome would result in a major downward revision to our merchandise trade forecast for 2019.

Impact on the forecast

We expect merchandise exports and imports to grow in value terms by 3.4% and 3.1% respectively in 2019, although heightened trade tensions with the US have raised downside risks to that forecast.

Credit readings nosedive in April

May 9, 2019: Monetary policy outlook

Event

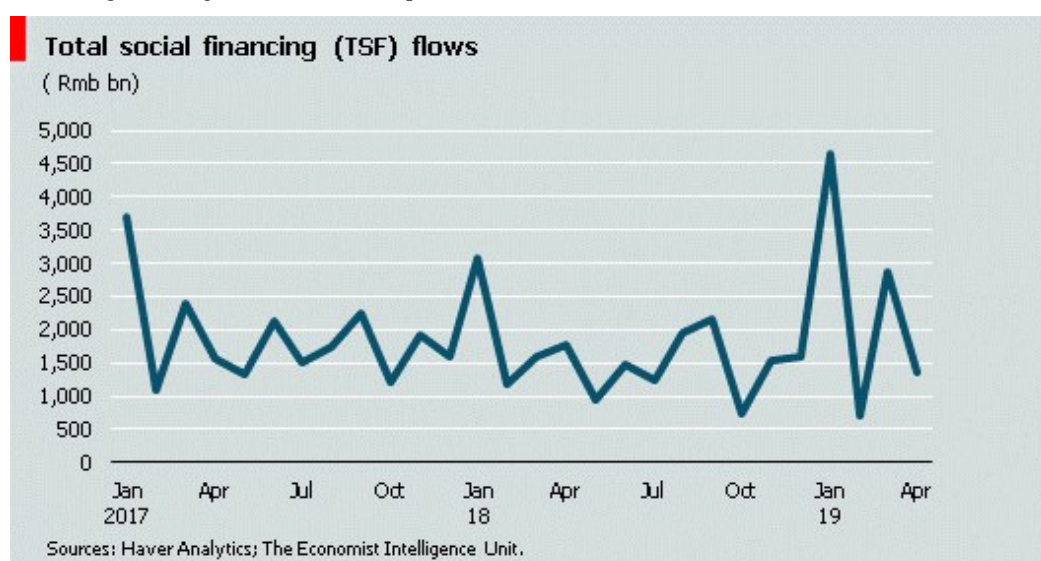
Renminbi-denominated bank loan issuance dropped to Rmb1.02trn (US\$150.4bn) in April 2019 from Rmb1.69bn in March, according to data released by the People's Bank of China (PBC, the central bank) on May 9th. Flows of total social financing (TSF, the broadest measure of credit) also decreased to Rmb1.36trn from Rmb2.83bn in the previous month.

Analysis

April credit numbers slowed significantly following a strong performance in [March](#), as seasonal effects from the Chinese New Year holiday have faded. Corporate long-term borrowing saw the most significant drop, indicating a lack of confidence among businesses despite the [stabilisation in the Chinese economy](#). Long-term household borrowing—mostly mortgages—remained robust, however, with related demand expanding amid a warming in the property market. Growth in the broad measure of money supply (M2) decelerated slightly to 8.5% year on year, after a strong rebound of 8.6% in March.



TSF flows also decreased in April, with the most significant drop coming from on-balance sheet financing. Although absolute levels of off-balance sheet financing (such as trust loans and undiscouted bank acceptance bills) dropped from March, these readings remained in positive territory. The data suggest that the Chinese economy may not be as robust as suggested by the headline growth figure from the first quarter.



Continuous monetary policy loosening since mid-2018 has nevertheless resulted in some of the resilience observed in the Chinese economy in January-March. The effectiveness of these policies has prompted the PBC to roll back its targeted stimulus policies to shift towards a more neutral

stance. However, fresh potential for [escalation in the US-China trade war](#) will put new downwards pressure on the Chinese economy. The PBC could once again shift to a loosening stance should US tariffs be hiked, although growing inflationary pressure will ultimately constrain any significant easing later this year.

Impact on forecast

The shift towards a more neutral policy stance is in line with our forecast that M2 growth will reach 8.9% by end-2019. The likelihood of further cuts to the reserve requirement ratio and the benchmark interest rate has similarly decreased. However, potential escalation in the US-China trade war may quickly change this policy stance, and risks to this forecast have grown.

Price growth spikes in April

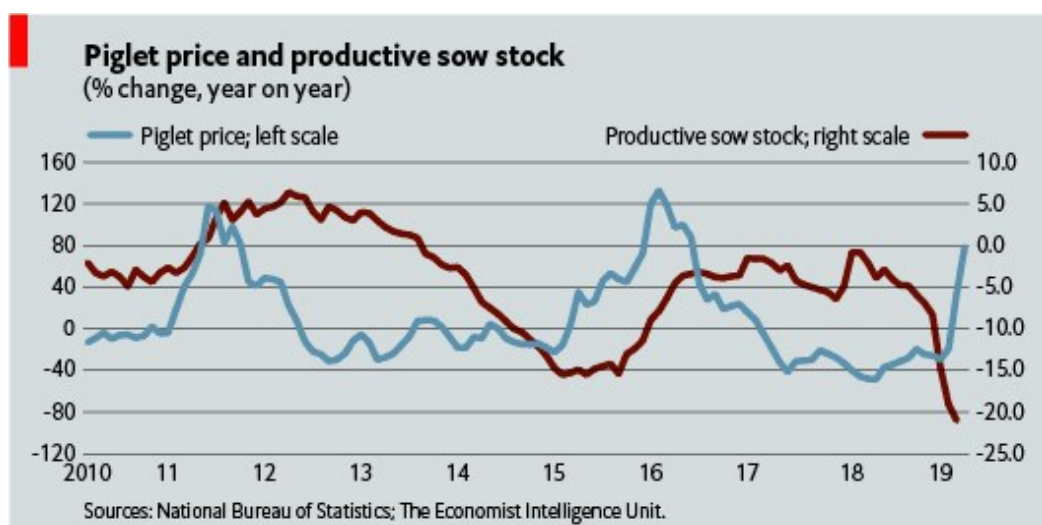
May 9, 2019: Inflation

Event

In April the consumer price index (CPI) rose by 2.5% year on year, accelerating from 2.3% in [March](#), according to data released on May 9th by the National Bureau of Statistics. The producer price index (PPI) rose by 0.9%, up from 0.4% in the previous month.

Analysis

The acceleration in consumer price inflation was driven by surging pork prices, which rose by 14.4% year on year—a huge 9.3 percentage points higher than in March. The upward trend in China's pork cycle has been exacerbated by an [outbreak of African swine fever](#), which emerged last August and has since spread to all provinces. There is no cure for the disease, which has caused pig farms to scale back their herd sizes or simply leave the market. We expect the shortage in pork supply to peak in the third quarter, with this pressure carrying on into 2020.



Within services, inflation in the residence category decelerated amid a slowdown in rental housing prices. Inflation for transport fuel also decelerated significantly to a mere 0.2%, despite a build-up in global crude oil prices over the same month.

Factory-gate inflation ticked up in April, driven mainly by the acceleration of prices in mining and quarrying. The biggest price hike was in the mining of ferrous metal ores, at 10.6%, probably prompted by a revival in infrastructure construction. Inflation in prices related to the extraction of petroleum and natural gas also continued to accelerate, reaching 10.1%, reflecting efforts to boost domestic production in preparation to offset the drop in foreign supply (including the [re-imposition of sanctions on Iranian oil](#)). The recovery in the headline figure suggests marginal improvement in future industrial profits, which should ease pressure on corporate debt.

The inflation environment remains benign, but the rising pressure from pork prices will drive inflation above 3% year on year in the second half of 2019. Higher inflation, however, will constrain the central bank from further easing its monetary policy, with data suggesting that the effect of stimulus policies since mid-2018 may have already peaked.

Impact on the forecast

For 2019 we will revise up our forecast for average consumer price inflation to 2.9%, from 2.5% at present. Third-quarter inflation in 2019 is likely to breach 3%, and we will raise our 2020 forecast to 3%. We will also raise our forecast for average producer price inflation in 2020 from 0.5% to 0.7%.

US moves ahead with tariff increase on Chinese exports

May 10, 2019: External sector

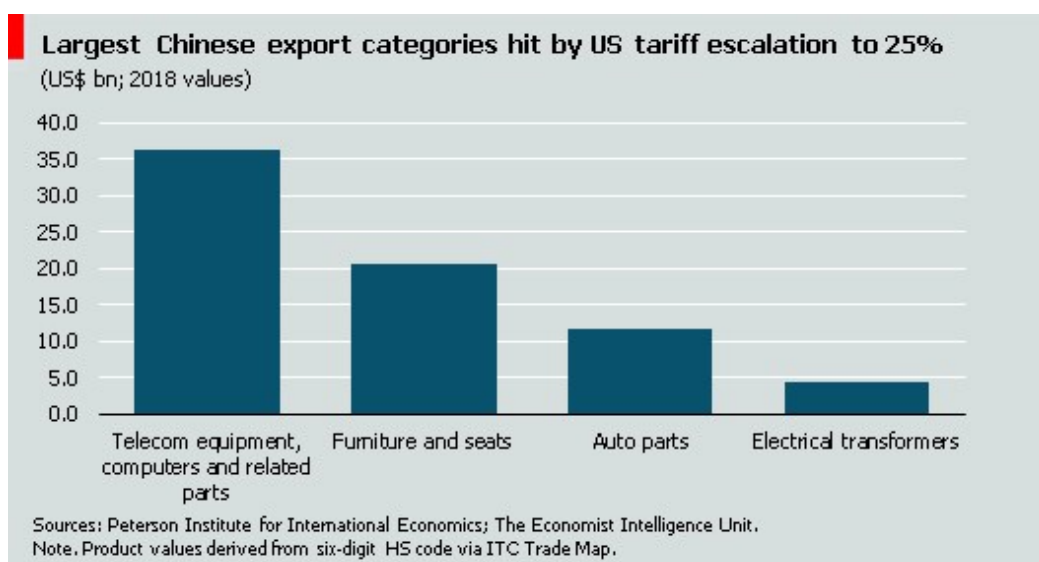
Event

On May 10th the US raised the tariff that it applies on around US\$200bn-worth of imported Chinese goods to 25%, from 10% previously. China pledged to take "necessary countermeasures".

Analysis

The tariff increase significantly escalated the US-China trade dispute and will necessitate changes to our economic forecasts. Although we were originally [sceptical](#) that a US-China trade deal could be reached, we recently took a [more positive view](#) following reports from bilateral negotiations and apparent steps by China to address the US's concerns about its economic policies. However, the decision to proceed with the tariff increase—as [threatened](#) on May 5th by the US president, Donald Trump—darkens the outlook again.

The tariff increase applies to Chinese goods targeted by the US Trade Representative's Section 301 report. Although Chinese exporters largely shrugged off the 10% rate increase initially [introduced](#) as a result of the report in September 2018, the latest rise will make them uncompetitive in the US market. This could add upward pressure on US inflation, with the main goods categories affected including telecommunications equipment, computer circuit boards and furniture. China has yet to specify its response, but we believe that at a minimum it will increase the punitive tariff rates that it applied on around US\$60bn of US goods last year. Chinese consumer boycotts and increased regulatory inspections on US firms are possible.



The tariff increase makes the agreement of a bilateral trade deal more challenging, but we plan to hold to this forecast at present. Positively, both sides remain committed to negotiations; a Chinese delegation visiting the US led by a vice-premier, Liu He, will hold a second day of talks on May 10th. The tariff rise will not apply to goods that left China before May 10th, in effect allowing many exports—namely those shipped by sea—a three-week grace period (although shipments by plane will be immediately affected). This gives a window of opportunity to resolve differences.

Nevertheless, the hardening political stances in the US and China have raised risks to our view. Moves to increase tariffs across all Chinese goods, as threatened by Mr Trump, will almost certainly lead to a breakdown in negotiations for now. Should this happen, we will amend our forecast accordingly.

Impact on the forecast

We will reassess our recently upgraded forecast that China's real GDP will grow by 6.4% in 2019. China will implement countervailing economic stimulus policies; however, growth will nevertheless be weaker than our current expectations.

Activity readings show that economy slowed in April

May 15, 2019: Economic growth

Event

On May 15th the National Bureau of Statistics released April data for industrial value-added output, retail sales of consumer goods and fixed-asset investment (FAI).

Analysis

As expected, economic data for April were softer than in [March](#), when seasonal factors tied to the variable timing of the Chinese New Year gave an unusual lift to economic activity. Although weak, the data print does not raise significant concerns about the [GDP outlook](#): in year-to-date terms, growth across the activity indicators was firmer than in late 2018. Nevertheless, the failure of policy loosening to stimulate investment—alongside renewed US-China trade tensions—points to a lengthier period of easing than originally assumed.

Industrial value-added growth decelerated to 5.4% year on year in April, from 8.5% in March. A slump in manufacturing dragged down the headline figure, with industries as varied as textiles, metal products and transport equipment reporting weaker growth in production. The slowdown was mainly tied to a front-loading of production in March, driven by a desire to maximise tax deductions before the manufacturing value-added tax rate was lowered in April. Industrial production growth is likely to be smoother over the remainder of the year.

Retail sales data were similarly concerning at first glance, with expansion slowing to 7.2% year on year in April, from 8.7% year on year in March. Sales of petroleum and petroleum-related products, communications equipment and clothing struggled. However, the data to some extent overstate the slowdown in the retail sector, with the comparison base having been skewed by additional working days falling in April this year. Elsewhere, the contraction in automotive sales narrowed, suggesting that price cuts are stabilising the sector. Sales of house-related products are also likely to recover, with property sales gathering steam.

The main concern was a weakening in FAI expansion to 6.1% year on year in January-April, from 6.3% in the first three months of 2019. This came despite efforts to raise the supply of credit, particularly to private firms, and lower taxes and fees. Instead, private-sector FAI growth slowed to 5.5% in January-April; this was 0.9 percentage points lower than in the first quarter. Only firmer FAI growth by state companies prevented a steeper drop in headline expansion.

Impact on the forecast

The data are consistent with our plans to lower our 2019 real GDP forecast from 6.4% currently, based on renewed US-China trade uncertainty. We are also likely to extend the period during which we assume stimulus will be applied.

House prices rise across the board in April

May 16, 2019: Economic growth

Event

In April new-home prices rose in 67 out of 70 surveyed cities in month-on-month terms, according to data released by the National Bureau of Statistics (NBS) on May 16th. This compares with 65 in [March](#) and 57 in February.

Analysis

Residential property remains one of the few bright spots in the economy. The recent price gains, along with the jump in sales, raise suspicions that liquidity resulting from the central bank's monetary easing over the past few months has seeped into the housing market.

Even so, the pace of price increases as reported by the NBS has been moderate. The report shows that the number of cities with month-on-month gains of 1% or more fell to 10, from 15 in March, and no cities reported increases of 2% or more. The beneficiaries appear to be the four first-tier cities of Beijing, Shanghai, Guangzhou and Shenzhen, where price increases leapt to 0.6%, from 0.2% in March. The 31 second-tier cities saw prices increase by 0.8%, from 0.6%, thanks to the [relaxation](#) of residential registration (*hukou*) policies initiated by the National Development and Reform Commission. By contrast, third-tier cities saw gains cool to 0.5%, from 0.7%, partly because of a less aggressive shantytown renovation budget plan announced in April by the Ministry of Finance. This has dampened related housing demand in lower-tier cities.

The government is alert to the potential for another housing bubble—in April, the Politburo Standing Committee reiterated its mantra that housing is "for living in, not speculation," and the housing ministry gave a warning about rising prices. Some cities have recently announced new restrictions in response; for example, Suzhou (in Jiangsu province) issued regulations covering the Suzhou Industrial Park and part of the Suzhou New District prohibiting new-home buyers from reselling their properties within three years. This was in order to cool prices.

Impact on the forecast

We now believe that the monetary easing period will be lengthier than previously expected. This will be owing to failed attempts thus far to stimulate investment, as well as to offset risks from renewed US-China trade tensions. Property price growth will therefore maintain its momentum for the rest of the year.

Authorities take over a struggling regional bank

May 27, 2019: Monetary policy outlook

Event

The People's Bank of China (PBC, the central bank) announced on May 24th that alongside the China Banking and Insurance Regulatory Commission, it had taken over temporary management of a local lender, Baoshang Bank, in the light of "serious credit risks".

Analysis

The takeover is the first in nearly two decades and highlights risks to the financial system from regional banks' fragile balance sheets. Baoshang is a joint-stock commercial bank founded in 1998 in Baotou (Inner Mongolia). Although it prospered during Inner Mongolia's coal-driven boom years, a slowing local economy and the central government's deleveraging drive led to a deterioration in asset quality and a drop in its capital-adequacy ratio to below regulatory requirements; the bank failed to produce annual reports for 2017 and 2018. It was also facing several imminent bond repayments.

The takeover is designed to stabilise the bank's operations, according to the PBC statement. The authorities have confirmed that the takeover will be effective for one year, and have provided a guarantee covering all principal and interest of personal deposits, as well as corporate deposits and interbank liabilities below Rmb50m (US\$7.4m; the handling of those above Rmb50m will be negotiable). Such commitments, alongside that to provide ongoing liquidity support, will ensure that Baoshang remains operational and deposits are not suddenly withdrawn. Markets responded tepidly to the news, judging by the stable interbank rates on May 27th.

Although the government's takeover is designed to project an image of stability, financial sector risks are quite elevated. The deleveraging campaign put great stress on the balance sheets of numerous regional banks, which often serve to fund local government investments. Should other smaller banks run into difficulties similar to those of Baoshang, liquidity in the banking system would become tighter as investors' concerns rise—many such banks are dependent on interbank loans rather than deposits—pointing to the prospect of broader economic disruption.

Such a scenario, however, remains outside our core forecast. Since mid-2018, the government has eased its deleveraging efforts and adopted a looser monetary policy stance. However, risks are broadening. The decision to enlist China Construction Bank to run Baoshang's merchant banking business during the takeover period highlights the exposure of China's larger state-owned lenders to problems across regional banks.

Impact on the forecast

The decision to take over Baoshang, rather than allow it to fail, suggests that the authorities remain attached to relatively loose policy settings. This is in line with our existing key forecasts.

Industrial profits slide in April

May 27, 2019: Economic growth

Event

Industrial enterprise profits fell by 3.4% year on year in January-April, deteriorating from a 3.3% contraction in January-March, according to data released on May 27th by the National Bureau of Statistics (NBS).

Analysis

Industrial profits fell by 3.7% year on year in April, erasing the [recovery in March](#), when profits rose by 13.9%. The readings were in line with other weak data from the same period. These indicate that broader economic fundamentals remain weak, and that the March data was likely owing to a positive seasonal blip following the Chinese New Year holiday.

Despite the poor headline figure, the overall picture of industrial profit performance was mixed in April. Upstream sectors, including oil extraction, saw major profit gains on the back of higher global oil prices over that same period. In addition, the drop in profits of steelmakers and chemical producers moderated from the previous three months, owing to a warming property market and a mild rebound in infrastructure investment. By contrast, manufacturing profits fell in March, particularly in the specialised equipment and machinery sectors. Telecommunications equipment manufacturing, which is vulnerable to the US-China [trade war](#), saw profits decline by 15.3% year on year—a worsening from the 7% contraction recorded over the first quarter. Profits from automotive manufacturing also fell, weighed down by a weak consumer market.

The value-added tax (VAT) cut, which became effective in April, may help to lift industrial profit growth later this year. It normally takes roughly half a year for changes in the tax code to feed into corporate performance, however, meaning that any tax-driven rebound is unlikely until the fourth quarter. In addition, the recent escalation in the US-China trade war may offset these gains, particularly if new tariffs are levied in the coming months (although this remains [outside our core forecast](#)). As a result, we expect the headline figure to remain under pressure in 2019.

Impact on the forecast

We already intend to reduce our forecast for real GDP growth in 2019, from 6.4% at present. The most recent data release supports that decision.

Manufacturing activity falls back into contraction

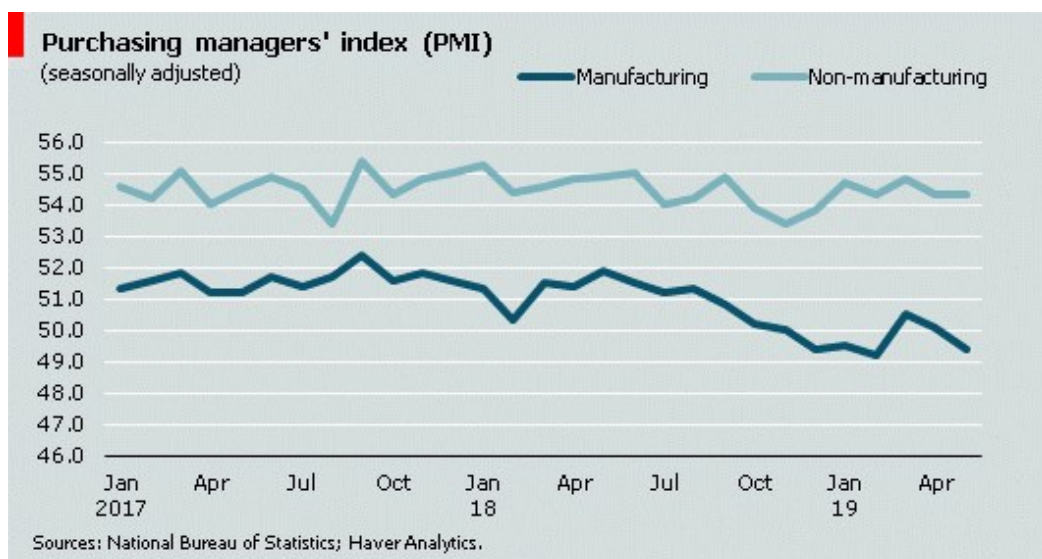
May 31, 2019: Economic growth

Event

The official manufacturing Purchasing Managers' Index (PMI) for May fell to 49.4, from 50.1 in [April](#), according to data released by the National Bureau of Statistics and the China Federation of Logistics and Purchasing on May 31st. A reading below 50 indicates a contraction in activity.

Analysis

The weak readings came in spite of central government efforts to bolster the economy, including through monetary policy loosening during the first quarter, which authorities had hoped would keep activity buoyant until later in 2019. After an anaemic recovery into positive territory in March and April, the manufacturing PMI dropped back below 50 in May, marking the third month of contraction since the start of 2019. The non-manufacturing PMI was unchanged in May, at 54.3.



The sub-index of new orders fell sharply to 49.8, from 51.4, dragged down by a further collapse in the gauge for new export orders, which fell to 46.5, from 49.2. The decline in new export orders marked the 12th consecutive month of contraction in this reading, with [export activity](#) likely to remain under pressure as the [most recent US tariffs](#) constrain trade performance over the next few months.

External-sector woes are not the only area of concern. The output sub-index showed the weakest reading for four months, falling to 51.7, from 52.1, while the gauge of employment sank to 47.0, the lowest level since February 2009. The new orders index fell back into contraction in May, while the contraction in the imports sub-index worsened, suggesting enduring challenges in kick-starting domestic demand. Furthermore, after recovering to a six-month high of 49.8 in April, the PMI reading for small companies sank to 47.8, reflecting the muted progress that government policies have had in supporting private enterprises amid the economic slowdown.

Impact on the forecast

The data are in line with the most recent revision to our real GDP growth forecast, to 6.3% in 2019 (from 6.4%, previously).

Analysis

Pork prices begin to surge in China

May 9, 2019

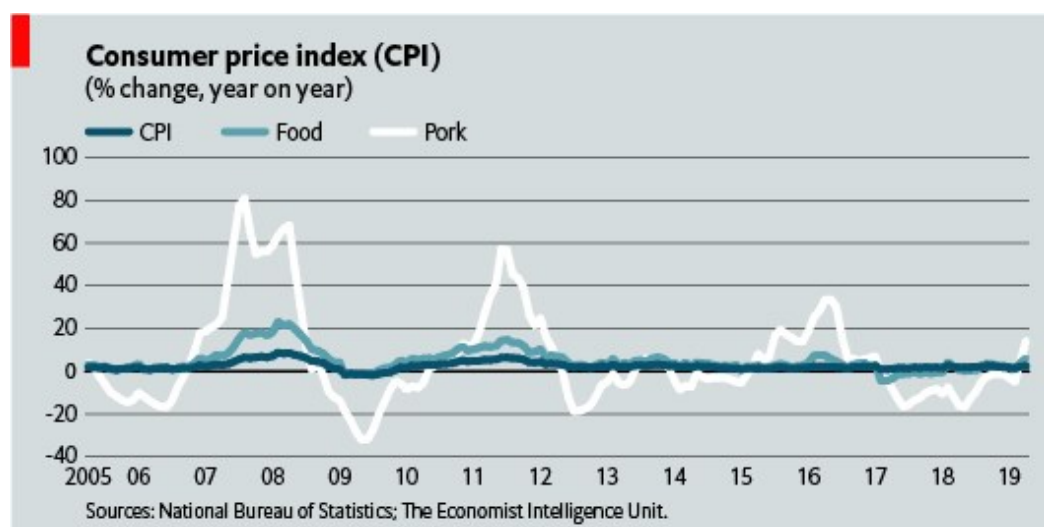
- An upswing in China's pork price cycle is being exacerbated by a nationwide outbreak of African swine fever (ASF). We now expect that consumer price inflation will average close to

3% in 2019 and 2020.

- Higher inflation will encourage the monetary policy authorities to step away this year from the easing cycle that they began in early 2018. This fits with our emerging view that stimulus policies have already peaked.
- ASF will have a broader impact across the agricultural sector, encouraging consolidation within the pork industry. The use of artificial intelligence and Big Data will increase, causing disruption but also driving efficiency.

In October 2018 we [wrote](#) about the likelihood that consumer price inflation would exceed market expectations this year. This has materialised as per our expectations, with expansion in the consumer price index (CPI) accelerating to 2.5% year on year in April. It rose by 1.7% in March and 1.5% in February.

As we noted last year, the main factor behind rising inflation is a rise in the price of pork. The staple meat is believed to be the single largest item in China's CPI basket, according to our estimates, accounting for 2.4%. A rough rule of thumb is therefore that a 10% increase in the price of pork will add 0.24 percentage points to the rate of headline consumer price inflation. Pork has experienced two price cycles since 2009, each lasting around four years. We are currently on the rising wave of the third cycle. After contracting for over two years, the price of pork started to rise in March and jumped by 14.4% in April.



African swine fever

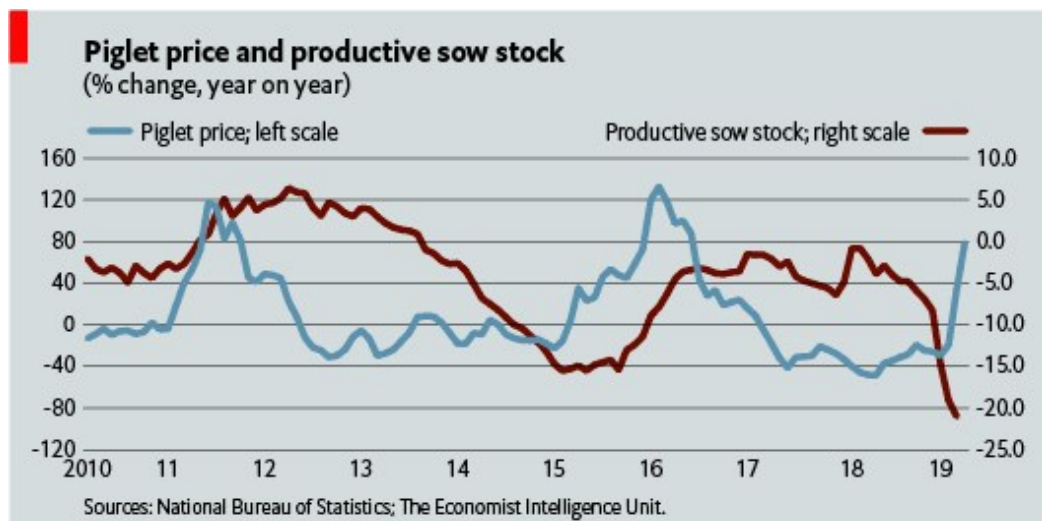
What we did not quite anticipate in our note last year was how the shift in the pork cycle would be exacerbated by [African swine fever](#) (ASF), in the most severe pandemic to hit the industry in the past 50 years. ASF was first found in China in Shenyang (the capital of Liaoning province, in the north-east) in August 2018; it had spread to all provinces by April 2019. The virus is deadly for pigs, although not harmful to humans. Looking at the experiences of European countries that have suffered bouts of ASF, an outbreak will typically reach its peak after one year, followed by a long battle to eradicate the virus that can take anywhere from a few years to several decades. So far there is no effective vaccination or cure.

To date, only around 1m pigs in China have been culled in response to ASF, according to official data. This represents a tiny fraction of total output: 693.8m pigs were slaughtered in 2018. Nevertheless, since the beginning of 2019 deaths and panic slaughters have caused steep declines in the pig population, with many smaller farms having exited the market. This is causing tightness in supply: large pork-producing provinces such as Heilongjiang, Henan, Jilin and Liaoning have seen a decline of more than 50% in production capacity.

Inflation risk

To assess what impact this could have on prices, two leading indicators are telling. The first is productive sow inventories, which plummeted in March 2019 by a record level of 21% year on year. This portends a tight supply of piglets from the third quarter of 2019, potentially lasting into 2021. The other indicator is the price of piglets, which rose by 33.8% in March and shot up by

79% in April.



Given these developments, there is a good chance that pork price inflation could exceed 80% year on year by the third quarter of this year. Inflationary pressures are likely to carry on into 2020-21, because farmers will be reluctant to expand production capacity until an ASF vaccination is available. Large pig farms are especially vulnerable, as even one infected piglet could wipe out the entire stock.

The impact of such a price shock on the CPI could be sizeable. Using the rule of thumb noted above, it would lift consumer price inflation by around 1.9 percentage points. However, there are factors that may cushion some of the shock. Demand for pork may soften, easing the tightness in supply, as concerns about ASF make consumers hesitant. The national pork reserve could also help to stabilise prices in some cities, albeit not across the country: the reserve accounts for less than 1% of annual consumption.

China will also increase pork imports to offset the domestic supply shortage. Brazil could be the biggest beneficiary, while the US could also profit, assuming that a US-China [trade deal](#) results in an agreement to remove tariffs that the two sides imposed in 2018 (China currently levies a 62% tariff on US pork imports). However, import volumes are not large enough to make a vast difference to domestic prices: China consumed half of the world's pork in 2018, of which only 2.4% was imported.

Impact on monetary policy

Given the situation, a jump in pork prices seems likely. Our current forecast is for the CPI to rise by an average of 2.5% in 2019 and 2.4% in 2020. However, this projection looks too conservative in light of recent developments, and so we plan to revise our forecast closer to 3% for both years.

What impact will this have on monetary policy? The People's Bank of China (PBC, the central bank) has a 3% target ceiling for consumer price inflation, so in theory it may feel compelled to intervene once rises in the CPI reach that level. In the past, the central bank has clarified that it will not respond to price changes in a "single product" (referring to pork). Given that the pork cycle is determined by changes in supply rather than demand, monetary policy is unlikely to be a useful tool in controlling runaway prices for the meat. Most studies suggest that the PBC is more sensitive to housing prices.

However, once inflation reaches around 3%, we believe—based on past experience—that it will encourage the PBC to step back from the looser credit stance it has adopted since early 2018. This fits with our broader belief that current stimulus policies have peaked, with policy set to shift to a neutral stance in the second half of 2019.

Industry developments

Besides inflation, ASF will have a broader impact across the pork industry. It is likely to hasten consolidation in the sector, as small farms bear the brunt of the disease and lack the means to respond. China had around 43m pig farms in 2016, according to the latest official data, only 0.6%

of which were large-scale facilities (producing more than 500 animals a year). The predominance of small farms has also been a factor behind price volatility, as they enter and exit the market frequently depending on the available price.

Consolidation is already under way. The Environmental Protection Law, which was implemented in 2015, instigated drastic consolidation in the industry; many small farms were demolished for not meeting emissions standards. China's agriculture ministry estimates that large-scale farms now account for around 50% of total pork output, up from 38% in 2010.

Elsewhere, artificial intelligence and Big Data applications are likely to be used more widely in the pork industry. Facial recognition may be useful to help to detect early symptoms of ASF, although it may take a few years to reach commercial use. Meanwhile, China's internet giants, led by NetEase and Alibaba, have the potential to disrupt the pig-rearing industry by using Big Data to track inventories, prices, feed and diseases with a much higher degree of efficiency.

EIU global forecast - Waiting for an elusive US-China deal

May 14, 2019

The Economist Intelligence Unit has long been forecasting a slowdown in global growth in 2019-20. However, recent data suggest that the world's three major economies proved surprisingly resilient in the first quarter of 2019. In the US, real GDP growth stood at a solid 3.2% year on year, a robust headline for an economy operating at near-full employment. In the euro zone, output expanded by 0.4% quarter on quarter over the same period, the strongest quarterly expansion in a year. The single currency area posts record-low unemployment rates, and the latest high-frequency data paint a positive picture in the services and construction sectors, offsetting softer manufacturing data. In China, a revival in the industrial sector stabilised economic growth, defying our expectations that the slowdown in economic growth that began in the third quarter of 2018 would extend further. Coupled with the roll-out of fifth-generation (5G) technology in a number of Asian countries this year, the recent solid Chinese performance will support global trade in the second half of 2019.

Detailed analysis of US growth data paints a contrasting picture

These rosier data will offer some respite to central bankers across developed economies who were previously weighing up whether a cautious "wait and see" approach was still appropriate, or whether it was time to brace for impact and prepare for more stimulus.

However, a more detailed analysis of the latest growth figures across developed markets does not alter our view that 2019-20 will be marked by a global slowdown. In the US the two main contributors to growth in the first quarter were external trade (owing to a sharp deceleration in import growth) and a surge in inventories. This is cause for serious concern. High inventories will later become a drag on growth; a slowdown in import growth hints at slowing consumer demand, in line with other high-frequency indicators.

Global trade is slowing sharply

The deceleration in US trade activity mirrors other data that all point to slowing global trade. The South Korean KOSPI-100 equity index, which is mainly made up of export-oriented companies, has been falling since mid-April; cargo volumes at Hong Kong's international airport contracted by 5% year on year in the first quarter; and the number of containers landing at the US port of Long Beach (one of the main trade hubs between the US and Asia) was down by 7% in January-March on an annual basis.

The slowdown in global trade reflects the slowdown in the Chinese economy, as well as uncertainty concerning trade policy. Against this backdrop, recent belligerent declarations by Donald Trump, the US president, cast doubts over the possibility of a US-China trade deal being concluded by late May or early June. Should a trade deal not be agreed (not our core scenario), investor sentiment would drop sharply and global growth prospects deteriorate. The latest trade data from China represent a stark warning: in April Chinese goods exports contracted by 2.7% year on year (in US-dollar terms), compared with a 13.8% increase in March.

The Brexit saga remains unsolved

Recent developments at the regional level also add cause for concern and hint at a deterioration in economic, political, and geopolitical stability. In Europe, almost three years after the Brexit referendum, this issue remains far from resolved. The range of potential outcomes varies from "no deal" to "no Brexit", compounding uncertainty, weighing on sentiment and depressing investment. The latest developments on the Brexit front include negotiations between the ruling Conservative Party and the left-wing opposition Labour Party. Given that the respective red lines of these parties are essentially incompatible, there is little chance that these negotiations will prove conclusive.

The EU has granted the UK an extension of the Brexit deadline to October 31st (from March 29th initially). It is far from guaranteed that the bloc will be willing to extend this timeline again should the UK parliament fail to ratify the Brexit deal by then. This would raise the risk of a no-deal scenario that would provoke catastrophic damage to the British economy.

Rerun of Istanbul mayoral election weighs on the lira

Also in Europe, the decision of Turkey's High Electoral Commission to bow to pressure from Recep Tayyip Erdogan, the Turkish president, to organise a rerun of the Istanbul mayoral election sent jitters through financial markets. Mr Erdogan's ruling Justice and Development Party (AKP) proceeded to lose this election in nationwide local polls at the end of March, causing another plunge in the lira against the US dollar.

This will remind financial markets that Turkey has not yet recovered from the severe currency crisis that it experienced less than a year ago. This will renew capital flight to perceived safe havens, fuelling volatility in emerging-market currencies across the globe. Even if it has been small up to now, the risk of contagion to other emerging-market currencies such as the Indian rupee, the South African rand and the Argentinian peso cannot be discounted. In fact, we believe that a full-blown emerging-markets crisis is the third-largest risk to global growth in 2019-20.

Argentina and Venezuela remain hotspots of volatility in Latin America

The risk of contagion to emerging-market currencies has been compounded by increased political uncertainty in Latin America in recent weeks. In Argentina the peso lost about 10% of its value against the US dollar between mid-April and early May as investors started to price in the risk of a victory by the left-wing populist, Cristina Fernández de Kirchner, in the presidential race in October. We continue to believe that the incumbent president, Mauricio Macri, will be re-elected. However, fears of a Fernández presidency will continue to weigh on the peso in the coming months, fuelling inflation and depressing consumption and sentiment.

Despite peaking at almost 55% in March, annual inflation in Argentina remains far from the levels seen in Venezuela: in the same month Venezuela's annualised consumer price inflation stood at more than 1,000,000%. To stabilise prices will be one of the main challenges that Juan Guaidó, the interim president of Venezuela, will face when he comes to power in the second half of the year, as we currently forecast. However, we also continue to acknowledge strong risks to this outlook: Nicolás Maduro, the leader of the incumbent regime, has managed to survive what he claimed was an attempted coup orchestrated by Mr Guaidó on April 30th, and has so far clung on to military support surprisingly well.

Iran sanctions will continue to fuel US-EU tensions

In the Middle East, Iran remains a hotspot of geopolitical volatility. On May 2nd the US administration let sanctions waivers expire for the eight countries that continued to import Iranian oil, in an attempt to deprive the Iranian regime of its main source of revenue. Shortly afterwards Iran announced that it would cease complying with some provisions of the nuclear deal, throwing the deal's future into doubt and raising tensions between the US (which has withdrawn from the deal) and the EU (which is trying to salvage it).

So far, this turn of events has not led to a surge in global oil prices, as an increase in tensions between the US and Iran had largely been priced in by global commodities markets. However, the

risk of a potential miscalculation by the US or Iran in the Middle East has risen sharply. This, together with trade disputes, has heightened political volatility in emerging markets, and the growing tensions between the US and the EU will continue to weigh on the global economic outlook in the coming months.

World economy: Forecast summary											
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Real GDP growth (%)											
World (PPP^a exchange rates)	3.5	3.4	3.3	3.7	3.5	3.2	3.4	3.5	3.6	3.5	
World (market exchange rates)	2.8	2.8	2.5	3.1	2.9	2.6	2.6	2.8	2.9	2.8	
US	2.5	2.9	1.6	2.2	2.9	2.2	1.7	1.8	2.0	1.7	
Euro area	1.4	2.0	1.9	2.5	1.9	1.3	1.5	1.7	1.7	1.7	
Europe	1.9	1.9	1.9	2.7	2.1	1.3	1.8	1.9	1.9	1.8	
China	7.3	6.9	6.7	6.8	6.6	6.4	6.1	5.6	5.2	5.0	
Asia and Australasia	4.4	4.5	4.5	4.9	4.5	4.5	4.2	4.3	4.2	4.1	
Latin America	1.0	-0.3	-1.2	0.8	0.7	0.5	1.6	2.6	2.6	2.9	
Middle East & Africa	2.8	2.3	4.7	1.5	1.3	1.8	2.4	3.0	3.2	3.2	
Sub-Saharan Africa	4.6	2.7	0.7	2.4	2.4	2.4	0.9	3.8	4.1	4.3	
World inflation (%; av)^b	3.4	3.0	3.1	3.2	3.5	3.7	3.1	3.2	3.2	3.0	
World trade growth (%)	2.9	2.0	2.1	5.4	4.4	3.3	2.9	3.9	4.0	4.1	
Commodities											
Oil (US\$/barrel; Brent)	98.9	52.4	44.0	54.4	71.1	66.5	60.5	69.8	75.6	75.0	
Industrial raw materials (US\$; % change)	-5.1	-15.2	-2.2	20.2	2.2	-2.8	1.9	1.6	3.4	0.6	
Food, feedstuffs & beverages (US\$; % change)	-5.3	-18.4	-3.5	-1.0	1.6	-5.8	4.8	4.1	0.9	0.8	
Exchange rates (av)											
¥:US\$	105.9	121.0	108.8	112.1	110.4	110.0	108.7	104.9	100.5	96.1	
US\$:€	1.3	1.1	1.1	1.1	1.2	1.1	1.2	1.2	1.2	1.2	

^a Purchasing power parity. ^b Excludes Venezuela.

Source: The Economist Intelligence Unit.

US expands its currency manipulator watchlist

May 31, 2019

On May 28th the US Treasury released a new edition of its twice-yearly report analysing the exchange-rate practices of key trading partners of the US. No countries were listed as currency manipulators, but nine were described as having exchange-rate policies that required close attention. The report provides a useful tool for the US to pressure other countries not to hold down the value of their currencies against the US dollar.

The Treasury's report poses risks for major trading partners of the US. Any found to be manipulating its currency's exchange rate to boost export competitiveness would be likely to face a retaliatory US response. The US legislation that mandates the report demands only that the US government initiate negotiations to resolve the matter. However, a stronger US response would be likely in the current environment, in which the administration of the US president, Donald Trump, has made reducing his country's goods trade deficit a policy priority. Indeed, on May 23rd the US Department of Commerce proposed a rule change that would allow the US to impose countervailing duties on countries that subsidise their exports by weakening the value of their currencies against the US dollar.

Of the 21 countries defined by the report as key US trading partners (with total bilateral trade exceeding US\$40bn), nine were placed on a special monitoring list. Included on this list were countries that met at least two of the Treasury's three red-flag indicators: a merchandise trade surplus with the US of US\$20bn or more; a current-account surplus of at least 2% of GDP; and persistent net purchases of foreign exchange over six months within a 12-month period, when net purchases over the 12-month period amount to 2% or more of GDP.

Widening the net

The nine countries on the list in the latest report are: China, Japan, South Korea, Vietnam, Germany, Italy, Ireland, Singapore and Malaysia. Of these, Vietnam, Italy, Ireland, Singapore and Malaysia are new additions, largely reflecting the broadening of the category used to define "major trading partners" of the US. (Previously, only the top 12 US trade partners were covered.) All of the countries listed met two of the three criteria, with the exception of China and South Korea, which each met only one but were included as special cases. India and Switzerland, which had been included on the list published in the previous report, in October 2018, were removed from it in this edition.

Among the countries listed, Singapore, which consistently runs a goods trade deficit with the US, is unlikely to fall into the currency manipulator category. It is also unlikely that the EU members would qualify as manipulators, on the basis that the European Central Bank has not intervened unilaterally in currency markets since 2001. Japan, similarly, has not intervened since 2011. In the absence of a significant shift in its exchange-rate policy—which is not our core forecast—Japan will not meet the US Treasury's criteria for currency manipulation in the next few years. However, we believe that this will not stop the US from forcing Japan to add a clause on currency manipulation in the trade deal that is likely to emerge from their [ongoing bilateral negotiations](#).

Malaysia and Vietnam, which have large trade surpluses with US and intervene heavily in exchange-rate markets, are more at risk of being labelled as currency manipulators. Vietnam, in particular, came close to meeting all three of the Treasury's criteria, falling short only because net foreign-exchange purchases came in below 2% of GDP in 2018 (at 1.7%, according to Vietnamese government reports to the US Treasury). Nevertheless, the Treasury noted that in both countries intervention was not persistently one-way, with governments intervening to resist depreciation as well as appreciation.

South Korea's position, too, could be vulnerable. Although the Treasury noted that it could be removed from the list next time, as it met only one of the watchlist criteria (a large current-account surplus), the South Korean government does intervene in foreign-exchange markets. Moreover, its goods trade surplus with the US remains sizeable, at US\$18bn in 2018, according to the Treasury. South Korea could risk US action if its trade surplus with the US were to rise and if it were to step up its intervention in foreign-exchange markets.

China remains difficult to classify as a currency manipulator under the Treasury's criteria. This is frustrating for Mr Trump, who once promised to label China as such within the first 100 days of his presidency. The Trump administration is [conducting a trade war on multiple other fronts](#) with China to reduce the size of its merchandise trade surplus with the US. However, tariffs and other sanctions imposed by the US have led the renminbi's exchange rate to weaken against the US dollar, by 3.8% between July 6th 2018 and May 28th 2019, reducing the impact of US trade measures. The Chinese government remains very opaque about its foreign-exchange interventions, but the Treasury has indicated that it believes that its recent actions have been limited in scope.

A valuable role

As reducing China's surplus in bilateral goods trade with the US is key to reducing the overall surplus, there remains a risk that the US government could shift the criteria for defining currency manipulation in such a way as to deliberately cover China. However, our core forecast is that the US government will rely instead on the other tools that it has available to achieve this goal. The monitoring list has nevertheless been successful in prompting greater transparency in other countries about their official intervention in the foreign-exchange markets. South Korea began making such data public in March, and Singapore has committed to do so from 2020.

The list's other major effect is that it is likely to serve as a cap on governments' capacities to intervene to hold down the value of their currencies. As foreign-exchange accumulation over a six-month period begins to approach 2% of GDP, governments will become more wary of trying to hold down their currencies against the US dollar, presenting upside risks for appreciation. This effect will be worth monitoring in exchange-rate markets, particularly for the dong, the ringgit and (to a lesser extent) the won.

The Treasury's report has come in for much criticism over the somewhat arbitrary definitions that it uses. It is certainly true that the focus on merchandise trade seems outdated, and its concentration on trade ties with the US is limiting. Nevertheless, it represents a rare and admirable attempt to address the distortions caused to the global economy by countries that run persistent large current-account surpluses and deliberately suppress their currencies' exchange rates. By increasing the potential costs of pursuing such policies, the report's beneficial effects are likely to extend well beyond the US.

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U.S.-China Trade Issues

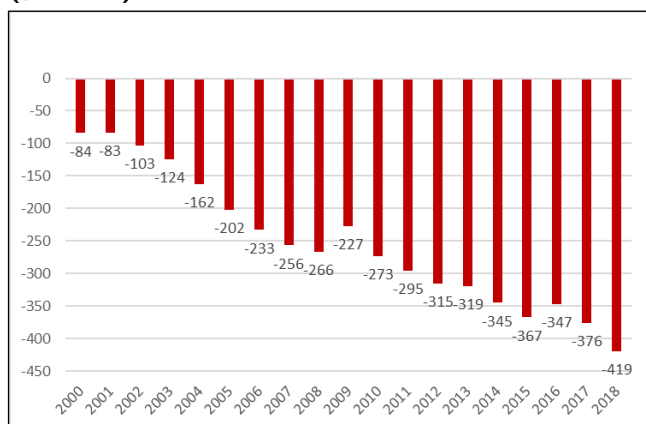
Background

The U.S.-China trade and economic relationship has expanded significantly over the past three decades. In 2018, China was the United States' largest U.S. merchandise trading partner (total trade at \$660 billion), third-largest export market (\$120 billion), and largest source of imports (\$540 billion). China is also the largest foreign holder of U.S. Treasury securities (at \$1.1 trillion year-end 2018). However, tensions have grown sharply in recent years over a number of economic and trade issues.

Key U.S. Issues

The Trade Deficit. President Trump has complained about the U.S. bilateral trade imbalances. The U.S. merchandise trade deficit with China in 2018 was \$419 billion (up from \$376 billion in 2017), and is by far the largest U.S. bilateral trade imbalance. Some U.S. policymakers view large U.S. bilateral trade deficits as an indicator of an “unfair” trade relationship. Others, however, view conventional bilateral trade deficit data as misleading, given the growth of global supply chains used by multinational firms. Products may be invented or developed in one country and manufactured or assembled elsewhere using imported components from multiple foreign sources and then exported. Conventional U.S. trade data may not fully reflect the value added in each country, and thus are often a relatively poor indicator of the beneficiaries of its global trade. Also, most economists argue that the overall size of the trade balance is what really matters to the economy (not bilateral balances), and that this is largely a function of macroeconomic forces, such as low U.S. domestic savings relative to total investment, not trade barriers.

Figure 1. U.S.-China Merchandise Trade Balances (\$ billions)



Source: USITC Dataweb.

Intellectual Property Rights (IPR) and Cyber-Theft.

U.S. firms cite the lack of effective protection of IPR as one of the biggest impediments that they face in conducting business in China. A May 2013 study by the Commission on the Theft of American Intellectual Property estimated that China accounted for up to 80% (or \$240 billion) of

U.S. annual economic losses from global IPR theft. The U.S. Customs and Border Protection reported that China and Hong Kong together accounted for 78% of counterfeit goods it seized in FY2017.

In 2011, the U.S. Office of the National Counterintelligence Executive described Chinese actors as “the world’s most active and persistent perpetrators of economic espionage” and as aggressive collectors of sensitive U.S. business information and technologies. In May 2014, the U.S. Justice Department indicted five members of the Chinese People’s Liberation Army for government-sponsored cyber-espionage against U.S. companies and theft of proprietary information to aid state-owned enterprises. During Chinese President Xi Jinping’s state visit to the United States in September 2015, the two sides reached an agreement on cyber security, pledging that neither country’s government would conduct or knowingly support cyber-enabled theft of intellectual property for commercial purposes and to establish a joint dialogue on cybercrime and related issues. In October 2018, CrowdStrike, a U.S. cybersecurity technology company, identified China as “the most prolific nation-state threat actor during the first half of 2018.” It found that Chinese entities had made targeted intrusion attempts against multiple sectors of the economy. In November 2018, FBI Director Christopher Wray stated: “No country presents a broader, more severe threat to our ideas, our innovation, and our economic security than China.” In December 2018, U.S. Assistant Attorney General John C. Demers stated at a Senate hearing that from 2011-2018, China was linked to more than 90% of the Justice Department’s cases involving economic espionage and two-thirds of its trade secrets cases.

Industrial Policies. Many U.S.-China trade tensions arise from China’s incomplete transition to a market economy, including the use of industrial policies to support and protect domestic firms, especially state-owned enterprises (SOEs). Major Chinese government practices of concern to U.S. stakeholders include subsidies, tax breaks, and low-cost loans given to Chinese firms; foreign trade and investment barriers; discriminatory intellectual property (IP) and technology policies; and technology transfer mandates. Several recently issued economic plans, such as the “Made in China 2025” plan, appear to indicate a sharply expanded government role in the economy. The Trump Administration has characterized such policies as “economic aggression.” Some officials have expressed concerns that participation by Chinese firms in certain global supply chains, such as for information and communications technology products and services, could pose risks to U.S. IP and national security interests.

Foreign Direct Investment (FDI). U.S.-China FDI flows are relatively small given the high level of bilateral trade, although estimates of such flows differ. The U.S. Bureau of Economic Analysis (BEA) is the official U.S. agency that collects and reports FDI data. BEA estimates the stock of

Chinese FDI in the United States through 2017 at \$40 billion and the stock of U.S. FDI in China at \$108 billion. Some analysts contend BEA’s methodology for measuring FDI significantly undercounts the level of actual U.S.-China FDI, in large part because it does not capture all FDI that is made through other countries, territories or tax havens, as well as acquisitions made by U.S. affiliates of foreign firms. The Rhodium Group (RG), a private advisory firm attempts to identify FDI by Chinese firms in the United States, regardless of where they are based or where the money for investment comes from. RG’s data on U.S.-China FDI are much higher than BEA’s data. For example, RG estimates the stock of China’s FDI in the United States through 2017 at \$140 billion and the stock of U.S. FDI in China at \$256 billion. RG estimates that China’s FDI flows to the United States rose from \$14.9 billion in 2015 to \$45.6 billion in 2016, but fell to \$29.4 billion in 2017 and to \$4.8 billion in 2018. The decline in Chinese FDI flows to the United States may reflect Beijing’s efforts rein in “irrational” capital outflows, as well as enhanced scrutiny by the Trump Administration, which contends that the Chinese government seeks to obtain U.S. cutting-edge technologies and IP in order to further its industrial policy goals. For example, in September 2017, President Trump prohibited a group of investors, with alleged links to the Chinese government, from acquiring U.S. firm Lattice Semiconductor Corporation.

Congressional concerns over the ability of the Committee on Foreign Investment in the United States (CFIUS) to adequately screen foreign investment in terms of U.S. national security led to the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) (P.L. 115-232) in August 2018. The act seeks to modernize CFIUS and expand the types of investment subject to review, including certain non-controlling investments in “critical technology.” In November 2018 the U.S. Commerce Department issued a notice requesting public comment on criteria for identifying emerging and foundational technologies deemed essential to U.S. national security that could be subject to new export controls.

Tariffs on Steel and Aluminum. On March 8, 2018, President Trump issued a proclamation increasing U.S. import tariffs on steel (by 25%) and aluminum (by 10%), based on “national security” justifications (§232 of the 1962 Trade Act). In response, China on April 2 raised tariffs by 15% to 25% on \$3 billion worth of imported U.S. products.

Section 301 Case on China’s IPR Policies. On August 14, 2017, President Trump issued a memorandum directing the USTR to determine if China’s policies on IPR protection and forced technology requirements “may be harming American intellectual property rights, innovation, or technology development,” and thus warranted a Section 301 investigation. On August 18th, the USTR launched a Section 301 investigation, and on March 22, President Trump signed a *Memorandum on Actions by the United States Related to the Section 301 Investigation*. It listed four IPR-related policies that justified U.S. action, including China’s forced technology transfer requirements, cyber-theft of U.S. trade secrets, discriminatory licensing requirements, and attempts to acquire U.S. technology to advance its industrial policies. The United States said it would propose to boost tariffs by 25% on about \$50 billion worth of Chinese goods, initiate a WTO dispute settlement case against China’s

discriminatory licensing policies (which it did on March 23) and impose new restrictions on certain Chinese investment in the United States.

On May 19, 2018, the United States and China released a joint statement announcing that that progress was made on a number of trade issues, including a Chinese commitment to “significantly increase purchases of United States goods and services,” including U.S. agricultural and energy products. On May 21, U.S. Secretary of the Treasury Steven Mnuchin stated that both sides had suspended threatened tariff hikes. However, on May 29, the United States said it would implement the proposed Section 301 tariff hikes against China. It subsequently imposed three rounds of tariff increases on a total of \$250 billion worth imports from China, while China retaliated with tariff hikes on \$110 billion worth of U.S. products (see **Table 1**). President Trump has warned that he may increase tariffs on an additional \$267 billion worth of imports from China.

Table 1. Section 301-Related Tariff Hikes

Effective Date	Tariff Hike	Import Value	China’s Reaction
July 6	25%	\$34 billion	Full retaliation
August 23	25%	\$16 billion	Full retaliation
September 24	10% (further rate hikes put on hold)	\$200 billion	5%-10% tariff hikes on \$60 billion worth of imports

Source: USTR and Chinese Ministry of Commerce.

On December 1, 2018, President’s Trump and Xi met at the G20 Summit in Argentina where the two sides announced they would hold intensive negotiations over 90 days. President Trump agreed to suspend the planned Stage 3 Section 301 tariff rate increases (from 10% to 25%) that were planned to take effect on January 1, 2019, but stated that the increases would go into effect if no agreement was reached by March 1, 2019. On February 24, he announced that tariff hikes would be suspended because of progress in recent trade talks. U.S. officials have indicated that the talks are focused on structural changes to China’s economy, including on IP and innovation policies, market barriers, and currency. The talks also focused on reducing the bilateral trade imbalance, including obtaining a Chinese commitment to purchase a “substantial amount” of agricultural, energy, manufactured goods from the United States. The U.S. side has indicated that it also wants a final agreement to include an enforcement mechanism.

Long Term Challenges. China’s emergence as a major economic power poses number of challenges for the United States. These include China’s efforts to become more technologically advanced in a number of dual-use industries (including through state intervention and IPR theft), attempts to use its financial resources to advance its interests globally (such as through the Belt and Road initiative) and promote its soft power, and attempts to present China’s economic model of authoritarian capitalism as an alternative to the U.S. economic model.

Wayne M. Morrison, Specialist in Asian Trade and Finance

U.S.-Taiwan Trade Relations

Overview

With a population of 23.6 million people, Taiwan has evolved to become a highly developed, dynamic, and globally competitive economy. In 2018, Taiwan's gross domestic product (GDP) on a purchasing power parity (PPP) basis was \$1.25 trillion, making it the world's 22nd-largest economy. Its per capita GDP on a PPP basis (a common measurement of living standards) was 19% greater than Japan's and about 85% of the U.S. level. In 2018, Taiwan was the world's 21st-largest trading economy for goods and services. The World Economic Forum ranked Taiwan as the world's 13th-most competitive economy in 2018, and the World Bank ranked Taiwan the 15th-best economy in terms of the ease of doing business. Taiwan is a major global producer of information and communications technology (ICT) products and semiconductors.

Taiwan's Economic Challenges

Taiwan's economy is very dependent on international trade. Taiwan's exports of goods and services in 2018 totaled \$393 billion (equivalent to 67% of its nominal GDP), and were up 5.4% over 2017 levels. Taiwan's real GDP growth averaged 2.9% from 2009 to 2018, and the International Monetary Fund projects that rate will average 2.1% over the next five years. Taiwan faces a number of economic challenges, including declining competitiveness for many industries, inability to participate in various regional trade agreements, stagnant wages, and a lack of job opportunities for some college graduates. A 2018 survey by the Importers and Exporters Association of Taipei assessed Taiwan to have the 17th-most competitive trading economy out of 54 major countries surveyed, which was down from 9th in its 2011 survey. While unemployment is low at 3.6% (January 2019), the rate for those aged 20-24 is 11.7%. The Taiwanese government estimates that in 2016, 728,000 Taiwanese citizens were employed overseas, of which 407,000 (56%) worked in China. The Taiwanese government has raised concerns over China's attempts to expand incentives for Taiwanese people to move to China for work, investment, and study.

Many in Taiwan, especially those in the Democratic Progressive Party (DPP), view the slowing Taiwanese economy as a consequence of Taiwan becoming overly reliant on China for economic growth (In 2018, 41% of Taiwan's merchandise exports went to mainland China and Hong Kong), and because closer cross-strait economic ties have led to the relocation of many Taiwanese industries to mainland China, which, many argue, may have contributed to lost jobs and stagnant wages in Taiwan. Others in Taiwan, especially those in the Kuomintang (KMT), contend that closer economic ties with China have benefited Taiwan's economy and argue that boosting those ties further, such as through the implementation of new trade agreements, will put Taiwan in a good position to take

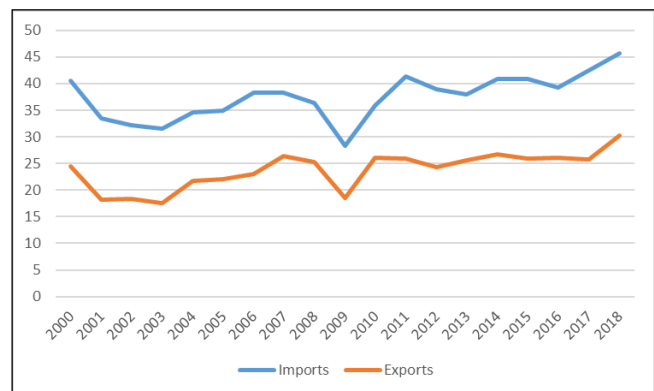
advantage of opportunities that might arise as China pursues new economic reforms and seeks to promote private consumption as the main driver of its economy.

Economic issues were a major focus of the January 2016 election in Taiwan, which resulted in a major victory for the DPP and its presidential candidate, Dr. Tsai Ing-wen. She proposed a "New Model for Economic Development" focused mainly on innovation, job creation, and addressing widening income gaps, such as by boosting social safety net policies. In an effort to lessen Taiwan's reliance on China's economy, Tsai has called for closer economic cooperation with the United States and has said that "there is an urgent need" for Taiwan to participate in the proposed Trans-Pacific Partnership (TPP), although the U.S. withdrawal from the TPP in January 2017 complicated this strategy.

U.S.-Taiwan Trade Relations

U.S. trade data show that in 2018, Taiwan was the United States' 11th-largest merchandise trading partner (at \$76 billion), 15th-largest export market (\$30 billion), and the 13th-largest source of imports (\$46 billion). From 2000 to 2018, U.S. exports to Taiwan grew by 24%, while imports grew by 13%. In comparison, U.S. global exports and imports rose by 113% and 109%, respectively.

Figure 1. U.S.-Taiwan Merchandise Trade: 2000-2018
\$ in billions



Source: U.S. International Trade Commission (USITC).

U.S. data on trade with Taiwan may understate the importance of Taiwan to the U.S. economy because of the role of global supply chains. For example, many of the consumer electronic products developed by Apple Inc. (such as iPads and iPhones) are assembled in China by Taiwanese-owned firms. Taiwan has moved a significant level of its labor-intensive manufacturing overseas, especially to China. This is reflected in Taiwan's data on export orders received by its firms from abroad. That data indicate that the percentage of export orders produced abroad rose from 13% in 2000 to 52% in 2018; and for ICT products, this figure rose from 25% to 94%.

Taiwan government data indicate that its manufacturing firms received export orders from the United States worth \$146 billion in 2018, which was more than three times larger than official U.S. data on its imports from Taiwan in 2018. From 2000 to 2018, U.S. orders to Taiwanese firms increased by 199%. The United States is the largest source of Taiwan's export orders, accounting for 29% of the total in 2018 (China and Hong Kong together accounted for 25%). This indicates that U.S.-Taiwan commercial ties are significantly greater (and more complex) than are reflected in standard bilateral trade data. Cumulative U.S. FDI flows to and from Taiwan through 2017 (on a historical-cost basis) totaled \$17 billion and \$22.4 billion, respectively.

Figure 2. Comparison of U.S. Export Orders Placed with Taiwanese Firms and U.S. Data on Merchandise Imports from Taiwan: 2000-2018 (\$billions)



Source: Taiwan export order data are from the Taiwan Ministry of Economic Affairs. Data on U.S. imports are from the USITC.

Taiwan's Dilemma on Trade

Taiwan's economy is heavily dependent on trade. Yet, its share of global merchandise exports fell from a peak of 2.5% in 1993 to 1.6% in 2018. Taiwanese officials attribute this trend in part to the proliferation of bilateral and regional free trade agreements (FTAs), especially among other major Asia-Pacific economies. Taiwan is currently not a party to these FTAs, in large part, it is believed, because China often pressures other countries to avoid signing trade deals with Taiwan. Taiwanese officials have expressed concern that its exclusion from FTAs could hurt the long-term competitiveness of many Taiwanese industries, which could reduce trade flows and diminish economic growth. To illustrate, countries with FTAs often reduce most or all of their tariff levels to zero. If Taiwan is not an FTA member, its products will be assessed the non-FTA (and thus higher) tariffs.

Taiwan has sought to boost commercial ties with China in order to help its firms take advantage of the opportunities arising from China's large and rapidly growing economy and to help reduce political tensions with China (including the hope that by expanding economic ties, China will lessen its opposition to Taiwan's attempts to negotiate FTAs). After coming into office in 2008, Taiwanese President Ma Ying-jeou sought to expand cross-strait commercial ties by lifting restrictions on direct trade, transportation, and postal links. He further proposed an Economic Cooperation Framework Agreement (ECFA) with China, described as a plan to significantly liberalize trade and investment barriers

over time. ECFA negotiations began in January 2010 and concluded in June 2010. The ECFA identified four main agreements that would be negotiated: trade in goods, trade in services, investment, and dispute settlement.

Following the signing of the ECFA, press reports indicated that China appeared to be less opposed to Taiwan seeking trade agreements with other countries, which Taiwan often refers to as "economic cooperation agreements." Taiwan concluded such agreements with New Zealand and Singapore in 2013. China-Taiwan trade relations soured in the spring of 2014 when consideration of a cross-strait Trade in Services Agreement (TiSA) by Taiwan's Legislative Yuan led to widespread protests (the "Sunflower Movement") and forced the government to suspend a vote on TiSA. Since then, cross-strait initiatives to boost commercial ties appear to have been put on hold.

The DPP has sought to maintain stable economic relations with China, but has not indicated whether it plans to reconsider the TISA agreement or pursue a new goods agreement under ECFA. President Tsai has not explicitly reaffirmed Taiwan's acceptance of the "1992 consensus" (where the two sides essentially agreed that there was one China but two interpretations), and this appears to have angered Chinese authorities enough so that they may have imposed restrictions on mainland tourists visiting Taiwan (arrivals from the mainland fell from 4.2 million in 2015 to 2.7 million in 2018, a 36% drop).

Recent U.S. Trade Action and Taiwan

The Trump Administration has pursued a number of trade policies that could hurt Taiwan's economy. In March 2018, President Trump imposed increased tariffs on U.S. imports of steel (by 25%) and aluminum (10%) under Section 232. In August 2017, the Trump Administration initiated a Section 301 investigation of China's policies on intellectual property, forced technology transfer, and innovation that may harm the U.S. economy, and it has subsequently increased tariffs on \$250 billion worth of products from China. China has raised tariffs on \$110 billion worth of imports from the United States. These tit-for-tat retaliation measures could disrupt global supply chains where Taiwanese firms play a significant role, especially for products assembled in China and exported to the United States. A January 2019 business survey by the American Chamber in Taipei found that 45.8% of those surveyed said they were very or somewhat confident about the economic prospects in Taiwan for 2019, a 10 percentage point drop from last year, caused in part by the ongoing U.S.-China trade conflict.

Several Members of Congress have expressed support for boosting commercial relations with Taiwan, including a U.S.-Taiwan FTA. Taiwan's trade barriers on U.S. agricultural products (in particular on U.S. beef and pork products containing ractopamine) are a major source of bilateral trade tensions.

Wayne M. Morrison, Specialist in Asian Trade and Finance

IF10256



NATIONAL SECURITY STRATEGY

of the United States of America

DECEMBER 2017





THE WHITE HOUSE

WASHINGTON, DC

My fellow Americans:

The American people elected me to make America great again. I promised that my Administration would put the safety, interests, and well-being of our citizens first. I pledged that we would revitalize the American economy, rebuild our military, defend our borders, protect our sovereignty, and advance our values.

During my first year in office, you have witnessed my America First foreign policy in action. We are prioritizing the interests of our citizens and protecting our sovereign rights as a nation. America is leading again on the world stage. We are not hiding from the challenges we face. We are confronting them head-on and pursuing opportunities to promote the security and prosperity of all Americans.

The United States faces an extraordinarily dangerous world, filled with a wide range of threats that have intensified in recent years. When I came into office, rogue regimes were developing nuclear weapons and missiles to threaten the entire planet. Radical Islamist terror groups were flourishing. Terrorists had taken control of vast swaths of the Middle East. Rival powers were aggressively undermining American interests around the globe. At home, porous borders and unenforced immigration laws had created a host of vulnerabilities. Criminal cartels were bringing drugs and danger into our communities. Unfair trade practices had weakened our economy and exported our jobs overseas. Unfair burden-sharing with our allies and inadequate investment in our own defense had invited danger from those who wish us harm. Too many Americans had lost trust in our government, faith in our future, and confidence in our values.

Nearly one year later, although serious challenges remain, we are charting a new and very different course.

We are rallying the world against the rogue regime in North Korea and confronting the danger posed by the dictatorship in Iran, which those determined to pursue a flawed nuclear deal had neglected. We have renewed our friendships in the Middle East and partnered with regional leaders to help drive out terrorists and extremists, cut off their financing, and discredit their wicked ideology. We crushed Islamic State of Iraq and Syria (ISIS) terrorists on the battlefields of Syria and Iraq, and will continue pursuing them until they are destroyed. America's allies are now contributing more to our common defense, strengthening even our strongest alliances. We have also continued to make clear that the United States will no longer tolerate economic aggression or unfair trading practices.

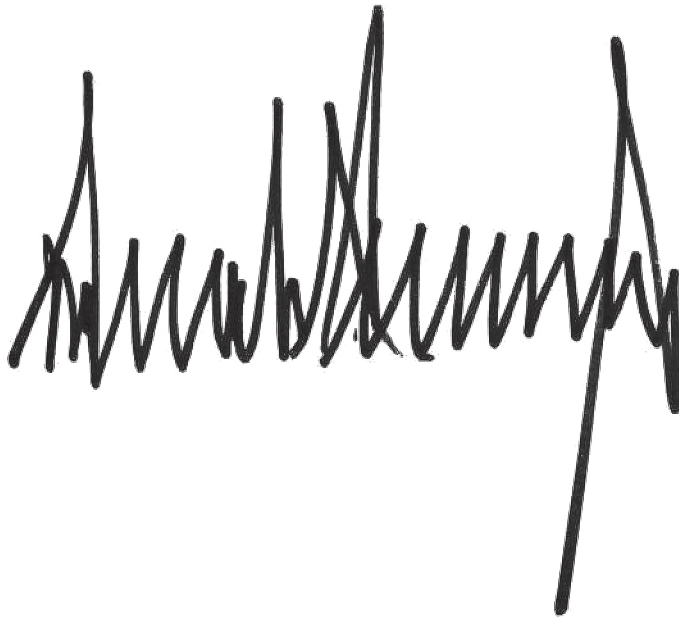
At home, we have restored confidence in America's purpose. We have recommitted ourselves to our founding principles and to the values that have made our families, communities, and society so successful. Jobs are coming back and our economy is growing. We are making historic investments in the United States military. We are enforcing our borders, building trade relationships based on fairness and reciprocity, and defending America's sovereignty without apology.

The whole world is lifted by America's renewal and the reemergence of American leadership. After one year, the world knows that America is prosperous, America is secure, and America is strong. We will bring about the better future we seek for our people and the world, by confronting the challenges and dangers posed by those who seek to destabilize the world and threaten America's people and interests.

My Administration's National Security Strategy lays out a strategic vision for protecting the American people and preserving our way of life, promoting our prosperity, preserving peace through strength, and advancing American influence in the world. We will pursue this beautiful vision—a world of strong, sovereign, and independent nations, each with its own cultures and dreams, thriving side-by-side in prosperity, freedom, and peace—throughout the upcoming year.

In pursuit of that future, we will look at the world with clear eyes and fresh thinking. We will promote a balance of power that favors the United States, our allies, and our partners. We will never lose sight of our values and their capacity to inspire, uplift, and renew.

Most of all, we will serve the American people and uphold their right to a government that prioritizes their security, their prosperity, and their interests. This National Security Strategy puts America First.

A large, bold, handwritten signature in black ink, characteristic of Donald Trump's signature style, featuring multiple sharp peaks and a long, sweeping tail.

President Donald J. Trump

The White House
December 2017



TABLE OF CONTENTS

INTRODUCTION	1
PILLAR I: PROTECT THE AMERICAN PEOPLE, THE HOMELAND, AND THE AMERICAN WAY OF LIFE	7
Secure U.S. Borders and Territory.....	8
<i>Defend Against Weapons of Mass Destruction (WMD)</i>	8
<i>Combat Biothreats and Pandemics</i>	9
<i>Strengthen Border Control and Immigration Policy</i>	9
Pursue Threats to Their Source.....	10
<i>Defeat Jihadist Terrorists</i>	10
<i>Dismantle Transnational Criminal Organizations</i>	11
Keep America Safe in the Cyber Era	12
Promote American Resilience.....	14
PILLAR II: PROMOTE AMERICAN PROSPERITY	17
Rejuvenate the Domestic Economy	18
Promote Free, Fair, and Reciprocal Economic Relationships	19
Lead in Research, Technology, Invention, and Innovation.....	20
Promote and Protect the U.S. National Security Innovation Base.....	21
Embrace Energy Dominance	22
PILLAR III: PRESERVE PEACE THROUGH STRENGTH	25
Renew America’s Competitive Advantages	26
Renew Capabilities	28
<i>Military</i>	28
<i>Defense Industrial Base</i>	29
<i>Nuclear Forces</i>	30
<i>Space</i>	31
<i>Cyberspace</i>	31
<i>Intelligence</i>	32

Diplomacy and Statecraft	33
<i>Competitive Diplomacy</i>	33
<i>Tools of Economic Diplomacy</i>	34
<i>Information Statecraft</i>	34
PILLAR IV: ADVANCE AMERICAN INFLUENCE	37
Encourage Aspiring Partners	38
Achieve Better Outcomes in Multilateral Forums.....	40
Champion American Values.....	41
THE STRATEGY IN A REGIONAL CONTEXT	45
Indo-Pacific.....	45
Europe.....	47
Middle East.....	48
South and Central Asia.....	50
Western Hemisphere	51
Africa.....	52
CONCLUSION	55



INTRODUCTION

An America that is safe, prosperous, and free at home is an America with the strength, confidence, and will to lead abroad. It is an America that can preserve peace, uphold liberty, and create enduring advantages for the American people. Putting America first is the duty of our government and the foundation for U.S. leadership in the world.

A strong America is in the vital interests of not only the American people, but also those around the world who want to partner with the United States in pursuit of shared interests, values, and aspirations.

This National Security Strategy puts America first.

An America First National Security Strategy is based on American principles, a clear-eyed assessment of U.S. interests, and a determination to tackle the challenges that we face. It is a strategy of principled realism that is guided by outcomes, not ideology. It is based upon the view that peace, security, and prosperity depend on strong, sovereign nations that respect their citizens at home and cooperate to advance peace abroad. And it is grounded in the realization that American principles are a lasting force for good in the world.

“We the People” is America’s source of strength.

The United States was born of a desire for life, liberty, and the pursuit of happiness—and a conviction that unaccountable political power is tyranny. For these reasons, our Founders crafted and ratified the Constitution, establishing the republican form of government we enjoy today. The Constitution grants our national government not only specified powers necessary to protect our God-given rights and liberties but also safeguards them by limiting the government’s size and scope,

separating Federal powers, and protecting the rights of individuals through the rule of law. All political power is ultimately delegated from, and accountable to, the people.

We protect American sovereignty by defending these institutions, traditions, and principles that have allowed us to live in freedom, to build the nation that we love. And we prize our national heritage, for the rare and fragile institutions of republican government can only endure if they are sustained by a culture that cherishes those institutions.

Liberty and independence have given us the flourishing society Americans enjoy today—a vibrant and confident Nation, welcoming of disagreement and differences, but united by the bonds of history, culture, beliefs, and principles that define who we are.

We are proud of our roots and honor the wisdom of the past. We are committed to protecting the rights and dignity of every citizen. And we are a nation of laws, because the rule of law is the shield that protects the individual from government corruption

and abuse of power, allows families to live without fear, and permits markets to thrive.

Our founding principles have made the United States of America among the greatest forces for good in history. But we are also aware that we must protect and build upon our accomplishments, always conscious of the fact that the interests of the American people constitute our true North Star.

America's achievements and standing in the world were neither inevitable nor accidental. On many occasions, Americans have had to compete with adversarial forces to preserve and advance our security, prosperity, and the principles we hold dear. At home, we fought the Civil War to end slavery and preserve our Union in the long struggle to extend equal rights for all Americans. In the course of the bloodiest century in human history, millions of Americans fought, and hundreds of thousands lost their lives, to defend liberty in two World Wars and the Cold War. America, with our allies and partners, defeated fascism, imperialism, and Soviet communism and eliminated any doubts about the power and durability of republican democracy when it is sustained by a free, proud, and unified people.

The United States consolidated its military victories with political and economic triumphs built on market economies and fair trade, democratic principles, and shared security partnerships. American political, business, and military leaders worked together with their counterparts in Europe and Asia to shape the post-war order through the United Nations, the Marshall Plan, the North Atlantic Treaty Organization (NATO), and other institutions designed to advance our shared interests of security, freedom, and peace. We recognize the invaluable advantages that our strong relationships with allies and partners deliver.

Following the remarkable victory of free nations in the Cold War, America emerged as the lone super-

power with enormous advantages and momentum in the world. Success, however, bred complacency. A belief emerged, among many, that American power would be unchallenged and self-sustaining. The United States began to drift. We experienced a crisis of confidence and surrendered our advantages in key areas. As we took our political, economic, and military advantages for granted, other actors steadily implemented their long-term plans to challenge America and to advance agendas opposed to the United States, our allies, and our partners.

We stood by while countries exploited the international institutions we helped to build. They subsidized their industries, forced technology transfers, and distorted markets. These and other actions challenged America's economic security. At home, excessive regulations and high taxes stifled growth and weakened free enterprise—history's greatest antidote to poverty. Each time government encroached on the productive activities of private commerce, it threatened not only our prosperity but also the spirit of creation and innovation that has been key to our national greatness.

A Competitive World

The United States will respond to the growing political, economic, and military competitions we face around the world.

China and Russia challenge American power, influence, and interests, attempting to erode American security and prosperity. They are determined to make economies less free and less fair, to grow their militaries, and to control information and data to repress their societies and expand their influence. At the same time, the dictatorships of the Democratic People's Republic of Korea and the Islamic Republic of Iran are determined to destabilize regions, threaten Americans and our allies, and brutalize their own people. Transnational

threat groups, from jihadist terrorists to transnational criminal organizations, are actively trying to harm Americans. While these challenges differ in nature and magnitude, they are fundamentally contests between those who value human dignity and freedom and those who oppress individuals and enforce uniformity.

These competitions require the United States to rethink the policies of the past two decades—policies based on the assumption that engagement with rivals and their inclusion in international institutions and global commerce would turn them into benign actors and trustworthy partners. For the most part, this premise turned out to be false.

Rival actors use propaganda and other means to try to discredit democracy. They advance anti-Western views and spread false information to create divisions among ourselves, our allies, and our partners. In addition, jihadist terrorists such as ISIS and al-Qa'ida continue to spread a barbaric ideology that calls for the violent destruction of governments and innocents they consider to be apostates. These jihadist terrorists attempt to force those under their influence to submit to Sharia law.

America's military remains the strongest in the world. However, U.S. advantages are shrinking as rival states modernize and build up their conventional and nuclear forces. Many actors can now field a broad arsenal of advanced missiles, including variants that can reach the American homeland. Access to technology empowers and emboldens otherwise weak states. North Korea—a country that starves its own people—has spent hundreds of millions of dollars on nuclear, chemical, and biological weapons that could threaten our homeland. In addition, many actors have become skilled at operating below the threshold of military conflict—challenging the United States, our allies, and our partners with hostile actions cloaked in deniability. Our task is to ensure that American military superiority endures, and

in combination with other elements of national power, is ready to protect Americans against sophisticated challenges to national security.

The contest over information accelerates these political, economic, and military competitions. Data, like energy, will shape U.S. economic prosperity and our future strategic position in the world. The ability to harness the power of data is fundamental to the continuing growth of America's economy, prevailing against hostile ideologies, and building and deploying the most effective military in the world.

We learned the difficult lesson that when America does not lead, malign actors fill the void to the disadvantage of the United States. When America does lead, however, from a position of strength and confidence and in accordance with our interests and values, all benefit.

Competition does not always mean hostility, nor does it inevitably lead to conflict—although none should doubt our commitment to defend our interests. An America that successfully competes is the best way to prevent conflict. Just as American weakness invites challenge, American strength and confidence deters war and promotes peace.

An America First National Security Strategy

The competitions and rivalries facing the United States are not passing trends or momentary problems. They are intertwined, long-term challenges that demand our sustained national attention and commitment.

America possesses unmatched political, economic, military, and technological advantages. But to maintain these advantages, build upon our strengths, and unleash the talents of the American people, we must protect four vital national interests in this competitive world.

First, our fundamental responsibility is to **protect the American people, the homeland, and the American way of life**. We will strengthen control of our borders and reform our immigration system. We will protect our critical infrastructure and go after malicious cyber actors. A layered missile defense system will defend our homeland against missile attacks. And we will pursue threats to their source, so that jihadist terrorists are stopped before they ever reach our borders.

Second, we will **promote American prosperity**. We will rejuvenate the American economy for the benefit of American workers and companies. We will insist upon fair and reciprocal economic relationships to address trade imbalances. The United States must preserve our lead in research and technology and protect our economy from competitors who unfairly acquire our intellectual property. And we will embrace America's energy dominance because unleashing abundant energy resources stimulates our economy.

Third, we will **preserve peace through strength** by rebuilding our military so that it remains pre-eminent, deters our adversaries, and if necessary, is able to fight and win. We will compete with all tools of national power to ensure that regions of the world are not dominated by one power. We will strengthen America's capabilities—including in space and cyberspace—and revitalize others that have been neglected. Allies and partners magnify our power. We expect them to shoulder a fair share of the burden of responsibility to protect against common threats.

Fourth, we will **advance American influence** because a world that supports American interests and reflects our values makes America more secure and prosperous. We will compete and lead in multilateral organizations so that American interests and principles are protected. America's commitment to liberty, democracy, and the rule of law serves as an inspiration for those living under

tyranny. We can play a catalytic role in promoting private-sector-led economic growth, helping aspiring partners become future trading and security partners. And we will remain a generous nation, even as we expect others to share responsibility.

Strengthening our sovereignty—the first duty of a government is to serve the interests of its own people—is a necessary condition for protecting these four national interests. And as we strengthen our sovereignty we will renew confidence in ourselves as a nation. We are proud of our history, optimistic about America's future, and confident of the positive example the United States offers to the world. We are also realistic and understand that the American way of life cannot be imposed upon others, nor is it the inevitable culmination of progress. Together with our allies, partners, and aspiring partners, the United States will pursue cooperation with reciprocity. Cooperation means sharing responsibilities and burdens. In trade, fair and reciprocal relationships benefit all with equal levels of market access and opportunities for economic growth. An America First National Security Strategy appreciates that America will catalyze conditions to unleash economic success for America and the world.

In the United States, free men and women have created the most just and prosperous nation in history. Our generation of Americans is now charged with preserving and defending that precious inheritance. This National Security Strategy shows the way.



PILLAR I

PROTECT THE AMERICAN PEOPLE, THE HOMELAND, AND THE AMERICAN WAY OF LIFE

*“We will defend our country, protect our communities,
and put the safety of the American people first.”*

PRESIDENT DONALD J. TRUMP | JULY 2017

This National Security Strategy begins with the determination to protect the American people, the American way of life, and American interests. Americans have long recognized the benefits of an interconnected world, where information and commerce flow freely. Engaging with the world, however, does not mean the United States should abandon its rights and duties as a sovereign state or compromise its security. Openness also imposes costs, since adversaries exploit our free and democratic system to harm the United States.

North Korea seeks the capability to kill millions of Americans with nuclear weapons. Iran supports terrorist groups and openly calls for our destruction. Jihadist terrorist organizations such as ISIS and al-Qa’ida are determined to attack the United States and radicalize Americans with their hateful ideology. Non-state actors undermine social order through drug and human trafficking networks, which they use to commit violent crimes and kill thousands of American each year.

Adversaries target sources of American strength, including our democratic system and our econ-

omy. They steal and exploit our intellectual property and personal data, interfere in our political processes, target our aviation and maritime sectors, and hold our critical infrastructure at risk. All of these actions threaten the foundations of the American way of life. Reestablishing lawful control of our borders is a first step toward protecting the American homeland and strengthening American sovereignty.

We must prevent nuclear, chemical, radiological, and biological attacks, block terrorists from reaching our homeland, reduce drug and human trafficking, and protect our critical infrastructure. We must also deter, disrupt, and defeat potential threats before they reach the United States. We will target jihadist terrorists and transnational criminal organizations at their source and dismantle their networks of support.

We must also take steps to respond quickly to meet the needs of the American people in the event of natural disaster or attack on our homeland. We must build a culture of preparedness and resilience across our governmental functions, critical infrastructure, and economic and political systems.

Secure U.S. Borders and Territory

State and non-state actors place the safety of the American people and the Nation’s economic vitality at risk by exploiting vulnerabilities across the land, air, maritime, space, and cyber-space domains. Adversaries constantly evolve their methods to threaten the United States and our citizens. We must be agile and adaptable.

Defend Against Weapons of Mass Destruction (WMD)

The danger from hostile state and non-state actors who are trying to acquire nuclear, chemical, radiological, and biological weapons is increasing. The Syrian regime’s use of chemical weapons against its own citizens undermines international norms against these heinous weapons, which may encourage more actors to pursue and use them. ISIS has used chemical weapons in Iraq and Syria. Terrorist groups continue to pursue WMD-related materials. We would face grave danger if terrorists obtained inadequately secured nuclear, radiological, or biological material.

As missiles grow in numbers, types, and effectiveness, to include those with greater ranges, they are the most likely means for states like North Korea to use a nuclear weapon against the United States. North Korea is also pursuing chemical and biological weapons which could also be delivered by missile. China and Russia are developing advanced weapons and capabilities that could threaten our critical infrastructure and our command and control architecture.

Priority Actions

ENHANCE MISSILE DEFENSE: The United States is deploying a layered missile defense system focused on North Korea and Iran to defend our homeland against missile attacks. This system will include the ability to defeat missile threats prior to launch. Enhanced missile defense is not intended to undermine strategic stability or disrupt longstanding strategic relationships with Russia or China.

DETECT AND DISRUPT WEAPONS OF MASS DESTRUCTION: At our borders and within our territory, we will bolster efforts to detect nuclear, chemical, radiological, and biological agents and keep them from being used against us. We will also better integrate intelligence, law enforcement, and emergency management operations to ensure that frontline defenders have the right information and capabilities to respond to WMD threats from state and non-state actors.

ENHANCE COUNTERPROLIFERATION MEASURES: Building on decades of initiatives, we will augment measures to secure, eliminate, and prevent the spread of WMD and related materials, their delivery systems, technologies, and knowledge to reduce the chance that they might fall into the hands of hostile actors. We will hold state and non-state actors accountable for the use of WMD.

TARGET WMD TERRORISTS: We will direct counterterrorism operations against terrorist WMD specialists, financiers, administrators, and facilitators. We will work with allies and partners to detect and disrupt plots.

Strengthening control over our borders and immigration system is central to national security, economic prosperity, and the rule of law.

Combat Biothreats and Pandemics

Biological incidents have the potential to cause catastrophic loss of life. Biological threats to the U.S. homeland—whether as the result of deliberate attack, accident, or a natural outbreak—are growing and require actions to address them at their source.

Naturally emerging outbreaks of viruses such as Ebola and SARS, as well as the deliberate 2001 anthrax attacks in the United States, demonstrated the impact of biological threats on national security by taking lives, generating economic losses, and contributing to a loss of confidence in government institutions.

Advancements in life sciences that benefit our health, economy, and society also open up new avenues to actors who want to cause harm. Dedicated state actors are likely to develop more advanced bioweapons, and these capabilities may become available to malicious non-state actors as well.

Priority Actions

DETECT AND CONTAIN BIOTHREATS AT THEIR SOURCE:

We will work with other countries to detect and mitigate outbreaks early to prevent the spread of disease. We will encourage other countries to invest in basic health care systems and to strengthen global health security across the intersection of human and animal health to prevent infectious disease outbreaks. And we will work with partners to ensure that laboratories that handle dangerous pathogens have in place safety and security measures.

SUPPORT BIOMEDICAL INNOVATION: We will protect and support advancements in biomedical innovation by strengthening the intellectual property system that is the foundation of the biomedical industry.

IMPROVE EMERGENCY RESPONSE: At home, we will strengthen our emergency response and uni-

fied coordination systems to rapidly characterize outbreaks, implement public health containment measures to limit the spread of disease, and provide surge medical care—including life-saving treatments.

Strengthen Border Control and Immigration Policy

Strengthening control over our borders and immigration system is central to national security, economic prosperity, and the rule of law. Terrorists, drug traffickers, and criminal cartels exploit porous borders and threaten U.S. security and public safety. These actors adapt quickly to outpace our defenses.

The United States affirms our sovereign right to determine who should enter our country and under what circumstances. The United States understands the contributions immigrants have made to our Nation throughout its history. Illegal immigration, however, burdens the economy, hurts American workers, presents public safety risks, and enriches smugglers and other criminals.

The United States recognizes that decisions about who to legally admit for residency, citizenship, or otherwise are among the most important a country has to make. The United States will continue to welcome lawful immigrants who do not pose a security threat and whose entry is consistent with the national interest, while at the same time enhancing the screening and vetting of travelers, closing dangerous loopholes, revising outdated laws, and eliminating easily exploited vulnerabilities. We will also reform our current immigration system, which, contrary to our national interest and national security, allows for randomized entry and extended-family chain migration. Residency and citizenship determinations should be based on individuals' merits and their ability to positively contribute to U.S. society, rather than chance or extended family connections.

Priority Actions

ENHANCE BORDER SECURITY: We will secure our borders through the construction of a border wall, the use of multilayered defenses and advanced technology, the employment of additional personnel, and other measures. The U.S. Government will work with foreign partners to deter, detect, and disrupt suspicious individuals well before they enter the United States.

ENHANCE VETTING: The U.S. Government will enhance vetting of prospective immigrants, refugees, and other foreign visitors to identify individuals who might pose a risk to national security or public safety. We will set higher security standards to ensure that we keep dangerous people out of the United States and enhance our information collection and analysis to identify those who may already be within our borders.

ENFORCE IMMIGRATION LAWS: We will enforce immigration laws, both at the border and in the interior, to provide an effective deterrent to illegal immigration. The apprehension and swift removal of illegal aliens at the border is critical to an effective border security strategy. We must also increase efforts to identify and counter fraud in the immigration process, which undermines the integrity of our immigration system, exploits vulnerable individuals, and creates national security risks.

BOLSTER TRANSPORTATION SECURITY: We will improve information sharing across our government and with foreign partners to enhance the security of the pathways through which people and goods enter the country. We will invest in technology to counter emerging threats to our aviation, surface, and maritime transportation sectors. We will also work with international and industry partners to raise security standards.

Pursue Threats to Their Source

There is no perfect defense against the range of threats facing our homeland. That is why America must, alongside allies and partners, stay on the offensive against those violent non-state groups that target the United States and our allies.

The primary transnational threats Americans face are from jihadist terrorists and transnational criminal organizations. Although their objectives differ, these actors pose some common challenges. First, they exploit our open society. Second, they often operate in loose confederations and adapt rapidly. Third, they rely on encrypted communication and the dark web to evade detection as they plot, recruit, finance, and execute their operations. Fourth, they thrive under conditions of state weakness and prey on the vulnerable as they accelerate the breakdown of rules to create havens from which to plan and launch attacks on the United States, our allies, and our partners. Fifth, some are sheltered and supported by states and do their bidding.

Defeat Jihadist Terrorists

Jihadist terrorist organizations present the most dangerous terrorist threat to the Nation. America, alongside our allies and partners, is fighting a long war against these fanatics who advance a totalitarian vision for a global Islamist caliphate that justifies murder and slavery, promotes repression, and seeks to undermine the American way of life. Jihadist terrorists use virtual and physical networks around the world to radicalize isolated individuals, exploit vulnerable populations, and inspire and direct plots.

Even after the territorial defeat of ISIS and al-Qa'ida in Syria and Iraq, the threat from jihadist terrorists will persist. They have used battlefields as test beds of terror and have exported tools and tactics to their followers. Many of these jihadist terror-

ists are likely to return to their home countries, from which they can continue to plot and launch attacks on the United States and our allies.

The United States also works with allies and partners to deter and disrupt other foreign terrorist groups that threaten the homeland—including Iranian-backed groups such as Lebanese Hizballah.

Priority Actions

DISRUPT TERROR PLOTS: We will enhance intelligence sharing domestically and with foreign partners. We will give our frontline defenders—including homeland security, law enforcement, and intelligence professionals—the tools, authorities, and resources to stop terrorist acts before they take place.

TAKE DIRECT ACTION: The U.S. military and other operating agencies will take direct action against terrorist networks and pursue terrorists who threaten the homeland and U.S. citizens regardless of where they are. The campaigns against ISIS and al-Qa’ida and their affiliates demonstrate that the United States will enable partners and sustain direct action campaigns to destroy terrorists and their sources of support, making it harder for them to plot against us.

ELIMINATE TERRORIST SAFE HAVENS: Time and territory allow jihadist terrorists to plot, so we will act against sanctuaries and prevent their reemergence, before they can threaten the U.S. homeland. We will go after their digital networks and work with private industry to confront the challenge of terrorists and criminals “going dark” and using secure platforms to evade detection.

SEVER SOURCES OF STRENGTH: We will disrupt the financial, materiel, and personnel supply chains of terrorist organizations. We will sever their financing and protect the U.S. and international financial systems from abuse. We will degrade their ability

to message and attract potential recruits. This includes combating the evil ideology of jihadists by exposing its falsehoods, promoting counter-narratives, and amplifying credible voices.

SHARE RESPONSIBILITY: Our allies and partners, who are also targets of terrorism, will continue to share responsibility in fighting these barbaric groups. We will help our partners develop and responsibly employ the capacity to

degrade and maintain persistent pressure against terrorists and will encourage partners to work independently of U.S. assistance.

COMBAT RADICALIZATION AND RECRUITMENT IN COMMUNITIES: The United States rejects bigotry and oppression and seeks a future built on our values as one American people. We will deny violent ideologies the space to take root by improving trust among law enforcement, the private sector, and American citizens. U.S. intelligence and homeland security experts will work with law enforcement and civic leaders on terrorism prevention and provide accurate and actionable information about radicalization in their communities.

Dismantle Transnational Criminal Organizations

The United States must devote greater resources to dismantle transnational criminal organizations (TCOs) and their subsidiary networks. Some have established global supply chains that are

We will give our frontline defenders—including homeland security, law enforcement, and intelligence professionals—the tools, authorities, and resources to stop terrorist acts before they take place.

comparable to Fortune 500 corporations. Every day they deliver drugs to American communities, fuel gang violence, and engage in cybercrime. The illicit opioid epidemic, fed by drug cartels as well as Chinese fentanyl traffickers, kills tens of thousands of Americans each year. These organizations weaken our allies and partners too, by corrupting and undermining democratic institutions. TCOs are motivated by profit, power, and political influence. They exploit weak governance and enable other national security threats, including terrorist organizations. In addition, some state adversaries use TCOs as instruments of national power, offering them territorial sanctuary where they are free to conduct unattributable cyber intrusions, sabotage, theft, and political subversion.

Priority Actions

IMPROVE STRATEGIC PLANNING AND INTELLIGENCE:

We will establish national-level strategic intelligence and planning capabilities to improve the ability of agencies to work together to combat TCOs at home and abroad.

DEFEND COMMUNITIES: We will deny TCOs the ability to harm Americans. We will support public health efforts to halt the growth of illicit drug use in the United States, expand national and community-based prevention efforts, increase access to evidenced-based treatment for addiction, improve prescription drug monitoring, and provide training on substance use disorders for medical personnel.

DEFEND IN DEPTH: U.S. agencies and foreign partners will target TCO leaders and their support infrastructure. We will assist countries, particularly in the Western Hemisphere, to break the power of these organizations and networks.

COUNTER CYBER CRIMINALS: We will use sophisticated investigative tools to disrupt the ability of criminals to use online marketplaces, cryptocurrencies, and other tools for illicit activities. The United States will hold countries accountable for harboring these criminals.

Keep America Safe in the Cyber Era

America’s response to the challenges and opportunities of the cyber era will determine our future prosperity and security. For most of our history, the United States has been able to protect the homeland by controlling its land, air, space, and maritime domains. Today, cyberspace offers state and non-state actors the ability to wage campaigns against American political, economic, and security interests without ever physically crossing our borders. Cyberattacks offer adversaries low-

cost and deniable opportunities to seriously damage or disrupt critical infrastructure, cripple American businesses, weaken our Federal networks, and attack the tools and devices that Americans use every day to communicate and conduct business.

Critical infrastructure keeps our food fresh, our houses warm, our trade flowing, and our citizens productive and safe. The vulnerability of U.S. critical infrastructure to cyber, physical, and electromagnetic attacks means that adversaries could disrupt military command and control, banking and financial operations, the electrical grid, and means of communication.

Federal networks also face threats. These networks allow government agencies to carry out vital functions and provide services to the American peo-

America’s response to the challenges and opportunities of the cyber era will determine our future prosperity and security.

ple. The government must do a better job of protecting data to safeguard information and the privacy of the American people. Our Federal networks must be modernized and updated.

In addition, the daily lives of most Americans rely on computer-driven and interconnected technologies. As our reliance on computers and connectivity increases, we become increasingly vulnerable to cyberattacks. Businesses and individuals must be able to operate securely in cyberspace.

Security was not a major consideration when the Internet was designed and launched. As it evolves, the government and private sector must design systems that incorporate prevention, protection, and resiliency from the start, not as an afterthought. We must do so in a way that respects free markets, private competition, and the limited but important role of government in enforcing the rule of law. As we build the next generation of digital infrastructure, we have an opportunity to put our experience into practice.

The Internet is an American invention, and it should reflect our values as it continues to transform the future for all nations and all generations. A strong, defensible cyber infrastructure fosters economic growth, protects our liberties, and advances our national security.

Priority Actions

IDENTIFY AND PRIORITIZE RISK: To improve the security and resilience of our critical infrastructure, we will assess risk across six key areas: national security, energy and power, banking and finance, health and safety, communications, and transportation. We will assess where cyberattacks could have catastrophic or cascading consequences and prioritize our protective efforts, capabilities, and defenses accordingly.

BUILD DEFENSIBLE GOVERNMENT NETWORKS: We will use the latest commercial capabilities, shared services, and best practices to modernize our Federal information technology. We will improve our ability to provide uninterrupted and secure communications and services under all conditions.

DETER AND DISRUPT MALICIOUS CYBER ACTORS: The Federal Government will ensure that those charged with securing critical infrastructure have the necessary authorities, information, and capabilities to prevent attacks before they affect or hold at risk U.S. critical infrastructure. The United States will impose swift and costly consequences on foreign governments, criminals, and other actors who undertake significant malicious cyber activities. We will work with allies and friends to expand our awareness of malicious activities. A stronger and more resilient critical infrastructure will strengthen deterrence by creating doubt in our adversaries that they can achieve their objectives.

IMPROVE INFORMATION SHARING AND SENSING: The U.S. Government will work with our critical infrastructure partners to assess their informational needs and to reduce the barriers to information sharing, such as speed and classification levels. We will also invest in capabilities that improve the ability of the United States to attribute cyberattacks. In accordance with the protection of civil liberties and privacy, the U.S. Government will expand collaboration with the private sector so that we can better detect and attribute attacks.

DEPLOY LAYERED DEFENSES: Since threats transit globally, passing through communications backbones without challenge, the U.S. Government will work with the private sector to remediate known bad activities at the network level to improve the security of all customers. Malicious activity must be defeated within a network and not be passed on to its destination whenever possible.

Promote American Resilience

Despite our best efforts, our government cannot prevent all dangers to the American people. We can, however, help Americans remain resilient in the face of adversity. Resilience includes the ability to withstand and recover rapidly from deliberate attacks, accidents, natural disasters, as well as unconventional stresses, shocks, and threats to our economy and democratic system. In the event of a disaster, Federal, state, and local agencies must perform essential functions and have plans in place to ensure the continuation of our constitutional form of government.

Reducing risk and building more resilient communities are the best ways to protect people, property, and taxpayer dollars from loss and disruption. Through risk-informed investments, we will build resilient communities and infrastructure to protect and benefit future generations.

Should tragedy strike, the U.S. Government will help communities recover and rebuild. Citizens must be confident in our government, but also recognize that response and recovery begins with individuals and local communities. In difficult times, the true character of the American people emerges: their strength, their love, and their resolve. Our first responders selflessly run toward danger, and volunteers rally to the aid of neighbors when disaster strikes.

A democracy is only as resilient as its people. An informed and engaged citizenry is the fundamental requirement for a free and resilient nation. For generations, our society has protected free press, free speech, and free thought. Today, actors such as Russia are using information tools in an attempt to undermine the legitimacy of democracies. Adversaries target media, political processes, financial networks, and personal data. The American public and private sectors must recognize this and

work together to defend our way of life. No external threat can be allowed to shake our shared commitment to our values, undermine our system of government, or divide our Nation.

Priority Actions

IMPROVE RISK MANAGEMENT: The United States will improve its ability to assess the threats and hazards that pose the greatest risks to Americans and will prioritize resources based on the highest risks.

BUILD A CULTURE OF PREPAREDNESS: This Administration will take steps to build a culture of preparedness, informing and empowering communities and individuals to obtain the skills and take the preparatory actions necessary to become more resilient against the threats and hazards that Americans face.

IMPROVE PLANNING: State and local governments must conduct realistic exercises that test existing plans to make sure that they are sound and can be executed. Agencies from all levels of government must coordinate better and apply lessons learned from exercises to pinpoint the areas and capabilities that require improvement.

INCENTIVIZE INFORMATION SHARING: To improve the coordination among the private sector and all levels of government that is needed to improve resilience, we must make a stronger commitment to protecting sensitive information so that all partners actively identify and share vulnerabilities and work collaboratively to reduce them.



PILLAR II

PROMOTE AMERICAN PROSPERITY

“Economic security is national security.”

PRESIDENT DONALD J. TRUMP | NOVEMBER 2017

A strong economy protects the American people, supports our way of life, and sustains American power. American workers thrive when they are free to innovate, develop and access our abundant natural resources, and operate in markets free from excessive regulations and unfair foreign trade practices. A growing and innovative economy allows the United States to maintain the world’s most powerful military and protect our homeland.

We must rebuild our economic strength and restore confidence in the American economic model. Over decades, American factories, companies, and jobs moved overseas. After the 2008 global financial crisis, doubt replaced confidence. Risk-aversion and regulations replaced investment and entrepreneurship. The recovery produced anemic growth in real earnings for American workers. The U.S. trade deficit grew as a result of several factors, including unfair trading practices.

For 70 years, the United States has embraced a strategy premised on the belief that leadership of a stable international economic system rooted in American principles of reciprocity, free markets, and free trade served our economic and security interests. Working with our allies and partners, the United States led the creation of a group of financial institutions and other economic forums that established equitable rules and built instruments to stabilize the interna-

tional economy and remove the points of friction that had contributed to two world wars.

That economic system continues to serve our interests, but it must be reformed to help American workers prosper, protect our innovation, and reflect the principles upon which that system was founded. Trading partners and international institutions can do more to address trade imbalances and adhere to and enforce the rules of the order.

Today, American prosperity and security are challenged by an economic competition playing out in a broader strategic context. The United States helped expand the liberal economic trading system to countries that did not share our values, in the hopes that these states would liberalize their economic and political practices and provide commensurate benefits to the United States. Experience shows that these countries distorted and undermined key economic institutions without undertaking significant reform of their economies or politics. They espouse free trade rhetoric and exploit its benefits, but only adhere selectively to the rules and agreements.

We welcome all economic relationships rooted in fairness, reciprocity, and faithful adherence to the rules. Those who join this pursuit will be our closest economic partners. But the United States will no longer turn a blind eye to violations, cheating, or economic aggression. We must work with like-

minded allies and partners to ensure our principles prevail and the rules are enforced so that our economies prosper.

The United States will pursue an economic strategy that rejuvenates the domestic economy, benefits the American worker, revitalizes the U.S. manufacturing base, creates middle-class jobs, encourages innovation, preserves technological advantage, safeguards the environment, and achieves energy dominance. Rebuilding economic strength at home and preserving a fair and reciprocal international economic system will enhance our security and advance prosperity and peace in the world.

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ulation burdened small businesses. Banking regulations squelched new bank formation and caused hundreds of small banks to close. Regulation decreased credit availability to consumers and decreased product choice. Excessive environmental and infrastructure regulations impeded American energy trade and the development of new infrastructure projects.

Moreover, the poor state of our physical infrastructure stultified the economy, reduced the profitability of American small businesses, and slowed the productivity of American workers. America's digital infrastructure also fell behind. Improvements

in bandwidth, better broadband connectivity, and protection from persistent cyberattacks are needed to support America's future growth. Economic and personal transactions are dependent upon the ".com world," and wealth creation depends on a reliable, secure Internet.

The Administration is dedicated to rejuvenating the U.S. economy, unleashing the potential of all Americans, and restoring confidence in our free market system. Promoting American prosperity makes America more secure and advances American influence in the world.

Rejuvenate the Domestic Economy

Economic challenges at home demand that we understand economic prosperity as a pillar of national security. Despite low unemployment rates and stock market gains, overall economic growth has, until recently, been anemic since the 2008 recession. In the past five years, gross domestic product (GDP) growth hovered barely above two percent, and wages stagnated. Taxes increased, and health insurance and prescription drug costs continued to rise, albeit at a slower pace. Education costs climbed at rates far above inflation, increasing student debt. Productivity growth fell to levels not seen in decades.

Significant government intrusion in the economy slowed growth and job creation. Regulatory and corporate tax policies incentivized businesses to invest overseas and disadvantaged American companies against foreign competitors. Excessive reg-

Priority Actions

REDUCE REGULATORY BURDENS: Departments and agencies will eliminate unnecessary regulations that stifle growth, drive up costs for American businesses, impede research and development, discourage hiring, and incentivize domestic businesses to move overseas. We will balance our reduction in regulations with adequate protections and oversight.

PROMOTE TAX REFORM: This Administration will work with the Congress to create a simpler, fairer, and pro-growth tax code that encourages the creation of higher wage jobs and gives middle-income families tax relief. Reduced business tax rates and a territorial system for foreign subsidiary earnings will improve the competitiveness of American companies and encourage their return to the United States.

IMPROVE AMERICAN INFRASTRUCTURE: Federal, state, and local governments will work together with private industry to improve our airports, seaports and waterways, roads and railways, transit systems, and telecommunications. The United States will use our strategic advantage as a leading natural gas producer to transform transportation and manufacturing. We will improve America's digital infrastructure by deploying a secure 5G Internet capability nationwide. These improvements will increase national competitiveness, benefit the environment, and improve our quality of life.

REDUCE THE DEBT THROUGH FISCAL RESPONSIBILITY: The national debt, now over \$20 trillion, presents a grave threat to America's long-term prosperity and, by extension, our national security. By restraining Federal spending, making government more efficient, and by modernizing our tax system and making our businesses globally competitive, our economy will grow and make the existing debt more serviceable.

SUPPORT EDUCATION AND APPRENTICESHIP PROGRAMS:

We will support apprenticeships and workforce development programs that prepare American workers for high-wage manufacturing and science, technology, engineering, and mathematics (STEM) jobs of the 21st century.

Promote Free, Fair, and Reciprocal Economic Relationships

For decades, the United States has allowed unfair trading practices to grow. Other countries have used dumping, discriminatory non-tariff barriers, forced technology transfers, non-economic capacity, industrial subsidies, and other support from governments and state-owned enterprises to gain economic advantages.

Today we must meet the challenge. We will address persistent trade imbalances, break down trade barriers, and provide Americans new opportunities to increase their exports. The United States will expand trade that is fairer so that U.S. workers and industries have more opportunities to compete for business. We oppose closed mercantilist trading blocks. By strengthening the international trading system and incentivizing other

countries to embrace market-friendly policies, we can enhance our prosperity.

The United States distinguishes between economic competition with countries that follow fair and free market principles and competition with those that act with little regard for those principles. We will compete with like-minded states in the economic domain—particularly where trade imbalances exist—while recognizing that competition is healthy when nations

share values and build fair and reciprocal relationships. The United States will pursue enforcement actions when countries violate the rules to gain unfair advantage. The United States will engage industrialized democracies and other like-minded states to defend against economic aggres-

The Administration is dedicated to rejuvenating the U.S. economy, unleashing the potential of all Americans, and restoring confidence in our free market system.

sion, in all its forms, that threatens our common prosperity and security.

Priority Actions

ADOPT NEW TRADE AND INVESTMENT AGREEMENTS AND MODERNIZE EXISTING ONES: The United States will pursue bilateral trade and investment agreements with countries that commit to fair and reciprocal trade and will modernize existing agreements to ensure they are consistent with those principles. Agreements must adhere to high standards in intellectual property, digital trade, agriculture, labor, and the environment.

COUNTER UNFAIR TRADE PRACTICES: The United States will counter all unfair trade practices that distort markets using all appropriate means, from dialogue to enforcement tools.

COUNTER FOREIGN CORRUPTION: Using our economic and diplomatic tools, the United States will continue to target corrupt foreign officials and work with countries to improve their ability to fight corruption so U.S. companies can compete fairly in transparent business climates.

WORK WITH LIKE-MINDED PARTNERS: The United States will work with like-minded partners to preserve and modernize the rules of a fair and reciprocal economic order. Together we will emphasize fair trade enforcement actions when necessary, as well as multinational efforts to ensure transparency and adherence to international standards within trade and investment projects.

FACILITATE NEW MARKET OPPORTUNITIES: The United States will partner with countries as they build their export markets, promote free market competition, and incentivize private sector growth. We will expand U.S. trade and investment opportunities and increase the market base for U.S. goods and services.

Lead in Research, Technology, Invention, and Innovation

The United States will build on the ingenuity that has launched industries, created jobs, and improved the quality of life at home and abroad. To maintain our competitive advantage, the United States will prioritize emerging technologies critical to economic growth and security, such as data science, encryption, autonomous technologies, gene editing, new materials, nanotechnology, advanced computing technologies, and artificial intelligence. From self-driving cars to autonomous weapons, the field of artificial intelligence, in particular, is progressing rapidly.

The United States must continue to attract the innovative and the inventive, the brilliant and the bold. We will encourage scientists in government, academia, and the private sector to achieve advancements across the full spectrum of discovery, from incremental improvements to game-changing breakthroughs. We will nurture a healthy innovation economy that collaborates with allies and partners, improves STEM education, draws on an advanced technical workforce, and invests in early-stage research and development (R&D).

Priority Actions

UNDERSTAND WORLDWIDE SCIENCE AND TECHNOLOGY (S&T) TRENDS: To retain U.S. advantages over our competitors, U.S. Government agencies must improve their understanding of worldwide S&T trends and how they are likely to influence—or undermine—American strategies and programs.

ATTRACT AND RETAIN INVENTORS AND INNOVATORS: The U.S. Government must improve our collaboration with industry and academia and our recruitment of technical talent. We will remove barriers to the full use of talent across Federal agencies, and increase incentives for hiring and retaining Federal STEM employees. Initiatives

will include rapid hiring, swift adjudication of national security clearances, and offers of competitive salaries. We must create easier paths for the flow of scientists, engineers, and technologists into and out of public service.

LEVERAGE PRIVATE CAPITAL AND EXPERTISE TO BUILD AND INNOVATE: The U.S. Government will use private sector technical expertise and R&D capabilities more effectively. Private industry owns many of the technologies that the government relies upon for critical national security missions. The Department of Defense and other agencies will establish strategic partnerships with U.S. companies to help align private sector R&D resources to priority national security applications.

RAPIDLY FIELD INVENTIONS AND INNOVATIONS: The United States must regain the element of surprise and field new technologies at the pace of modern industry. Government agencies must shift from an archaic R&D process to an approach that rewards rapid fielding and risk taking.

Promote and Protect the U.S. National Security Innovation Base

America's business climate and legal and regulatory systems encourage risk taking. We are a nation of people who work hard, dream big, and never give up. Not every country shares these characteristics. Some instead steal or illicitly acquire America's hard-earned intellectual property and proprietary information to compensate for their own systemic weaknesses.

Every year, competitors such as China steal U.S. intellectual property valued at hundreds of billions of dollars. Stealing proprietary technology and early-stage ideas allows competitors to unfairly tap into the innovation of free societies. Over the years, rivals have used sophisticated

means to weaken our businesses and our economy as facets of cyber-enabled economic warfare and other malicious activities. In addition to these illegal means, some actors use largely legitimate, legal transfers and relationships to gain access to fields, experts, and trusted foundries that fill their capability gaps and erode America's long-term competitive advantages.

We must defend our National Security Innovation Base (NSIB) against competitors. The NSIB is the American network of knowledge, capabilities, and people—including academia, National Laboratories, and the private sector—that turns ideas into innovations, transforms discoveries into successful commercial products and companies, and protects and enhances the American way of life. The genius of creative Americans, and the free system that enables them, is critical to American security and prosperity.

Protecting the NSIB requires a domestic and international response beyond the scope of any individual company, industry, university, or government agency. The landscape of innovation does not divide neatly into sectors. Technologies that are part of most weapon systems often originate in diverse businesses as well as in universities and colleges. Losing our innovation and technological edge would have far-reaching negative implications for American prosperity and power.

Priority Actions

UNDERSTAND THE CHALLENGES: The U.S. Government will develop a capability to integrate, monitor, and better understand the national security implications of unfair industry trends and the actions of our rivals. We will explore new ways to share this information with the private sector and academia so they better understand their responsibilities in curtailing activities that undercut America's NSIB.

PROTECT INTELLECTUAL PROPERTY: The United States will reduce the illicit appropriation of U.S. pub-

lic and private sector technology and technical knowledge by hostile foreign competitors. While maintaining an investor-friendly climate, this Administration will work with the Congress to strengthen the Committee on Foreign Investment in the United States (CFIUS) to ensure it addresses current and future national security risks. The United States will prioritize counterintelligence and law enforcement activities to curtail intellectual property theft by all sources and will explore new legal and regulatory mechanisms to prevent and prosecute violations.

For the first time in generations, the United States will be an energy-dominant nation.

TIGHTEN VISA PROCEDURES:

The United States will review visa procedures to reduce economic theft by non-traditional intelligence collectors. We will consider restrictions on foreign STEM students from designated countries to ensure that intellectual property is not transferred to our competitors, while acknowledging the importance of recruiting the most advanced technical workforce to the United States.

PROTECT DATA AND UNDERLYING INFRASTRUCTURE:

The United States will expand our focus beyond protecting networks to protecting the data on those networks so that it remains secure—both at rest and in transit. To do this, the U.S. Government will encourage practices across companies and universities to defeat espionage and theft.

Embrace Energy Dominance

For the first time in generations, the United States will be an energy-dominant nation. Energy dominance—America’s central position in the global energy system as a leading producer, consumer, and innovator—ensures that markets are free and U.S. infrastructure is resilient and secure. It ensures

that access to energy is diversified, and recognizes the importance of environmental stewardship.

Access to domestic sources of clean, affordable, and reliable energy underpins a prosperous, secure, and powerful America for decades to come.

Unleashing these abundant energy resources—coal, natural gas, petroleum, renewables, and nuclear—stimulates the economy and builds a foundation for future growth. Our Nation must take advantage of our wealth in domestic resources and energy efficiency to promote competitiveness across our industries.

The United States also anchors the North American energy system, which is one of the most highly integrated in the world. Our vibrant cross-border energy trade and investment are vital for a robust and resilient U.S. economy and energy market. We are committed to supporting energy initiatives that will attract investments, safeguard the environment, strengthen our energy security, and unlock the enormous potential of our shared region.

Climate policies will continue to shape the global energy system. U.S. leadership is indispensable to countering an anti-growth energy agenda that is detrimental to U.S. economic and energy security interests. Given future global energy demand, much of the developing world will require fossil fuels, as well as other forms of energy, to power their economies and lift their people out of poverty. The United States will continue to advance an approach that balances energy security, economic development, and environmental protection. The United States will remain a global leader in reducing traditional pollution, as well as greenhouse gases, while expanding our economy. This achievement, which can serve as a model to other countries, flows from innovation, technology breakthroughs, and energy efficiency gains, not from onerous regulation.

As a growing supplier of energy resources, technologies, and services around the world, the United States will help our allies and partners become more resilient against those that use energy to coerce. America's role as an energy exporter will also require an assessment of our vulnerabilities and a resilient American infrastructure.

Finally, the Nation's long-term energy security future rests with our people. We must invest in our future by supporting innovation and R&D, including through the National Laboratories.

Priority Actions

REDUCE BARRIERS: The United States will promote clean and safe development of our energy resources, while limiting regulatory burdens that encumber energy production and constrain economic growth. We will streamline the Federal regulatory approval processes for energy infrastructure, from pipeline and export terminals to container shipments and gathering lines, while also ensuring responsible environmental stewardship.

PROMOTE EXPORTS: The United States will promote exports of our energy resources, technologies, and services, which helps our allies and partners diversify their energy sources and brings economic gains back home. We will expand our export capacity through the continued support of private sector development of coastal terminals, allowing increased market access and a greater competitive edge for U.S. industries.

ENSURE ENERGY SECURITY: The United States will work with allies and partners to protect global energy infrastructure from cyber and physical threats. The United States will support the diversification of energy sources, supplies, and routes at home and abroad. We will modernize our strategic petroleum stocks and encourage other countries to develop their own—consistent with their national energy security needs.

ATTAIN UNIVERSAL ENERGY ACCESS: The United States will seek to ensure universal access to affordable, reliable energy, including highly efficient fossil fuels, nuclear, and renewables, to help reduce poverty, foster economic growth, and promote prosperity.

FURTHER AMERICA'S TECHNOLOGICAL EDGE: We will improve America's technological edge in energy, including nuclear technology, next-generation nuclear reactors, better batteries, advanced computing, carbon-capture technologies, and opportunities at the energy-water nexus. The United States will continue to lead in innovative and efficient energy technologies, recognizing the economic and environmental benefits to end users.



P I L L A R I I I

PRESERVE PEACE THROUGH STRENGTH

“As long as I am President, the servicemen and women who defend our Nation will have the equipment, the resources, and the funding they need to secure our homeland, to respond to our enemies quickly and decisively, and, when necessary, to fight, to overpower, and to always, always, always win.”

PRESIDENT DONALD J. TRUMP | DECEMBER 2017

A central continuity in history is the contest for power. The present time period is no different. Three main sets of challengers—the revisionist powers of China and Russia, the rogue states of Iran and North Korea, and transnational threat organizations, particularly jihadist terrorist groups—are actively competing against the United States and our allies and partners. Although differing in nature and magnitude, these rivals compete across political, economic, and military arenas, and use technology and information to accelerate these contests in order to shift regional balances of power in their favor. These are fundamentally political contests between those who favor repressive systems and those who favor free societies.

China and Russia want to shape a world antithetical to U.S. values and interests. China seeks to displace the United States in the Indo-Pacific region, expand the reaches of its state-driven economic model, and reorder the region in its favor. Russia seeks to restore its great power status and establish spheres of influence near its borders. The intentions of both nations are not necessarily fixed. The United

States stands ready to cooperate across areas of mutual interest with both countries.

For decades, U.S. policy was rooted in the belief that support for China’s rise and for its integration into the post-war international order would liberalize China. Contrary to our hopes, China expanded its power at the expense of the sovereignty of others. China gathers and exploits data on an unrivaled scale and spreads features of its authoritarian system, including corruption and the use of surveillance. It is building the most capable and well-funded military in the world, after our own. Its nuclear arsenal is growing and diversifying. Part of China’s military modernization and economic expansion is due to its access to the U.S. innovation economy, including America’s world-class universities.

Russia aims to weaken U.S. influence in the world and divide us from our allies and partners. Russia views the North Atlantic Treaty Organization (NATO) and European Union (EU) as threats. Russia is investing in new military capabilities, including nuclear systems that remain the most significant existential threat to the United States, and in

destabilizing cyber capabilities. Through modernized forms of subversive tactics, Russia interferes in the domestic political affairs of countries around the world. The combination of Russian ambition and growing military capabilities creates an unstable frontier in Eurasia, where the risk of conflict due to Russian miscalculation is growing.

The scourge of the world today is a small group of rogue regimes that violate all principles of free and civilized states. The Iranian regime sponsors terrorism around the world. It is developing more capable ballistic missiles and has the potential to resume its work on nuclear weapons that could threaten the United States and our partners. North Korea is ruled as a ruthless dictatorship without regard for human dignity. For more than 25 years, it has pursued nuclear weapons and ballistic missiles in defiance of every commitment it has made. Today, these missiles and weapons threaten the United States and our allies. The longer we ignore threats from countries determined to proliferate and develop weapons of mass destruction, the worse such threats become, and the fewer defensive options we have.

The United States continues to wage a long war against jihadist terrorist groups such as ISIS and al-Qa'ida. These groups are linked by a common radical Islamist ideology that encourages violence against the United States and our partners and produces misery for those under their control. Although the United States and our partners have inflicted defeats on ISIS and al-Qa'ida in Syria and Iraq, these organizations maintain global reach with established branches in strategic locations. The threat from jihadist terrorists will persist, even as we intensify efforts to prevent attacks on Americans, our allies, and our partners.

Protecting American interests requires that we compete continuously within and across these contests, which are being played out in regions around the world. The outcome of these con-

tests will influence the political, economic, and military strength of the United States and our allies and partners.

To prevail, we must integrate all elements of America's national power—political, economic, and military. Our allies and partners must also contribute the capabilities, and demonstrate the will, to confront shared threats. Experience suggests that the willingness of rivals to abandon or forgo aggression depends on their perception of U.S. strength and the vitality of our alliances.

The United States will seek areas of cooperation with competitors from a position of strength, foremost by ensuring our military power is second to none and fully integrated with our allies and all of our instruments of power. A strong military ensures that our diplomats are able to operate from a position of strength. In this way we can, together with our allies and partners, deter and if necessary, defeat aggression against U.S. interests and increase the likelihood of managing competitions without violent conflict and preserving peace.

Renew America's Competitive Advantages

The United States must consider what is enduring about the problems we face, and what is new. The contests over influence are timeless. They have existed in varying degrees and levels of intensity, for millennia. Geopolitics is the interplay of these contests across the globe. But some conditions are new, and have changed how these competitions are unfolding. We face simultaneous threats from different actors across multiple arenas—all accelerated by technology. The United States must develop new concepts and capabilities to protect our homeland, advance our prosperity, and preserve peace.

Since the 1990s, the United States displayed a great degree of strategic complacency. We assumed that our military superiority was guaranteed and that a democratic peace was inevitable. We believed that liberal-democratic enlargement and inclusion would fundamentally alter the nature of international relations and that competition would give way to peaceful cooperation.

Instead of building military capacity, as threats to our national security increased, the United States dramatically cut the size of our military to the lowest levels since 1940. Instead of developing important capabilities, the Joint Force entered a nearly decade long “procurement holiday” during which the acquisition of new weapon systems was severely limited. The breakdown of the Nation’s annual Federal budgeting process, exemplified by sequestration and repeated continuing resolutions, further contributed to the erosion of America’s military dominance during a time of increasing threats.

Despite decades of efforts to reform the way that the United States develops and procures new weapons, our acquisition system remained sclerotic. The Joint Force did not keep pace with emerging threats or technologies. We got less for our defense dollars, shortchanging American taxpayers and warfighters.

We also incorrectly believed that technology could compensate for our reduced capacity—for the ability to field enough forces to prevail militarily, consolidate our gains, and achieve our desired political ends. We convinced ourselves that all wars would be fought and won quickly, from stand-off distances and with minimal casualties.

In addition, after being dismissed as a phenomenon of an earlier century, great power competition returned. China and Russia began to reassert their influence regionally and globally. Today, they are fielding military capabilities designed to deny

America access in times of crisis and to contest our ability to operate freely in critical commercial zones during peacetime. In short, they are contesting our geopolitical advantages and trying to change the international order in their favor.

Moreover, deterrence today is significantly more complex to achieve than during the Cold War. Adversaries studied the American way of war and began investing in capabilities that targeted our strengths and sought to exploit perceived weaknesses. The spread of accurate and inexpensive weapons

and the use of cyber tools have allowed state and non-state competitors to harm the United States across various domains. Such capabilities contest what was until recently U.S. dominance across the land, air, maritime, space, and cyberspace domains. They also enable adversaries to attempt strategic attacks against the United States—without resorting to nuclear weapons—in ways that could cripple our economy and our ability to deploy our military forces. Deterrence must be extended across all of these domains and must address all possible strategic attacks.

In addition, adversaries and competitors became adept at operating below the threshold of open military conflict and at the edges of international law. Repressive, closed states and organizations, although brittle in many ways, are often more agile and faster at integrating economic, military, and especially informational

The United States will seek areas of cooperation with competitors from a position of strength, foremost by ensuring our military power is second to none and fully integrated with our allies and all of our instruments of power.

means to achieve their goals. They are unencumbered by truth, by the rules and protections of privacy inherent in democracies, and by the law of armed conflict. They employ sophisticated political, economic, and military campaigns that combine discrete actions. They are patient and content to accrue strategic gains over time—making it harder for the United States and our allies to respond. Such actions are calculated to achieve maximum effect without provoking a direct military response from the United States. And as these incremental gains are realized, over time, a new status quo emerges.

The United States must prepare for this type of competition. China, Russia, and other state and non-state actors recognize that the United States often views the world in binary terms, with states being either “at peace” or “at war,” when it is actually an arena of continuous competition. Our adversaries will not fight us on our terms. We will raise our competitive game to meet that challenge, to protect American interests, and to advance our values.

Our diplomatic, intelligence, military, and economic agencies have not kept pace with the changes in the character of competition. America’s military must be prepared to operate across a full spectrum of conflict, across multiple domains at once. To meet these challenges we must also upgrade our political and economic instruments to operate across these environments.

Bureaucratic inertia is powerful. But so is the talent, creativity, and dedication of Americans. By aligning our public and private sector efforts we can field a Joint Force that is unmatched. New advances in computing, autonomy, and manufacturing are already transforming the way we fight. When coupled with the strength of our allies and partners, this advantage grows. The future that we face is ours to win or lose. History suggests that Americans will rise to the occasion and that we can shift trends back in favor of the United States, our allies, and our partners.

Renew Capabilities

Given the new features of the geopolitical environment, the United States must renew key capabilities to address the challenges we face.

Military

U.S. military strength remains a vital component of the competition for influence. The Joint Force demonstrates U.S. resolve and commitment and provides us with the ability to fight and win across any plausible conflict that threatens U.S. vital interests.

The United States must retain overmatch—the combination of capabilities in sufficient scale to prevent enemy success and to ensure that America’s sons and daughters will never be in a fair fight. Overmatch strengthens our diplomacy and permits us to shape the international environment to protect our interests. To retain military overmatch the United States must restore our ability to produce innovative capabilities, restore the readiness of our forces for major war, and grow the size of the force so that it is capable of operating at sufficient scale and for ample duration to win across a range of scenarios.

We must convince adversaries that we can and will defeat them—not just punish them if they attack the United States. We must ensure the ability to deter potential enemies by denial, convincing them that they cannot accomplish objectives through the use of force or other forms of aggression. We need our allies to do the same—to modernize, acquire necessary capabilities, improve readiness, expand the size of their forces, and affirm the political will to win.

Priority Actions

MODERNIZATION: Ensuring that the U.S. military can defeat our adversaries requires weapon systems that clearly overmatch theirs in lethality. Where possible, we must improve existing systems to maximize returns on prior investments. In other areas we should seek new capabilities that create clear advantages for our military while posing costly dilemmas for our adversaries. We must eliminate bureaucratic impediments to innovation and embrace less expensive and time-intensive commercial off-the-shelf solutions. Departments and agencies must work with industry to experiment, prototype, and rapidly field new capabilities that can be easily upgraded as new technologies come online.

ACQUISITION: The United States will pursue new approaches to acquisition to make better deals on behalf of the American people that avoid cost overruns, eliminate bloated bureaucracies, and stop unnecessary delays so that we can put the right equipment into the hands of our forces. We must harness innovative technologies that are being developed outside of the traditional defense industrial base.

CAPACITY: The size of our force matters. To deter conflict and, if deterrence fails, to win in war, the Nation must be able to field forces capable of operating in sufficient scale and for ample duration to defeat enemies, consolidate military gains, and achieve sustainable outcomes that protect the American people and our vital interests. The United States must reverse recent decisions to reduce the size of the Joint Force and grow the force while modernizing and ensuring readiness.

Support for a vibrant domestic manufacturing sector, a solid defense industrial base, and resilient supply chains is a national priority.

IMPROVE READINESS: The United States must retain a ready force that is capable of protecting the homeland while defending U.S. interests. Readiness requires a renewed focus on training, logistics, and maintenance. We must be able to get to a theater in time to shape events quickly. This will require a resilient forward posture and agile global mobility forces.

RETAIN A FULL-SPECTRUM FORCE: The Joint Force must remain capable of deterring and defeating the full range of threats to the United States. The Department of Defense must develop new operational concepts and capabilities to win without assured dominance in air, maritime, land, space, and cyberspace domains, including against those operating below the level of conventional military conflict.

We must sustain our competence in irregular warfare, which requires planning for a long-term, rather than ad hoc, fight against terrorist networks and other irregular threats.

Defense Industrial Base

A healthy defense industrial base is a critical element of U.S. power and the National Security Innovation Base. The ability of the military to surge in response to an emergency depends on our Nation's ability to produce needed parts and systems, healthy and secure supply chains, and a skilled U.S. workforce. The erosion of American manufacturing over the last two decades, however, has had a negative impact on these capabilities and threatens to undermine the ability of U.S. manufacturers to meet national security requirements. Today, we rely on single domestic sources for some products and foreign supply chains for others, and we face the possibility of not being able to produce specialized components for

the military at home. As America’s manufacturing base has weakened, so too have critical workforce skills ranging from industrial welding, to high-technology skills for cybersecurity and aerospace. Support for a vibrant domestic manufacturing sector, a solid defense industrial base, and resilient supply chains is a national priority.

Priority Actions

UNDERSTAND THE PROBLEM: We will evaluate the strengths and weaknesses of our defense industrial base, including the identification of materials essential to national security, contingencies that could affect supply chains, and technologies that are likely to be critical for the future.

ENCOURAGE HOMELAND INVESTMENT: The United States will promote policies and incentives that return key national security industries to American shores. Where possible, the U.S. Government will work with industry partners to strengthen U.S. competitiveness in key technologies and manufacturing capabilities. In addition, we will reform regulations and processes to facilitate the export of U.S. military equipment.

PROTECT AND GROW CRITICAL SKILLS: The United States must maintain and develop skilled trades and high-technology skills through increased support for technical college and apprenticeship programs. We will support STEM efforts, at the Federal and state levels, and target national security technology areas.

Nuclear Forces

Nuclear weapons have served a vital purpose in America’s National Security Strategy for the past 70 years. They are the foundation of our strategy to preserve peace and stability by deterring aggression against the United States, our allies, and our partners. While nuclear deterrence strategies cannot prevent all conflict, they are essen-

tial to prevent nuclear attack, non-nuclear strategic attacks, and large-scale conventional aggression. In addition, the extension of the U.S. nuclear deterrent to more than 30 allies and partners helps to assure their security, and reduces their need to possess their own nuclear capabilities.

Following the Cold War, the United States reduced investments in our nuclear enterprise and reduced the role of nuclear weapons in our strategy. Some parts of America’s strategic nuclear Triad of bombers, sea-based missiles, and land-based missiles are over 30 years old, and much of our nuclear infrastructure dates to the World War II era. At the same time, however, nuclear-armed adversaries have expanded their arsenals and range of delivery systems. The United States must maintain the credible deterrence and assurance capabilities provided by our nuclear Triad and by U.S. theater nuclear capabilities deployed abroad. Significant investment is needed to maintain a U.S. nuclear arsenal and infrastructure that is able to meet national security threats over the coming decades.

Priority Actions

SUSTAIN U.S. NUCLEAR WEAPONS: The United States will sustain a nuclear force structure that meets our current needs and addresses unanticipated risks. The United States does not need to match the nuclear arsenals of other powers, but we must sustain a stockpile that can deter adversaries, assure allies and partners, and achieve U.S. objectives if deterrence fails.

MODERNIZE U.S. NUCLEAR FORCES AND INFRASTRUCTURE: We will modernize our nuclear enterprise to ensure that we have the scientific, engineering, and manufacturing capabilities necessary to retain an effective and safe nuclear Triad and respond to future national security threats. Modernization and sustainment require investing in our aging command and control system and maintaining and growing

the highly skilled workforce needed to develop, manufacture, and deploy nuclear weapons.

MAINTAIN STABLE DETERRENCE: To avoid miscalculation, the United States will conduct discussions with other states to build predictable relationships and reduce nuclear risks. We will consider new arms control arrangements if they contribute to strategic stability and if they are verifiable. We will not allow adversaries to use threats of nuclear escalation or other irresponsible nuclear behaviors to coerce the United States, our allies, and our partners. Fear of escalation will not prevent the United States from defending our vital interests and those of our allies and partners.

Space

The United States must maintain our leadership and freedom of action in space. Communications and financial networks, military and intelligence systems, weather monitoring, navigation, and more have components in the space domain. As U.S. dependence on space has increased, other actors have gained access to space-based systems and information. Governments and private sector firms have the ability to launch satellites into space at increasingly lower costs. The fusion of data from imagery, communications, and geolocation services allows motivated actors to access previously unavailable information. This “democratization of space” has an impact on military operations and on America’s ability to prevail in conflict.

Many countries are purchasing satellites to support their own strategic military activities. Others believe that the ability to attack space assets offers an asymmetric advantage and as a result, are pursuing a range of anti-satellite (ASAT) weapons. The United States considers unfettered access to and freedom to operate in space to be a vital interest. Any harmful interference with or an attack upon critical components of our space architecture that directly affects this vital U.S. inter-

est will be met with a deliberate response at a time, place, manner, and domain of our choosing.

Priority Actions

ADVANCE SPACE AS A PRIORITY DOMAIN: America’s newly re-established National Space Council, chaired by the Vice President, will review America’s long-range space goals and develop a strategy that integrates all space sectors to support innovation and American leadership in space.

PROMOTE SPACE COMMERCE: The United States will simplify and update regulations for commercial space activity to strengthen competitiveness. As the U.S. Government partners with U.S. commercial space capabilities to improve the resiliency of our space architecture, we will also consider extending national security protections to our private sector partners as needed.

MAINTAIN LEAD IN EXPLORATION: To enable human exploration across the solar system and to bring back to Earth new knowledge and opportunities, we will increase public-private partnerships and promote ventures beyond low Earth orbit with allies and friends.

Cyberspace

Malicious state and non-state actors use cyberattacks for extortion, information warfare, disinformation, and more. Such attacks have the capability to harm large numbers of people and institutions with comparatively minimal investment and a troubling degree of deniability. These attacks can undermine faith and confidence in democratic institutions and the global economic system.

Many countries now view cyber capabilities as tools for projecting influence, and some use cyber tools to protect and extend their autocratic regimes. Cyberattacks have become a key feature of modern conflict. The United States will deter,

defend, and when necessary defeat malicious actors who use cyberspace capabilities against the United States. When faced with the opportunity to take action against malicious actors in cyberspace, the United States will be risk informed, but not risk averse, in considering our options.

Priority Actions

IMPROVE ATTRIBUTION, ACCOUNTABILITY, AND RESPONSE: We will invest in capabilities to support and improve our ability to attribute cyberattacks, to allow for rapid response.

ENHANCE CYBER TOOLS AND EXPERTISE: We will improve our cyber tools across the spectrum of conflict to protect U.S. Government assets and U.S. critical infrastructure, and to protect the integrity of data and information. U.S. departments and agencies will recruit, train, and retain a workforce capable of operating across this spectrum of activity.

IMPROVE INTEGRATION AND AGILITY: We will improve the integration of authorities and procedures across the U.S. Government so that cyber operations against adversaries can be conducted as required. We will work with the Congress to address the challenges that continue to hinder timely intelligence and information sharing, planning and operations, and the development of necessary cyber tools.

Intelligence

America's ability to identify and respond to geostrategic and regional shifts and their political, economic, military, and security implications requires that the U.S. Intelligence Community (IC) gather, analyze, discern, and operationalize information. In this information-dominant era, the IC must continuously pursue strategic intelligence to anticipate geostrategic shifts, as well as shorter-term intelligence so that the United States can respond to the actions and provocations of rivals.

The ability of the United States to modernize our military forces to overmatch our adversaries requires intelligence support. Intelligence is needed to understand and anticipate foreign doctrine and the intent of foreign leaders, prevent tactical and operational surprise, and ensure that U.S. capabilities are not compromised before they are fielded. In addition, virtually all modern weapon systems depend upon data derived from scientific and technical intelligence.

The IC, as well as the law enforcement community, offer unique abilities to defend against and mitigate threat actors operating below the threshold of open conflict. Both communities have exceptionally strong liaison relationships throughout the world, allowing the United States to cooperate with allies and partners to protect against adversaries.

Priority Actions

IMPROVE UNDERSTANDING: To prevent the theft of sensitive and proprietary information and maintain supply chain integrity, the United States must increase our understanding of the economic policy priorities of our adversaries and improve our ability to detect and defeat their attempts to commit economic espionage.

HARNESS ALL INFORMATION AT OUR DISPOSAL: The United States will, in concert with allies and partners, use the information-rich open-source environment to deny the ability of state and non-state actors to attack our citizens, conduct offensive intelligence activities, and degrade America's democratic institutions.

FUSE INFORMATION AND ANALYSIS: The United States will fuse our analysis of information derived from the diplomatic, information, military, and economic domains to compete more effectively on the geopolitical stage.

Diplomacy and Statecraft

Competitive Diplomacy

Across the competitive landscape, America's diplomats are our forward-deployed political capability, advancing and defending America's interests abroad. Diplomacy catalyzes the political, economic, and societal connections that create America's enduring alignments and that build positive networks of relationships with partners. Diplomacy sustains dialogue and fosters areas of cooperation with competitors. It reduces the risk of costly miscommunication.

Diplomacy is indispensable to identify and implement solutions to conflicts in unstable regions of the world short of military involvement. It helps to galvanize allies for action and marshal the collective resources of like-minded nations and organizations to address shared problems. Authoritarian states are eager to replace the United States where the United States withdraws our diplomats and closes our outposts.

We must upgrade our diplomatic capabilities to compete in the current environment and to embrace a competitive mindset. Effective diplomacy requires the efficient use of limited resources, a professional diplomatic corps, modern and safe facilities, and secure methods to communicate and engage with local populations.

Priority Actions

PRESERVE A FORWARD DIPLOMATIC PRESENCE: Our diplomats must be able to build and sustain relationships where U.S. interests are at stake. Face-to-face diplomacy cannot be replaced by technology. Relationships, developed over time, create trust and shared understanding that the United States calls upon when confronting security threats, responding to crises, and encouraging others to share the burden for tackling the world's challenges. We must enable forward-deployed field work beyond the confines of diplomatic facilities, including partnering with military colleagues in conflict-affected states.

ADVANCE AMERICAN INTERESTS: In the ongoing contests for power, our diplomats must build and lead coalitions that advance shared interests and articulate America's vision in international forums, in bilateral relationships, and at local levels within states. Our diplomats need additional flexibility to operate in complex conflict-affected areas.

CATALYZE OPPORTUNITIES: Diplomats must identify opportunities for commerce and cooperation, and facilitate the cultural, educational, and people-to-people exchanges that create the networks of current and future political, civil society, and educational leaders who will extend a free and prosperous world.

Diplomacy is indispensable to identify and implement solutions to conflicts in unstable regions of the world short of military involvement. It helps to galvanize allies for action and marshal the collective resources of like-minded nations and organizations to address shared problems.

Tools of Economic Diplomacy

Retaining our position as the world’s preeminent economic actor strengthens our ability to use the tools of economic diplomacy for the good of Americans and others. Maintaining America’s central role in international financial forums enhances our security and prosperity by expanding a community of free market economies, defending against threats from state-led economies, and protecting the U.S. and international economy from abuse by illicit actors.

We want to create wealth for Americans and our allies and partners. Prosperous states are stronger security partners who are able to share the burden of confronting common threats. Fair and reciprocal trade, investments, and exchanges of knowledge deepen our alliances and partnerships, which are necessary to succeed in today’s competitive geopolitical environment. Trade, export promotion, targeted use of foreign assistance, and modernized development finance tools can promote stability, prosperity, and political reform, and build new partnerships based on the principle of reciprocity.

Economic tools—including sanctions, anti-money-laundering and anti-corruption measures, and enforcement actions—can be important parts of broader strategies to deter, coerce, and constrain adversaries. We will work with like-minded partners to build support for tools of economic diplomacy against shared threats. Multilateral economic pressure is often more effective because it limits the ability of targeted states to circumvent measures and conveys united resolve.

America's competitors weaponize information to attack the values and institutions that underpin free societies, while shielding themselves from outside information.

Priority Actions

REINFORCE ECONOMIC TIES WITH ALLIES AND PARTNERS: We will strengthen economic ties as a core aspect of our relationships with like-minded states and use our economic expertise, markets, and resources to bolster states threatened by our competitors.

DEPLOY ECONOMIC PRESSURE ON SECURITY THREATS: We will use existing and pursue new economic authorities and mobilize international actors to increase pressure on threats to peace and security in order to resolve confrontations short of military action.

SEVER SOURCES OF FUNDING: We will deny revenue to terrorists, WMD proliferators, and other illicit actors in order to constrain their ability to use and move funds to support hostile acts and operations.

Information Statecraft

America’s competitors weaponize information to attack the values and institutions that underpin free societies, while shielding themselves from outside information. They exploit marketing techniques to target individuals based upon their activities, interests,

opinions, and values. They disseminate misinformation and propaganda.

Risks to U.S. national security will grow as competitors integrate information derived from personal and commercial sources with intelligence collection and data analytic capabilities based on Artificial Intelligence (AI) and machine learning. Breaches of U.S. commercial and government organizations also provide adversaries with data and insights into their target audiences.

China, for example, combines data and the use of AI to rate the loyalty of its citizens to the state and uses these ratings to determine jobs and more. Jihadist terrorist groups continue to wage ideological information campaigns to establish and legitimize their narrative of hate, using sophisticated communications tools to attract recruits and encourage attacks against Americans and our partners.

Russia uses information operations as part of its offensive cyber efforts to influence public opinion across the globe. Its influence campaigns blend covert intelligence operations and false online personas with state-funded media, third-party intermediaries, and paid social media users or “trolls.”

U.S. efforts to counter the exploitation of information by rivals have been tepid and fragmented. U.S. efforts have lacked a sustained focus and have been hampered by the lack of properly trained professionals. The American private sector has a direct interest in supporting and amplifying voices that stand for tolerance, openness, and freedom.

Priority Actions

PRIORITIZE THE COMPETITION: We will improve our understanding of how adversaries gain informational and psychological advantages across all policies. The United States must empower a true public diplomacy capability to compete effectively in this arena.

DRIVE EFFECTIVE COMMUNICATIONS: We will craft and direct coherent communications campaigns to advance American influence and counter challenges from the ideological threats that emanate from radical Islamist groups and competitor nations. These campaigns will adhere to American values and expose adversary propaganda and disinformation.

ACTIVATE LOCAL NETWORKS: Local voices are most compelling and effective in ideological competitions. We must amplify credible voices and partner with them to advance alternatives to violent and hateful messages. Since media and Internet companies are the platforms through which messages are transported, the private sector should lend its creativity and resources to promoting the values that inspire and grow a community of civilized groups and individuals.

SHARE RESPONSIBILITY: The United States will urge states where radicalism thrives to take greater responsibility for countering violent messaging and promoting tolerant and pluralistic worldviews.

UPGRADE, TAILOR, AND INNOVATE: We will reexamine legacy delivery platforms for communicating U.S. messages overseas. We must consider more cost-effective and efficient ways to deliver and evaluate content consistent with U.S. national security interests.



P I L L A R I V

ADVANCE AMERICAN INFLUENCE

“Above all, we value the dignity of every human life, protect the rights of every person, and share the hope of every soul to live in freedom. That is who we are.”

PRESIDENT DONALD J. TRUMP | JULY 2017

Our America First foreign policy celebrates America’s influence in the world as a positive force that can help set the conditions for peace and prosperity and for developing successful societies.

There is no arc of history that ensures that America’s free political and economic system will automatically prevail. Success or failure depends upon our actions. This Administration has the confidence to compete to protect our values and interests and the fundamental principles that underpin them.

During the Cold War, a totalitarian threat from the Soviet Union motivated the free world to create coalitions in defense of liberty. Today’s challenges to free societies are just as serious, but more diverse. State and non-state actors project influence and advance their objectives by exploiting information, democratic media freedoms, and international institutions. Repressive leaders often collaborate to subvert free societies and corrupt multilateral organizations.

Around the world, nations and individuals admire what America stands for. We treat people equally and value and uphold the rule of law. We have a democratic system that allows the best ideas to flourish. We know how to grow economies so that individuals can achieve prosperity. These

qualities have made America the richest country on earth—rich in culture, talent, opportunities, and material wealth.

The United States offers partnership to those who share our aspirations for freedom and prosperity. We lead by example. “The world has its eye upon America,” Alexander Hamilton once observed. “The noble struggle we have made in the cause of liberty, has occasioned a kind of revolution in human sentiment. The influence of our example has penetrated the gloomy regions of despotism.”

We are not going to impose our values on others. Our alliances, partnerships, and coalitions are built on free will and shared interests. When the United States partners with other states, we develop policies that enable us to achieve our goals while our partners achieve theirs.

Allies and partners are a great strength of the United States. They add directly to U.S. political, economic, military, intelligence, and other capabilities. Together, the United States and our allies and partners represent well over half of the global GDP. None of our adversaries have comparable coalitions.

We encourage those who want to join our community of like-minded democratic states and

improve the condition of their peoples. By modernizing U.S. instruments of diplomacy and development, we will catalyze conditions to help them achieve that goal. These aspiring partners include states that are fragile, recovering from conflict, and seeking a path forward to sustainable security and economic growth. Stable, prosperous, and friendly states enhance American security and boost U.S. economic opportunities.

We will continue to champion American values and offer encouragement to those struggling for human dignity in their societies. There can be no moral equivalency between nations that uphold the rule of law, empower women, and respect individual rights and those that brutalize and suppress their people. Through our words and deeds, America demonstrates a positive alternative to political and religious despotism.

Encourage Aspiring Partners

Some of the greatest triumphs of American statecraft resulted from helping fragile and developing countries become successful societies. These successes, in turn, created profitable markets for American businesses, allies to help achieve favorable regional balances of power, and coalition partners to share burdens and address a variety of problems around the world. Over time, the United States has helped create a network of states that advance our common interests and values.

This historical record is unprecedented and exceptional. American support to aspiring partners enabled the recovery of the countries of Western Europe under the Marshall Plan, as well as the

ongoing integration of Central and Eastern Europe into Western institutions after the Cold War. In Asia, the United States worked with South Korea and Japan, countries ravaged by war, to help them become successful democracies and among the most prosperous economies in the world.

These achievements were products of patient partnerships with those who aspired to build prosperous societies and join the community of democratic states. They resulted in mutually beneficial relationships in which the United States helped states mobilize their own resources to achieve transitions to growth and stability. Working with these countries made the United States wealthier and

more competitive. This progress illustrates how effective foreign assistance programs should reach their natural endpoint.

Today, the United States must compete for positive relationships around the world. China and Russia target their investments in the developing world to expand influence and gain competitive advantages against the United States. China is investing billions of dollars in infrastructure across the globe. Russia, too, projects its influence economically, through the control of key energy and other infrastructure throughout parts of Europe and Central Asia. The United States provides an alternative to state-directed investments, which often leave developing countries worse off. The United States pursues economic ties not only for market access but also to create enduring relationships to advance common political and security interests.

The United States will promote a development model that partners with countries that want progress, consistent with their culture, based on free market principles, fair and reciprocal trade, private

There is no arc of history that ensures that America's free political and economic system will automatically prevail. Success or failure depends upon our actions.

sector activity, and rule of law. The United States will shift away from a reliance on assistance based on grants to approaches that attract private capital and catalyze private sector activity. We will emphasize reforms that unlock the economic potential of citizens, such as the promotion of formal property rights, entrepreneurial reforms, and infrastructure improvements—projects that help people earn their livelihood and have the added benefit of helping U.S. businesses. By mobilizing both public and private resources, the United States can help maximize returns and outcomes and reduce the burden on U.S. Government resources. Unlike the state-directed mercantilism of some competitors that can disadvantage recipient nations and promote dependency, the purpose of U.S. foreign assistance should be to end the need for it. The United States seeks strong partners, not weak ones.

U.S. development assistance must support America's national interests. We will prioritize collaboration with aspiring partners that are aligned with U.S. interests. We will focus on development investments where we can have the most impact—where local reformers are committed to tackling their economic and political challenges.

Within this framework, the United States will also assist fragile states to prevent threats to the U.S. homeland. Transnational threat organizations, such as jihadist terrorists and organized crime, often operate freely from fragile states and undermine sovereign governments. Failing states can destabilize entire regions.

Across Africa, Latin America, and Asia, states are eager for investments and financing to develop their infrastructure and propel growth. The United States and its partners have opportunities to work with countries to help them realize their potential as prosperous and sovereign states that are accountable to their people. Such states can become trading partners that buy more American-made goods and create more predictable business environments that benefit American

companies. American-led investments represent the most sustainable and responsible approach to development and offer a stark contrast to the corrupt, opaque, exploitive, and low-quality deals offered by authoritarian states.

Priority Actions: Developing Countries

MOBILIZE RESOURCES: The United States will modernize its development finance tools so that U.S. companies have incentives to capitalize on opportunities in developing countries. With these changes, the United States will not be left behind as other states use investment and project finance to extend their influence. In addition, the U.S. Government must not be an obstacle to U.S. companies that want to conduct business in the developing world.

CAPITALIZE ON NEW TECHNOLOGIES: We will incorporate innovative technologies in our diplomatic and development programs. For example, digital technologies enable millions to access financial services through their cell phones and can connect farmers to markets. Such technologies can reduce corruption, increase transparency, and help ensure that money reaches its intended destination.

INCENTIVIZE REFORMS: The United States will use diplomacy and assistance to encourage states to make choices that improve governance, rule of law, and sustainable development. We already do this through the Millennium Challenge Corporation, which selects countries that are committed to reform and then monitors and evaluates their projects.

Priority Actions: Fragile States

COMMIT SELECTIVELY: We will give priority to strengthening states where state weaknesses or failure would magnify threats to the American

homeland. For instance, engagement in Afghanistan seeks to prevent the reemergence of terrorist safe havens.

WORK WITH REFORMERS: Political problems are at the root of most state fragility. The United States will prioritize programs that empower reform-minded governments, people, and civil society. As the United States designs its efforts, inputs from local actors improve the likelihood of enduring solutions, reduce costs, and increase accountability to the American taxpayer.

SYNCHRONIZE ACTIONS: The United States must use its diplomatic, economic, and military tools simultaneously when assisting aspiring partners. We will place a priority on economic support that achieves local and macroeconomic stability, helps build capable security forces, and strengthens the rule of law.

Achieve Better Outcomes in Multilateral Forums

The United States must lead and engage in the multinational arrangements that shape many of the rules that affect U.S. interests and values. A competition for influence exists in these institutions. As we participate in them, we must protect American sovereignty and advance American interests and values.

A range of international institutions establishes the rules for how states, businesses, and individuals interact with each other, across land and sea, the Arctic, outer space, and the digital realm. It is vital to U.S. prosperity and security that these institutions uphold the rules that help keep these common domains open and free. Free access to the seas remains a central principle of national security and economic prosperity, and exploration of sea and space provides opportunities for commercial gain and scientific breakthroughs. The flow of data

and an open, interoperable Internet are inseparable from the success of the U.S. economy.

Authoritarian actors have long recognized the power of multilateral bodies and have used them to advance their interests and limit the freedom of their own citizens. If the United States cedes leadership of these bodies to adversaries, opportunities to shape developments that are positive for the United States will be lost. All institutions are not equal, however. The United States will prioritize its efforts in those organizations that serve American interests, to ensure that they are strengthened and supportive of the United States, our allies, and our partners. Where existing institutions and rules need modernizing, the United States will lead to update them. At the same time, it should be clear that the United States will not cede sovereignty to those that claim authority over American citizens and are in conflict with our constitutional framework.

Priority Actions

EXERCISE LEADERSHIP IN POLITICAL AND SECURITY BODIES: The United States will strive for outcomes in political and security forums that are consistent with U.S. interests and values—values which are shared by our allies and partners. The United Nations can help contribute to solving many of the complex problems in the world, but it must be reformed and recommit to its founding principles. We will require accountability and emphasize shared responsibility among members. If the United States is asked to provide a disproportionate level of support for an institution, we will expect a commensurate degree of influence over the direction and efforts of that institution.

SHAPE AND REFORM INTERNATIONAL FINANCIAL AND TRADE INSTITUTIONS: The United States will continue to play a leading role in institutions such as the International Monetary Fund (IMF), World Bank, and World Trade Organization (WTO), but will

improve their performance through reforms. These reforms include encouraging multilateral development banks to invest in high-quality infrastructure projects that promote economic growth. We will press to make the WTO a more effective forum to adjudicate unfair trade practices.

ENSURE COMMON DOMAINS

REMAIN FREE: The United States will provide leadership and technology to shape and govern common domains—space, cyberspace, air, and maritime—within the framework of international law. The United States supports the peaceful resolution of disputes under international law but will use all of its instruments of power to defend U.S. interests and to ensure common domains remain free.

PROTECT A FREE AND OPEN

INTERNET: The United States will advocate for open, interoperable communications, with minimal barriers to the global exchange of information and services. The United States will promote the free flow of data and protect its interests through active engagement in key organizations, such as the Internet Corporation for Assigned Names and Numbers (ICANN), the Internet Governance Forum (IGF), the UN, and the International Telecommunication Union (ITU).

Champion American Values

The extraordinary trajectory of the United States from a group of colonies to a thriving, industrialized, sovereign republic—the world's lone superpower—is a testimony to the strength of the idea on which our Nation is founded, namely that each of our citizens is born free and equal under

the law. America's core principles, enshrined in the Declaration of Independence, are secured by the Bill of Rights, which proclaims our respect for fundamental individual liberties beginning with the freedoms of religion, speech, the press, and assembly. Liberty, free enterprise, equal justice under the law, and the dignity of every human life are central to who we are as a people.

*For much of the world,
America's liberties are
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We will remain a beacon
of liberty and opportunity
around the world.*

These principles form the foundation of our most enduring alliances, and the United States will continue to champion them. Governments that respect the rights of their citizens remain the best vehicle for prosperity, human happiness, and peace. In contrast, governments that routinely abuse the rights of their citizens do not play constructive roles in the world. For example, governments that fail to treat women equally do not allow their societies to reach their potential.

No nation can unilaterally alleviate all human suffering, but just because we cannot help everyone does not mean that we should stop trying to help anyone. For much of the world, America's liberties are inspirational, and the United States will always stand with those who seek freedom. We will remain a beacon of liberty and opportunity around the world.

The United States also remains committed to supporting and advancing religious freedom—America's first freedom. Our Founders understood religious freedom not as the state's creation, but as the gift of God to every person and a fundamental right for our flourishing society.

And it is part of our culture, as well as in America's interest, to help those in need and those trying to

build a better future for their families. We aid others judiciously, aligning our means to our objectives, but with a firm belief that we can improve the lives of others while establishing conditions for a more secure and prosperous world.

Priority Actions

SUPPORT THE DIGNITY OF INDIVIDUALS: We support, with our words and actions, those who live under oppressive regimes and who seek freedom, individual dignity, and the rule of law. We are under no obligation to offer the benefits of our free and prosperous community to repressive regimes and human rights abusers. We may use diplomacy, sanctions, and other tools to isolate states and leaders who threaten our interests and whose actions run contrary to our values. We will not remain silent in the face of evil. We will hold perpetrators of genocide and mass atrocities accountable.

DEFEAT TRANSNATIONAL TERRORIST ORGANIZATIONS: There can be no greater action to advance the rights of individuals than to defeat jihadist terrorists and other groups that foment hatred and use violence to advance their supremacist Islamist ideologies. We will continue to join with other states to defeat this scourge of all civilized peoples.

EMPOWER WOMEN AND YOUTH: Societies that empower women to participate fully in civic and economic life are more prosperous and peaceful. We will support efforts to advance women's equality, protect the rights of women and girls, and promote women and youth empowerment programs.

PROTECT RELIGIOUS FREEDOM AND RELIGIOUS MINORITIES: We will advocate on behalf of religious freedom and threatened minorities. Religious minorities continue to be victims of violence. We will place a priority on protecting these groups and will continue working with regional partners to protect minority communities from attacks and to preserve their cultural heritage.

REDUCE HUMAN SUFFERING: The United States will continue to lead the world in humanitarian assistance. Even as we expect others to share responsibility, the United States will continue to catalyze international responses to man-made and natural disasters and provide our expertise and capabilities to those in need. We will support food security and health programs that save lives and address the root cause of hunger and disease. We will support displaced people close to their homes to help meet their needs until they can safely and voluntarily return home.



THE STRATEGY IN A REGIONAL CONTEXT

The United States must tailor our approaches to different regions of the world to protect U.S. national interests. We require integrated regional strategies that appreciate the nature and magnitude of threats, the intensity of competitions, and the promise of available opportunities, all in the context of local political, economic, social, and historical realities.

Changes in a regional balance of power can have global consequences and threaten U.S. interests. Markets, raw materials, lines of communication, and human capital are located within, or move among, key regions of the world. China and Russia aspire to project power worldwide, but they interact most with their neighbors. North Korea and Iran also pose the greatest menace to those closest to them. But, as destructive weapons proliferate and regions become more interconnected, threats become more difficult to contain. And regional balances that shift against the United States could combine to threaten our security.

The United States must marshal the will and capabilities to compete and prevent unfavorable shifts in the Indo-Pacific, Europe, and the Middle East. Sustaining favorable balances of power will require a strong commitment and close cooperation with allies and partners because allies and partners magnify U.S. power and extend U.S. influence. They share our interests and responsibility for resisting authoritarian trends, contesting radical ideologies, and deterring aggression.

In other regions of the world, instability and weak governance threaten U.S. interests. Some governments are unable to maintain security and meet the basic needs of their people, making their country and citizens vulnerable to preda-

tors. Terrorists and criminals thrive where governments are weak, corruption is rampant, and faith in government institutions is low. Strategic competitors often exploit rather than discourage corruption and state weakness to extract resources and exploit their populations.

Regions afflicted by instability and weak governments also offer opportunities to improve security, promote prosperity, and restore hope. Aspiring partner states across the developing world want to improve their societies, build transparent and effective governments, confront non-state threats, and strengthen their sovereignty. Many recognize the opportunities offered by market economies and political liberties and are eager for partnership with the United States and our allies. The United States will encourage aspiring partners as they undertake reforms and pursue their aspirations. States that prosper and nations that transition from recipients of development assistance to trading partners offer economic opportunities for American businesses. And stability reduces threats that target Americans at home.

Indo-Pacific

A geopolitical competition between free and repressive visions of world order is taking place in the Indo-Pacific region. The region, which stretches

from the west coast of India to the western shores of the United States, represents the most populous and economically dynamic part of the world. The U.S. interest in a free and open Indo-Pacific extends back to the earliest days of our republic.

Although the United States seeks to continue to cooperate with China, China is using economic inducements and penalties, influence operations, and implied military threats to persuade other states to heed its political and security agenda. China's infrastructure investments and trade strategies reinforce its geopolitical aspirations. Its efforts to build and militarize outposts in the South China Sea endanger the free flow of trade, threaten the sovereignty of other nations, and undermine regional stability. China has mounted a rapid military modernization campaign designed to limit U.S. access to the region and provide China a freer hand there. China presents its ambitions as mutually beneficial, but Chinese dominance risks diminishing the sovereignty of many states in the Indo-Pacific. States throughout the region are calling for sustained U.S. leadership in a collective response that upholds a regional order respectful of sovereignty and independence.

In Northeast Asia, the North Korean regime is rapidly accelerating its cyber, nuclear, and ballistic missile programs. North Korea's pursuit of these weapons poses a global threat that requires a global response. Continued provocations by North Korea will prompt neighboring countries and the United States to further strengthen security bonds and take additional measures to protect themselves. And a nuclear-armed North Korea could lead to the prolif-

eration of the world's most destructive weapons across the Indo-Pacific region and beyond.

U.S. allies are critical to responding to mutual threats, such as North Korea, and preserving our mutual interests in the Indo-Pacific region. Our alliance and friendship with South Korea, forged by the trials of history, is stronger than ever. We welcome and support the strong leadership role of our critical ally, Japan. Australia has fought alongside us in every significant conflict since World War I, and continues to reinforce economic and security arrangements that support our shared interests and safeguard democratic values across the region. New Zealand is a key U.S. partner contributing to peace and security across the region. We welcome

Sustaining favorable balances of power will require a strong commitment and close cooperation with allies and partners because allies and partners magnify U.S. power and extend U.S. influence.

India's emergence as a leading global power and stronger strategic and defense partner. We will seek to increase quadrilateral cooperation with Japan, Australia, and India.

In Southeast Asia, the Philippines and Thailand remain important allies and markets for Americans. Vietnam, Indonesia, Malaysia, and Singapore are growing security and economic partners of the United States. The Association of Southeast Asian Nations (ASEAN) and Asia-Pacific Economic Cooperation (APEC) remain centerpieces of the Indo-Pacific's regional architecture and platforms for promoting an order based on freedom.

Priority Actions

POLITICAL: Our vision for the Indo-Pacific excludes no nation. We will redouble our commitment to established alliances and partnerships, while expanding and deepening relationships with new

partners that share respect for sovereignty, fair and reciprocal trade, and the rule of law. We will reinforce our commitment to freedom of the seas and the peaceful resolution of territorial and maritime disputes in accordance with international law. We will work with allies and partners to achieve complete, verifiable, and irreversible denuclearization on the Korean Peninsula and preserve the non-proliferation regime in Northeast Asia.

ECONOMIC: The United States will encourage regional cooperation to maintain free and open seaways, transparent infrastructure financing practices, unimpeded commerce, and the peaceful resolution of disputes. We will pursue bilateral trade agreements on a fair and reciprocal basis. We will seek equal and reliable access for American exports. We will work with partners to build a network of states dedicated to free markets and protected from forces that would subvert their sovereignty. We will strengthen cooperation with allies on high-quality infrastructure. Working with Australia and New Zealand, we will shore up fragile partner states in the Pacific Islands region to reduce their vulnerability to economic fluctuations and natural disasters.

MILITARY AND SECURITY: We will maintain a forward military presence capable of deterring and, if necessary, defeating any adversary. We will strengthen our long-standing military relationships and encourage the development of a strong defense network with our allies and partners. For example, we will cooperate on missile defense with Japan and South Korea to move toward an area defense capability. We remain ready to respond with overwhelming force to North Korean aggression and will improve options to compel denuclearization of the peninsula. We will improve law enforcement, defense, and intelligence cooperation with Southeast Asian partners to address the growing terrorist threat. We will maintain our strong ties with Taiwan in accordance with our “One China” policy, including our commitments under the

Taiwan Relations Act to provide for Taiwan’s legitimate defense needs and deter coercion. We will expand our defense and security cooperation with India, a Major Defense Partner of the United States, and support India’s growing relationships throughout the region. We will re-energize our alliances with the Philippines and Thailand and strengthen our partnerships with Singapore, Vietnam, Indonesia, Malaysia, and others to help them become cooperative maritime partners.

Europe

A strong and free Europe is of vital importance to the United States. We are bound together by our shared commitment to the principles of democracy, individual liberty, and the rule of law. Together, we rebuilt Western Europe after World War II and created institutions that produced stability and wealth on both sides of the Atlantic. Today, Europe is one of the most prosperous regions in the world and our most significant trading partner.

Although the menace of Soviet communism is gone, new threats test our will. Russia is using subversive measures to weaken the credibility of America’s commitment to Europe, undermine transatlantic unity, and weaken European institutions and governments. With its invasions of Georgia and Ukraine, Russia demonstrated its willingness to violate the sovereignty of states in the region. Russia continues to intimidate its neighbors with threatening behavior, such as nuclear posturing and the forward deployment of offensive capabilities.

China is gaining a strategic foothold in Europe by expanding its unfair trade practices and investing in key industries, sensitive technologies, and infrastructure. Europe also faces immediate threats from violent Islamist extremists. Attacks by ISIS and other jihadist groups in Spain, France, Germany, Belgium, the United Kingdom, and

other countries show that our European partners continue to face serious threats. Instability in the Middle East and Africa has triggered the movement of millions of migrants and refugees into Europe, exacerbating instability and tensions in the region.

The United States is safer when Europe is prosperous and stable, and can help defend our shared interests and ideals. The United States remains firmly committed to our European allies and partners. The NATO alliance of free and sovereign states is one of our great advantages over our competitors, and the United States remains committed to Article V of the Washington Treaty.

European allies and partners increase our strategic reach and provide access to forward basing and overflight rights for global operations. Together we confront shared threats. European nations are contributing thousands of troops to help fight jihadist terrorists in Afghanistan, stabilize Iraq, and fight terrorist organizations across Africa and the greater Middle East.

The NATO alliance will become stronger when all members assume greater responsibility for and pay their fair share to protect our mutual interests, sovereignty, and values.

Priority Actions

POLITICAL: The United States will deepen collaboration with our European allies and partners to confront forces threatening to undermine our common values, security interests, and shared vision. The United States and Europe will work together to counter Russian subversion and aggression, and the threats posed by North Korea and Iran. We will continue to advance our shared principles and interests in international forums.

ECONOMIC: The United States will work with the European Union, and bilaterally with the United Kingdom and other states, to ensure fair and reciprocal trade practices and eliminate barriers to

growth. We will encourage European foreign direct investment in the United States to create jobs. We will work with our allies and partners to diversify European energy sources to ensure the energy security of European countries. We will work with our partners to contest China's unfair trade and economic practices and restrict its acquisition of sensitive technologies.

MILITARY AND SECURITY: The United States fulfills our defense responsibilities and expects others to do the same. We expect our European allies to increase defense spending to 2 percent of gross domestic product by 2024, with 20 percent of this spending devoted to increasing military capabilities. On NATO's eastern flank we will continue to strengthen deterrence and defense, and catalyze frontline allies and partners' efforts to better defend themselves. We will work with NATO to improve its integrated air and missile defense capabilities to counter existing and projected ballistic and cruise missile threats, particularly from Iran. We will increase counterterrorism and cybersecurity cooperation.

Middle East

The United States seeks a Middle East that is not a safe haven or breeding ground for jihadist terrorists, not dominated by any power hostile to the United States, and that contributes to a stable global energy market.

For years, the interconnected problems of Iranian expansion, state collapse, jihadist ideology, socio-economic stagnation, and regional rivalries have convulsed the Middle East. The United States has learned that neither aspirations for democratic transformation nor disengagement can insulate us from the region's problems. We must be realistic about our expectations for the region without allowing pessimism to obscure our interests or vision for a modern Middle East.

The region remains home to the world’s most dangerous terrorist organizations. ISIS and al-Qa’ida thrive on instability and export violent jihad. Iran, the world’s leading state sponsor of terrorism, has taken advantage of instability to expand its influence through partners and proxies, weapon proliferation, and funding. It continues to develop more capable ballistic missiles and intelligence capabilities, and it undertakes malicious cyber activities. These activities have continued unabated since the 2015 nuclear deal. Iran continues to perpetuate the cycle of violence in the region, causing grievous harm to civilian populations. Rival states are filling vacuums created by state collapse and prolonged regional conflict.

Despite these challenges, there are emerging opportunities to advance American interests in the Middle East. Some of our partners are working together to reject radical ideologies, and key leaders are calling for a rejection of Islamist extremism and violence. Encouraging political stability and sustainable prosperity would contribute to dampening the conditions that fuel sectarian grievances.

For generations the conflict between Israel and the Palestinians has been understood as the prime irritant preventing peace and prosperity in the region. Today, the threats from jihadist terrorist organizations and the threat from Iran are creating the realization that Israel is not the cause of the region’s problems. States have increasingly found common interests with Israel in confronting common threats.

Today, the United States has the opportunity to catalyze greater economic and political cooperation that will expand prosperity for those who want to partner with us. By revitalizing partnerships with reform-minded nations and encour-

aging cooperation among partners in the region, the United States can promote stability and a balance of power that favors U.S. interests.

Priority Actions

POLITICAL: We will strengthen partnerships, and form new ones, to help advance security through stability. Whenever possible, we will encourage gradual reforms. We will support efforts to counter violent ideologies and increase respect for the dignity of individuals. We remain committed to helping our partners achieve a stable and prosperous region, including through a strong and integrated Gulf Cooperation Council. We will strengthen our long-term strategic partnership with Iraq as an independent state. We will seek a settlement to the Syrian civil war that sets the conditions for refugees to return home and rebuild their lives in safety. We will work with partners to deny the Iranian

regime all paths to a nuclear weapon and neutralize Iranian malign influence. We remain committed to helping facilitate a comprehensive peace agreement that is acceptable to both Israelis and Palestinians.

ECONOMIC: The United States will support the reforms underway that begin to address core inequities that jihadist terrorists exploit. We will encourage states in the region, including

Egypt and Saudi Arabia, to continue modernizing their economies. We will play a role in catalyzing positive developments by engaging economically, supporting reformers, and championing the benefits of open markets and societies.

MILITARY AND SECURITY: We will retain the necessary American military presence in the region to protect the United States and our allies from terrorist attacks and preserve a favorable regional

Terrorists and criminals thrive where governments are weak, corruption is rampant, and faith in government institutions is low.

balance of power. We will assist regional partners in strengthening their institutions and capabilities, including in law enforcement, to conduct counterterrorism and counterinsurgency efforts. We will help partners procure interoperable missile defense and other capabilities to better defend against active missile threats. We will work with partners to neutralize Iran's malign activities in the region.

South and Central Asia

With over a quarter of the world's population, a fifth of all U.S.-designated terrorist groups, several fast-growing economies, and two nuclear-armed states, South and Central Asia present some of the most complicated national security challenges and opportunities. The region spans the terrorist threats emanating from the Middle East and the competition for power unfolding in Europe and the Indo-Pacific. The United States continues to face threats from transnational terrorists and militants operating from within Pakistan. The prospect for an Indo-Pakistani military conflict that could lead to a nuclear exchange remains a key concern requiring consistent diplomatic attention.

U.S. interests in the region include countering terrorist threats that impact the security of the U.S. homeland and our allies, preventing cross-border terrorism that raises the prospect of military and nuclear tensions, and preventing nuclear weapons, technology, and materials from falling into the hands of terrorists. We seek an American presence in the region proportionate to threats to the homeland and our allies. We seek a Pakistan that is not engaged in destabilizing behavior and a stable and self-reliant Afghanistan. And we seek Central Asian states that are resilient against domination by rival powers, are resistant to becoming jihadist safe havens, and prioritize reforms.

Priority Actions

POLITICAL: We will deepen our strategic partnership with India and support its leadership role in Indian Ocean security and throughout the broader region. We will press Pakistan to intensify its counterterrorism efforts, since no partnership can survive a country's support for militants and terrorists who target a partner's own service members and officials. The United States will also encourage Pakistan to continue demonstrating that it is a responsible steward of its nuclear assets. We will continue to partner with Afghanistan to promote peace and security in the region. We will continue to promote anti-corruption reform in Afghanistan to increase the legitimacy of its government and reduce the appeal of violent extremist organizations. We will help South Asian nations maintain their sovereignty as China increases its influence in the region.

ECONOMIC: We will encourage the economic integration of Central and South Asia to promote prosperity and economic linkages that will bolster connectivity and trade. And we will encourage India to increase its economic assistance in the region. In Pakistan, we will build trade and investment ties as security improves and as Pakistan demonstrates that it will assist the United States in our counterterrorism goals.

MILITARY AND SECURITY: We are committed to supporting the Afghan government and security forces in their fight against the Taliban, al-Qa'ida, ISIS, and other terrorists. We will bolster the fighting strength of the Afghan security forces to convince the Taliban that they cannot win on the battlefield and to set the conditions for diplomatic efforts to achieve enduring peace. We will insist that Pakistan take decisive action against militant and terrorist groups operating from its soil. We will work with the Central Asian states to guarantee access to the region to support our counterterrorism efforts.

Western Hemisphere

Stable, friendly, and prosperous states in the Western Hemisphere enhance our security and benefit our economy. Democratic states connected by shared values and economic interests will reduce the violence, drug trafficking, and illegal immigration that threaten our common security, and will limit opportunities for adversaries to operate from areas of close proximity to us.

In the last half century, parts of this hemisphere were marred by dictatorships and insurgencies that killed tens of thousands of people. Today, this region stands on the cusp of prosperity and peace, built upon democracy and the rule of law. U.S. trade in the region is thriving and market opportunities for American goods and services, energy and infrastructure projects, and foreign direct investment continue to expand.

Challenges remain, however. Transnational criminal organizations—including gangs and cartels—perpetuate violence and corruption, and threaten the stability of Central American states including Guatemala, Honduras, and El Salvador. In Venezuela and Cuba, governments cling to anachronistic leftist authoritarian models that continue to fail their people. Competitors have found operating space in the hemisphere.

China seeks to pull the region into its orbit through state-led investments and loans. Russia continues its failed politics of the Cold War by bolstering its radical Cuban allies as Cuba continues to repress its citizens. Both China and Russia support the dictatorship in Venezuela and are seeking to expand military linkages and arms sales across the region. The hemisphere's democratic states have a shared interest in confronting threats to their sovereignty.

Canada and the United States share a unique strategic and defense partnership. The United States also has important and deepening rela-

tions with key countries in the region. Together, we will build a stable and peaceful hemisphere that increases economic opportunities for all, improves governance, reduces the power of criminal organizations, and limits the malign influence of non-hemispheric forces.

Priority Actions

POLITICAL: We will catalyze regional efforts to build security and prosperity through strong diplomatic engagement. We will isolate governments that refuse to act as responsible partners in advancing hemispheric peace and prosperity. We look forward to the day when the people of Cuba and Venezuela can enjoy freedom and the benefits of shared prosperity, and we encourage other free states in the hemisphere to support this shared endeavor.

ECONOMIC: We will modernize our trade agreements and deepen our economic ties with the region and ensure that trade is fair and reciprocal. We will encourage further market-based economic reforms and encourage transparency to create conditions for sustained prosperity. We will ensure the U.S. financial system does not serve as a haven or transit point for criminal proceeds.

MILITARY AND SECURITY: We will build upon local efforts and encourage cultures of lawfulness to reduce crime and corruption, including by supporting local efforts to professionalize police and other security forces; strengthen the rule of law and undertake judicial reform; and improve information sharing to target criminals and corrupt leaders and disrupt illicit trafficking.

Africa

Africa remains a continent of promise and enduring challenges. Africa contains many of the world's fastest growing economies, which represent potential new markets for U.S. goods and services. Aspiring partners across the continent are eager to build market-based economies and enhance stability. The demand for quality American exports is high and will likely grow as Africa's population and prosperity increase. People across the continent are demanding government accountability and less corruption, and are opposing autocratic trends. The number of stable African nations has grown since the independence era as numerous countries have emerged from devastating conflicts and undergone democratic transitions.

Despite this progress, many states face political turbulence and instability that spills into other regions. Corruption and weak governance threaten to undermine the political benefits that should emerge from new economic opportunities. Many African states are battlegrounds for violent extremism and jihadist terrorists. ISIS, al-Qa'ida, and their affiliates operate on the continent and have increased the lethality of their attacks, expanded into new areas, and targeted U.S. citizens and interests. African nations and regional organizations have demonstrated a commitment to confront the threat from jihadist terrorist organizations, but their security capabilities remain weak.

China is expanding its economic and military presence in Africa, growing from a small investor in the continent two decades ago into Africa's largest trading partner today. Some Chinese prac-

tices undermine Africa's long-term development by corrupting elites, dominating extractive industries, and locking countries into unsustainable and opaque debts and commitments.

The United States seeks sovereign African states that are integrated into the world economy, able to provide for their citizens' needs, and capable of managing threats to peace and security. Improved governance in these states supports economic development and opportunities, diminishes the attraction of illegal migration, and reduces vulnerability to extremists, thereby reducing instability.

Priority Actions

POLITICAL: The United States will partner with governments, civil society, and regional organizations to end long-running, violent conflicts. We will encourage reform, working with promising nations to promote effective governance, improve the rule of law, and develop institutions accountable and responsive to citizens. We will continue to respond to humanitarian needs while also working with committed governments and regional organizations to address the root causes of human suffering. If necessary, we are prepared to sanction government officials and institutions that prey on their citizens and commit atrocities. When there is no alternative, we will suspend aid rather than see it exploited by corrupt elites.

ECONOMIC: We will expand trade and commercial ties to create jobs and build wealth for Americans and Africans. We will work with reform-oriented governments to help establish conditions that can transform them into trading partners and improve

We will encourage reform, working with promising nations to promote effective governance, improve the rule of law, and develop institutions accountable and responsive to citizens.

their business environment. We will support economic integration among African states. We will work with nations that seek to move beyond assistance to partnerships that promote prosperity. We will offer American goods and services, both because it is profitable for us and because it serves as an alternative to China's often extractive economic footprint on the continent.

MILITARY AND SECURITY: We will continue to work with partners to improve the ability of their security services to counter terrorism, human trafficking, and the illegal trade in arms and natural resources. We will work with partners to defeat terrorist organizations and others who threaten U.S. citizens and the homeland.



CONCLUSION

This National Security Strategy sets a positive strategic direction for the United States that is meant to reassert America's advantages on the world stage and to build upon our country's great strengths. During the Trump Administration, the American people can be confident that their security and prosperity will always come first. A secure, prosperous, and free America will be strong and ready to lead abroad to protect our interests and our way of life.

America's renewed strategic confidence is anchored in our recommitment to the principles inscribed in our founding documents. The National Security Strategy celebrates and protects what we hold dear—individual liberty, the rule of law, a democratic system of government, tolerance, and opportunity for all. By knowing ourselves and what we stand for, we clarify what we must defend and we establish guiding principles for our actions.

This strategy is guided by principled realism. It is realist because it acknowledges the central role of power in international politics, affirms that sovereign states are the best hope for a peaceful world, and clearly defines our national interests. It is principled because it is grounded in the knowledge that advanc-

ing American principles spreads peace and prosperity around the globe. We are guided by our values and disciplined by our interests.

This Administration has a bright vision of America's future. America's values and influence, underwritten by American power, make the world more free, secure, and prosperous.

Our Nation derives its strength from the American people. Every American has a role to play in this grand, national effort to implement this America First National Security Strategy. Together, our task is to strengthen our families, to build up our communities, to serve our citizens, and to celebrate American greatness as a shining example to the world. We will leave our children and grandchildren a Nation that is stronger, better, freer, prouder, and greater than ever before.

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Summary of the

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National Defense Strategy

of

The United States of America

Sharpening the American Military's Competitive Edge

Table of Contents

Introduction	1
Strategic Environment	2
Department of Defense Objectives	4
Strategic Approach	4
Build a More Lethal Force	5
Strengthen Alliances and Attract New Partners	8
Reform the Department for Greater Performance and Affordability	10
Conclusion	11

INTRODUCTION

The Department of Defense's enduring mission is to provide combat-credible military forces needed to deter war and protect the security of our nation. Should deterrence fail, the Joint Force is prepared to win. Reinforcing America's traditional tools of diplomacy, the Department provides military options to ensure the President and our diplomats negotiate from a position of strength.

Today, we are emerging from a period of strategic atrophy, aware that our competitive military advantage has been eroding. We are facing increased global disorder, characterized by decline in the long-standing rules-based international order—creating a security environment more complex and volatile than any we have experienced in recent memory. Inter-state strategic competition, not terrorism, is now the primary concern in U.S. national security.

China is a strategic competitor using predatory economics to intimidate its neighbors while militarizing features in the South China Sea. Russia has violated the borders of nearby nations and pursues veto power over the economic, diplomatic, and security decisions of its neighbors. As well, North Korea's outlaw actions and reckless rhetoric continue despite United Nation's censure and sanctions. Iran continues to sow violence and remains the most significant challenge to Middle East stability. Despite the defeat of ISIS's physical caliphate, threats to stability remain as terrorist groups with long reach continue to murder the innocent and threaten peace more broadly.

This increasingly complex security environment is defined by rapid technological change, challenges from adversaries in every operating domain, and the impact on current readiness from the longest continuous stretch of armed conflict in our Nation's history. In this environment, there can be no complacency—we must make difficult choices and prioritize what is most important to field a lethal, resilient, and rapidly adapting Joint Force. America's military has no preordained right to victory on the battlefield.

This unclassified synopsis of the classified 2018 National Defense Strategy articulates our strategy to compete, deter, and win in this environment. The reemergence of long-term strategic competition, rapid dispersion of technologies, and new concepts of warfare and competition that span the entire spectrum of conflict require a Joint Force structured to match this reality.

A more lethal, resilient, and rapidly innovating Joint Force, combined with a robust constellation of allies and partners, will sustain American influence and ensure favorable balances of power that safeguard the free and open international order. Collectively, our force posture, alliance and partnership architecture, and Department modernization will provide the capabilities and agility required to prevail in conflict and preserve peace through strength.

The costs of not implementing this strategy are clear. Failure to meet our defense objectives will result in decreasing U.S. global influence, eroding cohesion among allies and partners, and reduced access to markets that will contribute to a decline in our prosperity and standard of living. Without sustained and predictable investment to restore readiness and modernize our military to make it fit for our time, we will rapidly lose our military advantage, resulting in a Joint Force that has legacy systems irrelevant to the defense of our people.

STRATEGIC ENVIRONMENT

The National Defense Strategy acknowledges an increasingly complex global security environment, characterized by overt challenges to the free and open international order and the re-emergence of long-term, strategic competition between nations. These changes require a clear-eyed appraisal of the threats we face, acknowledgement of the changing character of warfare, and a transformation of how the Department conducts business.

The central challenge to U.S. prosperity and security is the reemerged long-term, strategic competition by what the National Security Strategy classifies as revisionist powers. It is increasingly clear that China and Russia want to shape a world consistent with their authoritarian model—gaining veto authority over other nations' economic, diplomatic, and security decisions.

China is leveraging military modernization, influence operations, and predatory economics to coerce neighboring countries to reorder the Indo-Pacific region to their advantage. As China continues its economic and military ascendance, asserting power through an all-of-nation long-term strategy, it will continue to pursue a military modernization program that seeks Indo-Pacific regional hegemony in the near-term and displacement of the United States to achieve global preeminence in the future. The most far-reaching objective of this defense strategy is to set the military relationship between our two countries on a path of transparency and non-aggression.

Concurrently, Russia seeks veto authority over nations on its periphery in terms of their governmental, economic, and diplomatic decisions, to shatter the North Atlantic Treaty Organization and change European and Middle East security and economic structures to its favor. The use of emerging technologies to discredit and subvert democratic processes in Georgia, Crimea, and eastern Ukraine is concern enough, but when coupled with its expanding and modernizing nuclear arsenal the challenge is clear.

Another change to the strategic environment is a resilient, but weakening post-WWII international order. In the decades after fascism's defeat in World War II, the United States and its allies and partners constructed a free and open international order to better safeguard their liberty and people from aggression and coercion. Although this system has evolved since the end of the Cold War, our network of alliances and partnerships remain the backbone of global security. China and Russia are now undermining the international order from within the system by exploiting its benefits while simultaneously undercutting its principles and "rules of the road."

Rogue regimes such as North Korea and Iran are destabilizing regions through their pursuit of nuclear weapons or sponsorship of terrorism. North Korea seeks to guarantee regime survival and increased leverage by seeking a mixture of nuclear, biological, chemical, conventional, and unconventional weapons and a growing ballistic missile capability to gain coercive influence over South Korea, Japan, and the United States. In the Middle East, Iran is competing with its neighbors, asserting an arc of influence and instability while vying for regional hegemony, using state-sponsored terrorist activities, a growing network of proxies, and its missile program to achieve its objectives.

Both revisionist powers and rogue regimes are competing across all dimensions of power. They have increased efforts short of armed conflict by expanding coercion to new fronts, violating principles of sovereignty, exploiting ambiguity, and deliberately blurring the lines between civil and military goals.

NATIONAL DEFENSE STRATEGY

Challenges to the U.S. military advantage represent another shift in the global security environment. For decades the United States has enjoyed uncontested or dominant superiority in every operating domain. We could generally deploy our forces when we wanted, assemble them where we wanted, and operate how we wanted. Today, every domain is contested—air, land, sea, space, and cyberspace.

We face an ever more lethal and disruptive battlefield, combined across domains, and conducted at increasing speed and reach—from close combat, throughout overseas theaters, and reaching to our homeland. Some competitors and adversaries seek to optimize their targeting of our battle networks and operational concepts, while also using other areas of competition short of open warfare to achieve their ends (e.g., information warfare, ambiguous or denied proxy operations, and subversion). These trends, if unaddressed, will challenge our ability to deter aggression.

The security environment is also affected by rapid technological advancements and the changing character of war. The drive to develop new technologies is relentless, expanding to more actors with lower barriers of entry, and moving at accelerating speed. New technologies include advanced computing, “big data” analytics, artificial intelligence, autonomy, robotics, directed energy, hypersonics, and biotechnology—the very technologies that ensure we will be able to fight and win the wars of the future.

New commercial technology will change society and, ultimately, the character of war. The fact that many technological developments will come from the commercial sector means that state competitors and non-state actors will also have access to them, a fact that risks eroding the conventional overmatch to which our Nation has grown accustomed. Maintaining the Department’s technological advantage will require changes to industry culture, investment sources, and protection across the National Security Innovation Base.

States are the principal actors on the global stage, but non-state actors also threaten the security environment with increasingly sophisticated capabilities. Terrorists, trans-national criminal organizations, cyber hackers and other malicious non-state actors have transformed global affairs with increased capabilities of mass disruption. There is a positive side to this as well, as our partners in sustaining security are also more than just nation-states: multilateral organizations, non-governmental organizations, corporations, and strategic influencers provide opportunities for collaboration and partnership. Terrorism remains a persistent condition driven by ideology and unstable political and economic structures, despite the defeat of ISIS’s physical caliphate.

It is now undeniable that the homeland is no longer a sanctuary. America is a target, whether from terrorists seeking to attack our citizens; malicious cyber activity against personal, commercial, or government infrastructure; or political and information subversion. New threats to commercial and military uses of space are emerging, while increasing digital connectivity of all aspects of life, business, government, and military creates significant vulnerabilities. During conflict, attacks against our critical defense, government, and economic infrastructure must be anticipated.

Rogue regimes, such as North Korea, continue to seek out or develop weapons of mass destruction (WMD) – nuclear, chemical, and biological – as well as long range missile capabilities and, in some cases, proliferate these capabilities to malign actors as demonstrated by Iranian ballistic missile exports. Terrorists likewise continue to pursue WMD, while the spread of nuclear weapon technology and advanced manufacturing technology remains a persistent problem. Recent advances in bioengineering raise another concern, increasing the potential, variety, and ease of access to biological weapons.

DEPARTMENT OF DEFENSE OBJECTIVES

In support of the *National Security Strategy*, the Department of Defense will be prepared to defend the homeland, remain the preeminent military power in the world, ensure the balances of power remain in our favor, and advance an international order that is most conducive to our security and prosperity.

Long-term strategic competitions with China and Russia are the principal priorities for the Department, and require both increased and sustained investment, because of the magnitude of the threats they pose to U.S. security and prosperity today, and the potential for those threats to increase in the future. Concurrently, the Department will sustain its efforts to deter and counter rogue regimes such as North Korea and Iran, defeat terrorist threats to the United States, and consolidate our gains in Iraq and Afghanistan while moving to a more resource-sustainable approach.

Defense objectives include:

- 1. Defending the homeland from attack;
- 2. Sustaining Joint Force military advantages, both globally and in key regions;
- 3. Deterring adversaries from aggression against our vital interests;
- 4. Enabling U.S. interagency counterparts to advance U.S. influence and interests;
- 5. Maintaining favorable regional balances of power in the Indo-Pacific, Europe, the Middle East, and the Western Hemisphere;
- 6. Defending allies from military aggression and bolstering partners against coercion, and fairly sharing responsibilities for common defense;
- 7. Dissuading, preventing, or deterring state adversaries and non-state actors from acquiring, proliferating, or using weapons of mass destruction;
- 8. Preventing terrorists from directing or supporting external operations against the United States homeland and our citizens, allies, and partners overseas;
- 9. Ensuring common domains remain open and free;
- 10. Continuously delivering performance with affordability and speed as we change Departmental mindset, culture, and management systems; and
- 11. Establishing an unmatched twenty-first century National Security Innovation Base that effectively supports Department operations and sustains security and solvency.

STRATEGIC APPROACH

A long-term strategic competition requires the seamless integration of multiple elements of national power— diplomacy, information, economics, finance, intelligence, law enforcement, and military. More than any other nation, America can expand the competitive space, seizing the initiative to challenge our competitors where we possess advantages and they lack strength. A more lethal force, strong alliances and partnerships, American technological innovation, and a culture of performance will generate decisive and sustained U.S. military advantages.

NATIONAL DEFENSE STRATEGY

As we expand the competitive space, we continue to offer competitors and adversaries an outstretched hand, open to opportunities for cooperation but from a position of strength and based on our national interests. Should cooperation fail, we will be ready to defend the American people, our values, and interests. The willingness of rivals to abandon aggression will depend on their perception of U.S. strength and the vitality of our alliances and partnerships.

Be strategically predictable but operationally unpredictable. Detering or defeating long-term strategic competitors is a fundamentally different challenge than the regional adversaries that were the focus of previous strategies. Our strength and integrated actions with allies will demonstrate our commitment to deterring aggression, but our dynamic force employment, military posture, and operations must introduce unpredictability to adversary decision-makers. With our allies and partners, we will challenge competitors by maneuvering them into unfavorable positions, frustrating their efforts, precluding their options while expanding our own, and forcing them to confront conflict under adverse conditions.

Integrate with U.S. interagency. Effectively expanding the competitive space requires combined actions with the U.S. interagency to employ all dimensions of national power. We will assist the efforts of the Departments of State, Treasury, Justice, Energy, Homeland Security, Commerce, USAID, as well as the Intelligence Community, law enforcement, and others to identify and build partnerships to address areas of economic, technological, and informational vulnerabilities.

Counter coercion and subversion. In competition short of armed conflict, revisionist powers and rogue regimes are using corruption, predatory economic practices, propaganda, political subversion, proxies, and the threat or use of military force to change facts on the ground. Some are particularly adept at exploiting their economic relationships with many of our security partners. We will support U.S. interagency approaches and work by, with, and through our allies and partners to secure our interests and counteract this coercion.

Foster a competitive mindset. To succeed in the emerging security environment, our Department and Joint Force will have to out-think, out-maneuver, out-partner, and out-innovate revisionist powers, rogue regimes, terrorists, and other threat actors.

We will expand the competitive space while pursuing three distinct lines of effort:

- 1. First, rebuilding military readiness as we build a more lethal Joint Force;
- 2. Second, strengthening alliances as we attract new partners; and
- 3. Third, reforming the Department's business practices for greater performance and affordability.

Build a More Lethal Force

The surest way to prevent war is to be prepared to win one. Doing so requires a competitive approach to force development and a consistent, multiyear investment to restore warfighting readiness and field a lethal force. The size of our force matters. The Nation must field sufficient, capable forces to defeat enemies and achieve sustainable outcomes that protect the American people and our vital interests. Our aim is a Joint Force that possesses decisive advantages for any likely conflict, while remaining proficient across the entire spectrum of conflict.

NATIONAL DEFENSE STRATEGY

Prioritize preparedness for war. Achieving peace through strength requires the Joint Force to deter conflict through preparedness for war. During normal day-to-day operations, the Joint Force will sustainably compete to: deter aggression in three key regions—the Indo-Pacific, Europe, and Middle East; degrade terrorist and WMD threats; and defend U.S. interests from challenges below the level of armed conflict. In wartime, the fully mobilized Joint Force will be capable of: defeating aggression by a major power; deterring opportunistic aggression elsewhere; and disrupting imminent terrorist and WMD threats. During peace or in war, the Joint Force will deter nuclear and non-nuclear strategic attacks and defend the homeland. To support these missions, the Joint Force must gain and maintain information superiority; and develop, strengthen, and sustain U.S. security relationships.

Modernize key capabilities. We cannot expect success fighting tomorrow's conflicts with yesterday's weapons or equipment. To address the scope and pace of our competitors' and adversaries' ambitions and capabilities, we must invest in modernization of key capabilities through sustained, predictable budgets. Our backlog of deferred readiness, procurement, and modernization requirements has grown in the last decade and a half and can no longer be ignored. We will make targeted, disciplined increases in personnel and platforms to meet key capability and capacity needs. The 2018 National Defense Strategy underpins our planned fiscal year 2019-2023 budgets, accelerating our modernization programs and devoting additional resources in a sustained effort to solidify our competitive advantage.

- Nuclear forces.** The Department will modernize the nuclear triad—including nuclear command, control, and communications, and supporting infrastructure. Modernization of the nuclear force includes developing options to counter competitors' coercive strategies, predicated on the threatened use of nuclear or strategic non-nuclear attacks.
- Space and cyberspace as warfighting domains.** The Department will prioritize investments in resilience, reconstitution, and operations to assure our space capabilities. We will also invest in cyber defense, resilience, and the continued integration of cyber capabilities into the full spectrum of military operations.
- Command, control, communications, computers and intelligence, surveillance, and reconnaissance (C4ISR).** Investments will prioritize developing resilient, survivable, federated networks and information ecosystems from the tactical level up to strategic planning. Investments will also prioritize capabilities to gain and exploit information, deny competitors those same advantages, and enable us to provide attribution while defending against and holding accountable state or non-state actors during cyberattacks.
- Missile defense.** Investments will focus on layered missile defenses and disruptive capabilities for both theater missile threats and North Korean ballistic missile threats.
- Joint lethality in contested environments.** The Joint Force must be able to strike diverse targets inside adversary air and missile defense networks to destroy mobile power-projection platforms. This will include capabilities to enhance close combat lethality in complex terrain.
- Forward force maneuver and posture resilience.** Investments will prioritize ground, air, sea, and space forces that can deploy, survive, operate, maneuver, and regenerate in all domains while under attack. Transitioning from large, centralized, unhardened infrastructure to smaller, dispersed, resilient, adaptive basing that include active and passive defenses will also be prioritized.

NATIONAL DEFENSE STRATEGY

- 1. **Advanced autonomous systems.** The Department will invest broadly in military application of autonomy, artificial intelligence, and machine learning, including rapid application of commercial breakthroughs, to gain competitive military advantages.
- 2. **Resilient and agile logistics.** Investments will prioritize prepositioned forward stocks and munitions, strategic mobility assets, partner and allied support, as well as non-commercially dependent distributed logistics and maintenance to ensure logistics sustainment while under persistent multi-domain attack.

Evolve innovative operational concepts. Modernization is not defined solely by hardware; it requires change in the ways we organize and employ forces. We must anticipate the implications of new technologies on the battlefield, rigorously define the military problems anticipated in future conflict, and foster a culture of experimentation and calculated risk-taking. We must anticipate how competitors and adversaries will employ new operational concepts and technologies to attempt to defeat us, while developing operational concepts to sharpen our competitive advantages and enhance our lethality.

Develop a lethal, agile and resilient force posture and employment. Force posture and employment must be adaptable to account for the uncertainty that exists in the changing global strategic environment. Much of our force employment models and posture date to the immediate post-Cold War era, when our military advantage was unchallenged and the primary threats were rogue regimes.

- 3. **Dynamic Force Employment.** Dynamic Force Employment will prioritize maintaining the capacity and capabilities for major combat, while providing options for proactive and scalable employment of the Joint Force. A modernized Global Operating Model of combat-credible, flexible theater postures will enhance our ability to compete and provide freedom of maneuver during conflict, providing national decision-makers with better military options.

The global strategic environment demands increased strategic flexibility and freedom of action. The Dynamic Force Employment concept will change the way the Department uses the Joint Force to provide proactive and scalable options for priority missions. Dynamic Force Employment will more flexibly use ready forces to shape proactively the strategic environment while maintaining readiness to respond to contingencies and ensure long-term warfighting readiness.

- 4. **Global Operating Model.** The Global Operating Model describes how the Joint Force will be postured and employed to achieve its competition and wartime missions. Foundational capabilities include nuclear; cyber; space; C4ISR; strategic mobility, and counter WMD proliferation. It comprises four layers: contact, blunt, surge, and homeland. These are, respectively, designed to help us compete more effectively below the level of armed conflict; delay, degrade, or deny adversary aggression; surge war-winning forces and manage conflict escalation; and defend the U.S. homeland.

Cultivate workforce talent. Recruiting, developing, and retaining a high-quality military and civilian workforce is essential for warfighting success. Cultivating a lethal, agile force requires more than just new technologies and posture changes; it depends on the ability of our warfighters and the Department workforce to integrate new capabilities, adapt warfighting approaches, and change

business practices to achieve mission success. The creativity and talent of the American warfighter is our greatest enduring strength, and one we do not take for granted.

- P
M
E **Professional Military Education (PME).** PME has stagnated, focused more on the accomplishment of mandatory credit at the expense of lethality and ingenuity. We will emphasize intellectual leadership and military professionalism in the art and science of warfighting, deepening our knowledge of history while embracing new technology and techniques to counter competitors. PME will emphasize independence of action in warfighting concepts to lessen the impact of degraded/ lost communications in combat. PME is to be used as a strategic asset to build trust and interoperability across the Joint Forces and with allied and partner forces.

- P
M
E **Talent management.** Developing leaders who are competent in national-level decision-making requires broad revision of talent management among the Armed Services, including fellowships, civilian education, and assignments that increase understanding of interagency decision-making processes, as well as alliances and coalitions.

- P
M
E **Civilian workforce expertise.** A modern, agile, information-advantaged Department requires a motivated, diverse, and highly skilled civilian workforce. We will emphasize new skills and complement our current workforce with information experts, data scientists, computer programmers, and basic science researchers and engineers—to use information, not simply manage it. The Department will also continue to explore streamlined, non-traditional pathways to bring critical skills into service, expanding access to outside expertise, and devising new public-private partnerships to work with small companies, start-ups, and universities.

Strengthen Alliances and Attract New Partners

Mutually beneficial alliances and partnerships are crucial to our strategy, providing a durable, asymmetric strategic advantage that no competitor or rival can match. This approach has served the United States well, in peace and war, for the past 75 years. Our allies and partners came to our aid after the terrorist attacks on 9/ 11, and have contributed to every major U.S.-led military engagement since. Every day, our allies and partners join us in defending freedom, deterring war, and maintaining the rules which underwrite a free and open international order.

By working together with allies and partners we amass the greatest possible strength for the long-term advancement of our interests, maintaining favorable balances of power that deter aggression and support the stability that generates economic growth. When we pool resources and share responsibility for our common defense, our security burden becomes lighter. Our allies and partners provide complementary capabilities and forces along with unique perspectives, regional relationships, and information that improve our understanding of the environment and expand our options. Allies and partners also provide access to critical regions, supporting a widespread basing and logistics system that underpins the Department's global reach.

We will strengthen and evolve our alliances and partnerships into an extended network capable of deterring or decisively acting to meet the shared challenges of our time. We will focus on three elements for achieving a capable alliance and partnership network:

NATIONAL DEFENSE STRATEGY

- 1.1** Uphold a foundation of mutual respect, responsibility, priorities, and accountability. Our alliances and coalitions are built on freewill and shared responsibilities. While we will unapologetically represent America's values and belief in democracy, we will not seek to impose our way of life by force. We will uphold our commitments and we expect allies and partners to contribute an equitable share to our mutually beneficial collective security, including effective investment in modernizing their defense capabilities. We have shared responsibilities for resisting authoritarian trends, contesting radical ideologies, and serving as bulwarks against instability.
- 1.2** Expand regional consultative mechanisms and collaborative planning. We will develop new partnerships around shared interests to reinforce regional coalitions and security cooperation. We will provide allies and partners with a clear and consistent message to encourage alliance and coalition commitment, greater defense cooperation, and military investment.
- 1.3** Deepen interoperability. Each ally and partner is unique. Combined forces able to act together coherently and effectively to achieve military objectives requires interoperability. Interoperability is a priority for operational concepts, modular force elements, communications, information sharing, and equipment. In consultation with Congress and the Department of State, the Department of Defense will prioritize requests for U.S. military equipment sales, accelerating foreign partner modernization and ability to integrate with U.S. forces. We will train to high-end combat missions in our alliance, bilateral, and multinational exercises.

Enduring coalitions and long-term security partnerships, underpinned by our bedrock alliances and reinforced by our allies' own webs of security relationships, remain a priority:

- 1.4** Expand Indo-Pacific alliances and partnerships. A free and open Indo-Pacific region provides prosperity and security for all. We will strengthen our alliances and partnerships in the Indo-Pacific to a networked security architecture capable of deterring aggression, maintaining stability, and ensuring free access to common domains. With key countries in the region, we will bring together bilateral and multilateral security relationships to preserve the free and open international system.
- 1.5** Fortify the Trans-Atlantic NATO Alliance. A strong and free Europe, bound by shared principles of democracy, national sovereignty, and commitment to Article 5 of the North Atlantic Treaty is vital to our security. The alliance will deter Russian adventurism, defeat terrorists who seek to murder innocents, and address the arc of instability building on NATO's periphery. At the same time, NATO must adapt to remain relevant and fit for our time—in purpose, capability, and responsive decision-making. We expect European allies to fulfill their commitments to increase defense and modernization spending to bolster the alliance in the face of our shared security concerns.
- 1.6** Form enduring coalitions in the Middle East. We will foster a stable and secure Middle East that denies safe havens for terrorists, is not dominated by any power hostile to the United States, and that contributes to stable global energy markets and secure trade routes. We will develop enduring coalitions to consolidate gains we have made in Afghanistan, Iraq, Syria, and elsewhere, to support the lasting defeat of terrorists as we sever their sources of strength and counterbalance Iran.
- 1.7** Sustain advantages in the Western Hemisphere. The U.S. derives immense benefit from a stable, peaceful hemisphere that reduces security threats to the homeland. Supporting the U.S. interagency lead,

the Department will deepen its relations with regional countries that contribute military capabilities to shared regional and global security challenges.

- Support relationships to address significant terrorist threats in Africa. We will bolster existing bilateral and multilateral partnerships and develop new relationships to address significant terrorist threats that threaten U.S. interests and contribute to challenges in Europe and the Middle East. We will focus on working by, with, and through local partners and the European Union to degrade terrorists; build the capability required to counter violent extremism, human trafficking, trans-national criminal activity, and illegal arms trade with limited outside assistance; and limit the malign influence of non-African powers.

Reform the Department for Greater Performance and Affordability

The current bureaucratic approach, centered on exacting thoroughness and minimizing risk above all else, is proving to be increasingly unresponsive. We must transition to a culture of performance where results and accountability matter. We will put in place a management system where leadership can harness opportunities and ensure effective stewardship of taxpayer resources. We have a responsibility to gain full value from every taxpayer dollar spent on defense, thereby earning the trust of Congress and the American people.

Deliver performance at the speed of relevance. Success no longer goes to the country that develops a new technology first, but rather to the one that better integrates it and adapts its way of fighting. Current processes are not responsive to need; the Department is over-optimized for exceptional performance at the expense of providing timely decisions, policies, and capabilities to the warfighter. Our response will be to prioritize speed of delivery, continuous adaptation, and frequent modular upgrades. We must not accept cumbersome approval chains, wasteful applications of resources in uncompetitive space, or overly risk-averse thinking that impedes change. Delivering performance means we will shed outdated management practices and structures while integrating insights from business innovation.

Organize for innovation. The Department's management structure and processes are not written in stone, they are a means to an end—empowering the warfighter with the knowledge, equipment and support systems to fight and win. Department leaders will adapt their organizational structures to best support the Joint Force. If current structures hinder substantial increases in lethality or performance, it is expected that Service Secretaries and Agency heads will consolidate, eliminate, or restructure as needed. The Department's leadership is committed to changes in authorities, granting of waivers, and securing external support for streamlining processes and organizations.

Drive budget discipline and affordability to achieve our end state. Better management begins with effective financial stewardship. The Department will continue its plan to achieve full auditability of all its operations, improving its financial processes, systems, and tools to understand, manage, and improve cost. We will continue to leverage the scale of our operations to drive greater efficiency in procurement of materiel and services while pursuing opportunities to consolidate and streamline contracts in areas such as logistics, information technology, and support services. We will also continue efforts to reduce management overhead and the size of headquarters staff. We will reduce or eliminate duplicative organizations and systems for managing human resources, finance, health services, travel, and supplies. The Department will also work to reduce excess property and infrastructure, providing Congress with options for a Base Realignment and Closure.

Streamline rapid, iterative approaches from development to fielding. A rapid, iterative approach to capability development will reduce costs, technological obsolescence, and acquisition risk. The Department will realign incentive and reporting structures to increase speed of delivery, enable design tradeoffs in the requirements process, expand the role of warfighters and intelligence analysis throughout the acquisitions process, and utilize non-traditional suppliers. Prototyping and experimentation should be used prior to defining requirements and commercial-off-the-shelf systems. Platform electronics and software must be designed for routine replacement instead of static configurations that last more than a decade. This approach, a major departure from previous practices and culture, will allow the Department to more quickly respond to changes in the security environment and make it harder for competitors to offset our systems.

Harness and protect the National Security Innovation Base. The Department's technological advantage depends on a healthy and secure national security innovation base that includes both traditional and non-traditional defense partners. The Department, with the support of Congress, will provide the defense industry with sufficient predictability to inform their long-term investments in critical skills, infrastructure, and research and development. We will continue to streamline processes so that new entrants and small-scale vendors can provide cutting-edge technologies. We will also cultivate international partnerships to leverage and protect partner investments in military capabilities.

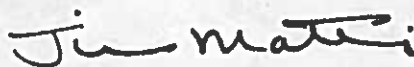
CONCLUSION

This strategy establishes my intent to pursue urgent change at significant scale.

We must use creative approaches, make sustained investment, and be disciplined in execution to field a Joint Force fit for our time, one that can compete, deter, and win in this increasingly complex security environment. A dominant Joint Force will protect the security of our nation, increase U.S. influence, preserve access to markets that will improve our standard of living, and strengthen cohesion among allies and partners.

While any strategy must be adaptive in execution, this summary outlines what we must do to pass intact to the younger generation the freedoms we currently enjoy. But there is nothing new under the sun: while this strategy will require sustained investment by the American people, we recall past generations who made harsher sacrifices so that we might enjoy our way of life today.

As it has for generations, free men and women in America's military will fight with skill and valor to protect us. To carry out any strategy, history teaches us that wisdom and resources must be sufficient. I am confident this defense strategy is appropriate and worthy of the support of the American people.



Jim Mattis

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Asia Pacific

James J. Przystup and Phillip C. Saunders

This chapter examines the strategic challenges the United States confronts in the Asia-Pacific region and argues that the United States should work with allies, partners, and multilateral organizations to build a rules-based regional order that includes China and advances U.S. national interests. This requires sustaining the U.S. rebalance to the Asia-Pacific and intensifying cooperation with other regional actors to shape China's choices. The chapter begins by reviewing the history of U.S. engagement with Asia and describing the range of important U.S. national interests located in the Asia-Pacific region or strongly influenced by developments there. It then reviews major trends shaping the region (including economic dynamism, China's rise, and the U.S. rebalance to Asia) and considers specific security challenges in Northeast Asia, the Korean Peninsula, the China-Taiwan relationship, and in the South China Sea. The authors argue that the United States needs to devote high-level attention to its alliances in Asia, to cooperation with new regional security partners, and to shaping the Asia-Pacific strategic and economic order in favorable directions. These actions will place the United States in a better position to shape China's strategic choices and integrate China within a rules-based regional and global order.

America's engagement with Asia began before the United States existed. In February 1784, the ship *Empress of China* departed New York harbor, arriving in Macau in August of that year. The ship returned the following year with a cargo of Chinese goods that netted a \$30,000 profit. In Federalist Paper No. 4, John Jay referred to American commerce with China and India.

In 1835, before the United States touched the shores of the Pacific Ocean, the U.S. Navy East India Squadron was established. In 1844, China, in the Treaty of Wanghia, granted trading rights to the United States. Two years later, the United States attempted to negotiate a commercial treaty with Japan. The talks ended in failure, but a decade later

Commodore Matthew C. Perry concluded the Treaty of Kanagawa, opening Japan to American goods and providing protection for shipwrecked American sailors engaged in the China trade.

In the last half of the 19th century, U.S. commercial interests expanded rapidly. At the end of the century, U.S. interests expanded beyond trade. In the Treaty of Paris ending the Spanish-American War, Spain ceded the Philippines and Guam to the United States.

Expansion across the Pacific brought the United States into contact with the geopolitics of Asia, focused then on China and the efforts of the imperial powers (France, Germany, Great Britain, Italy, Japan, and Russia) to carve out spheres of influence and commercial privileges in the weakening Qing empire.

Over the past century, the United States has adopted multiple policy frameworks to protect and advance its national interests in the Asia-Pacific region. The Open Door policy toward China represented a unilateral U.S. initiative aimed at rejecting imperial spheres of influence and special privilege and advancing the principle of equality of commercial opportunity. The Open Door evolved into a multilateral framework for managing commercial competition in China. A second Open Door note, issued at the time of the Boxer Rebellion, appealed to the imperial powers to preserve China's territorial and administrative integrity.

President Theodore Roosevelt, playing balance-of-power politics, aligned the United States with Japan to check Russia's efforts to develop an exclusive sphere of influence in Northern China and Korea. Roosevelt's diplomatic intervention in the Treaty of Portsmouth brought the Russo-Japanese war to a close.

In 1920, at the Washington Conference, the United States worked to fashion a multilateral, cooperative framework to preserve China's territorial integrity and the postwar status quo in the Asia-Pacific region. Lacking any enforcement mechanism, the Washington Conference system failed to meet the challenges of rising Chinese nationalism, the great depression, and Japanese unilateralism.

From 1945 through the end of the Cold War and the Barack Obama administration's rebalance to the Asia-Pacific, the United States has relied on bilateral security treaties with Japan, the Republic of Korea (ROK), Australia, the Philippines, and Thailand to protect and advance its security interests. This bilateral "hub and spokes" framework has served as the region's informal security structure, underpinning its remarkable postwar reconstruction and present-day prosperity. Today, the hub-and-spokes framework is evolving to encompass trilateral cooperation among alliance partners and multilateral cooperation involving U.S. allies and strategic partners.

Asia Pacific

The common principle underlying these various policy approaches is the concept of “access”: economic access to the markets of the region to pursue U.S. commercial interests; strategic and physical access to our allies to ensure confidence in U.S. security commitments; and political access to allow for the promotion of democracy and human rights.

At the same time, the United States has championed the evolution of a postwar liberal, open, rules-based international order allowing for the free flow of commerce and capital supported by the Bretton Woods institutions of the World Bank, International Monetary Fund, General Agreement on Tariffs and Trade, and its successor the World Trade Organization. At the same time, the United States has promoted efforts to support international stability and the peaceful resolution of disputes. This principled U.S. commitment has contributed significantly to the stability and prosperity of the Asia-Pacific region today.

U.S. National Interests in the Asia-Pacific Region

The United States has a range of important national interests either located in the Asia-Pacific region or strongly influenced by developments there. These interests include:

- defense of the homeland, U.S. territories, and U.S. citizens
- maintenance of an open, rules-based international order, including resolution of disputes through peaceful means rather than coercion or the use of force
- access to the region and freedom of navigation in the maritime and air domains
- maintenance of a stable balance of power that supports regional stability and promotes economic prosperity joined with opposition to any power or group of powers that would deny U.S. access to the region or threaten U.S. interests
- strengthening U.S. alliance relationships and reinforcing U.S. commitment to security of its allies
- prevention of the proliferation of weapons of mass destruction and missile delivery systems

- promotion of global norms and values, such as human rights, democracy, and good governance.

Defining Trends in the Asia-Pacific Region

The Asia-Pacific region is marked by important opportunities and challenges that require high-level attention. Economic dynamism is increasing the region's weight in world affairs and its importance to U.S. interests. China's rise is part of this positive story, but Beijing is also converting its astonishing economic growth into military power and diplomatic influence that are challenging the regional balance of power and threatening the stability of the existing order. The Obama administration has responded to regional opportunities and challenges via its rebalance to the Asia-Pacific, which sought to increase U.S. diplomatic, military, and economic engagement there. U.S. interests merit increased strategic attention and resources, but the next administration will need to decide how to sustain the rebalance and what adjustments are necessary given the changing global and regional strategic environment and the U.S. domestic political context.

Asia's Economic Dynamism

In 2013, the Asia-Pacific region generated close to \$21 trillion in economic activity, over a quarter of the global economy. China and Japan stand as the world's second and third largest economies, while the 10 countries in the Association of Southeast Asian Nations (ASEAN) have a combined economic output of over \$2.3 trillion.¹ East Asia remains one of the fastest growing regions in the world, with an annual growth rate of 6.8 percent in 2014, accounting for about 40 percent of global growth.² This economic dynamism is increasing the region's overall strategic weight and importance to the U.S. economy.

In 2015, U.S. trade with Asia totaled more than \$1.5 trillion, growing from \$397 billion at the end of the Cold War and \$503 billion at the turn of the century.³ In 2014, U.S. exports to the Asia-Pacific region represented 27.8 percent of total exports, while imports accounted for 37 percent of total imports. Capital goods, excluding automotive, led U.S. exports to the region, amounting to 26.3 percent, while consumer goods, excluding food and automotive, accounted for 32.2 percent of U.S. imports from the region. Meanwhile the U.S. direct investment position in the region amounted to \$738.8 billion, an increase of 6.1 percent over 2013.⁴ The United States remains the single largest investor in the Asia-Pacific region.

Asia Pacific

In 2012, 32 percent of export-related jobs in the United States were tied to the Asia-Pacific region, representing 1.2 million American jobs, an increase of more than 52 percent over 2002. In 2011, 68 percent of all congressional districts exported more than \$500 million to the region, with 39 states sending approximately 25 percent of their exports to the Asia-Pacific region.⁵ Governor-led trade missions target the region's booming economies. Top U.S. trading partners include China (the second largest), Japan (fourth), and South Korea (sixth); if taken as a whole, ASEAN would be the fourth largest U.S. trading partner.⁶

The Rise of China

China's rise is altering the strategic landscape of the region and challenging the existing regional order. In 1980, as Deng Xiaoping began to open China to the market, China had a \$200 billion economy; by 2014, its economy topped \$10 trillion. This remarkable transformation was achieved by adopting market-oriented economic reforms and opening China to foreign trade, investment, technology, and ideas. The result is a China that is firmly integrated into the regional and global economy. China is now more exposed to external economic developments; the 1998 Asian Financial Crisis and 2008 Great Recession both caused significant slowdowns in Chinese growth.⁷ Conversely, China's economy is now big enough and integrated enough that its economic problems can move global trade patterns and U.S. stock markets.

Like other Asian countries, China's economic rise was enabled by an open international trading order and stability in the Asia-Pacific region underpinned by U.S. military power and the U.S. alliance system. A reasonably good working relationship with the United States remains critical for Chinese goals such as sustaining economic growth and maintaining regional stability, but the relationship has become more competitive and many Chinese elites believe that the United States seeks to subvert the Chinese political system and contain China's economic and military potential. As China has become more powerful, and has converted some of its economic gains into military power, it has become less comfortable with the U.S. alliance system and begun to seek more influence within the region and in the international system as a whole.

China's economic growth has reshaped regional trade and investment patterns and greatly increased Beijing's influence. China is now the number one export market for almost all countries within the region and has dramatically expanded its foreign investment across Asia. China has a free-trade agreement (FTA) with ASEAN and is currently pursuing both a China–Japan–South Korea FTA and a broader Regional Comprehensive Economic Partnership agreement. Chinese foreign aid and infrastructure

projects within Asia, some of which are now under the umbrella of Xi Jinping's "One Belt, One Road" initiative, are another source of influence. Beijing has mostly used its economic power as assurance measures and inducements to cooperate with China, but in recent years has become more willing to use more coercive economic measures to punish countries that displease it.⁸

Rapid economic growth has also supported modernization and expansion of the Chinese military, which has enjoyed double-digit budget increases for most of the last 20 years and now has the largest defense budget in the Asia-Pacific region (\$154 billion for 2016).⁹ The People's Liberation Army has been modernizing its forces and developing the joint doctrine, training, and capabilities necessary to win "local wars under conditions of informationization."¹⁰ This modernization effort gives priority to naval, air, and missile forces capable of projecting power beyond China's borders and places increasing emphasis on the maritime, space, and cyber domains. As part of its efforts to deter potential U.S. intervention in a Taiwan contingency, the People's Liberation Army has emphasized the development of antiaccess/area-denial capabilities that would raise the costs and risks for U.S. forces operating near China.¹¹ These capabilities threaten to put at risk the U.S. ability to access its allies, extend deterrence, and meet its regional security commitments. Expanded naval and coast guard capabilities have also supported more assertive Chinese efforts with respect to maritime territorial disputes in the East and South China seas.

Countries in Asia have been carefully monitoring China's rise and the potential for a strong China to dominate the region. Aggressive Chinese behavior toward Taiwan and in the South China Sea from 1994 to 1996 created regional alarm about a "China threat," but more restrained Chinese behavior and assurance measures adopted over the period from 1997 to 2008 helped ease regional concerns. During this period, Asian views largely shifted from regarding China as a potential threat to regarding China as an opportunity; this shift was widely interpreted as an indicator of the success of China's Asia policy.¹² Beginning in 2009, however, more assertive Chinese behavior on maritime territorial disputes and other issues dissipated much of the goodwill built by China's charm offensive and revived regional concerns about how a strong China might behave in the future.¹³ These concerns are most acute for countries with maritime or land territorial disputes with China, such as India, Japan, Malaysia, the Philippines, and Vietnam. Chinese policymakers talk about the need to maintain the proper balance between the competing goals of defending Chinese sovereignty (*weiquan*) and maintaining regional stability (*weiwen*); under President Xi Jinping there has been more emphasis

on pursuing territorial claims and less concern about the negative impact on relations with China's neighbors.

In interviews conducted as part of the Institute for National Strategic Studies research project "The Rebalance Beyond 2016," analysts across the region described China's rise as "inexorable." Despite the significant economic and political challenges facing China, they were confident that China will, at worst, muddle through, if not succeed eventually. Looking ahead, interviewees defined a best-case China scenario as one in which the pace of change would slow, allowing countries of the region to adapt and, over time, engage and socialize China toward acceptance and support of the existing regional order. This will require sustained U.S. involvement and coordination with regional allies and partners. For the United States and the Asia-Pacific region, China's rise (and international reactions to that rise) will shape the contours of the international order in the century ahead.

While participating in the postwar Bretton Woods system and benefiting from a stable regional order underpinned by U.S. alliances, China has moved to advance a parallel set of institutions that mostly exclude the United States. These include the Shanghai Cooperation Organization; the initial proposal for an East Asian Summit that would have excluded the United States; and under President Xi, the Asian Infrastructure Investment Bank, the One Belt, One Road Eurasian trade initiative, the Regional Comprehensive Economic Partnership, and the "Asia for Asians" security concept, widely viewed as aimed at U.S. alliances and the U.S. security role in the region. Taken as a whole, China's growing power and willingness to use that power to try to alter regional security arrangements and support new institutions that advance Chinese interests and exclude the United States pose a significant challenge to U.S. interests in the Asia-Pacific.

The U.S. Rebalance to Asia

Upon taking office in January 2009, Obama administration officials proclaimed a U.S. "return to Asia." This pronouncement was backed with more frequent travel to the region by senior officials and increased U.S. participation in regional multilateral meetings, culminating in the decision to sign the ASEAN Treaty of Amity and Cooperation and to participate in the East Asia Summit at the head-of-state level.

The strategic rebalance to Asia built on these actions to deepen and institutionalize U.S. commitment to the Asia-Pacific region. In announcing the rebalance in a November 17, 2011, address to the Australian Parliament, President Obama argued that "Our new focus on this region reflects a fundamental truth—the United States has been, and always

will be a Pacific nation. . . . Here we see the future.” The President noted that Asia is “the world’s fastest growing region,” “home to more than half of the global economy,” and critical to “creating jobs and opportunity for the American people.” He described the rebalance as “a deliberate and strategic decision” to increase the priority placed on Asia in U.S. policy.¹⁴

Then—Secretary of State Hillary Clinton elaborated on the rationale for the rebalance, arguing that “harnessing Asia’s growth and dynamism is central to American economic and strategic interests” and that the United States had an opportunity to help build “a more mature security and economic architecture to promote stability and prosperity.” Given the importance of the Asia-Pacific region, she argued that “a strategic turn to the region fits logically into our overall global effort to secure and sustain America’s global leadership.”¹⁵

While the main objective of the rebalance was to bring U.S. foreign policy commitments in line with U.S. interests, it also responded to China’s increasingly assertive regional policies, especially on maritime territorial disputes. Countries across the Asia-Pacific region urged Washington to play a more active role in regional economic, diplomatic, and security affairs in order to demonstrate U.S. commitment and help maintain regional stability in the face of a more powerful and more active China.

Obama administration officials have stressed that the rebalance includes diplomatic, economic, and military elements, all of which must be applied in a coordinated manner for maximum effect.¹⁶ The diplomatic element has involved enhanced high-level diplomatic engagement, including frequent travel to the region by the President, Secretary of State, and Secretary of Defense. President Obama has participated regularly in Asia-Pacific Economic Cooperation (APEC) and East Asia Summit meetings; had periodic meetings with the leaders of U.S. allies Japan, South Korea, and Australia; and launched a new U.S.-ASEAN dialogue mechanism that included a summit with Southeast Asian leaders at Sunnyside, California, in February 2016.

American allies and partners in the region have stressed U.S. economic engagement with Asia as a key means of demonstrating U.S. staying power. The Obama administration faced a number of practical and political obstacles in increasing U.S. trade and investment ties with the Asia-Pacific, especially in the context of the global financial crisis. The centerpiece of the administration’s efforts is the Trans-Pacific Partnership (TPP), as “an ambitious, next-generation Asia-Pacific trade agreement” including Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.¹⁷ The TPP agreement was signed on February 4, 2016, but will not

take effect until all member countries have ratified the agreement. The Obama administration has not submitted the agreement to Congress for approval; once submitted, Congress will have 90 legislative days to approve or disapprove it. TPP is an example of “open regionalism,” meaning that other Asia-Pacific countries willing to meet TPP standards will eventually be able to join the agreement.

The military element of the rebalance includes both increased commitments of U.S. military forces to the Asia-Pacific region and enhanced military and security cooperation with a range of allies and partners. The Navy and Air Force both announced plans to devote 60 percent of overseas-based forces to the Asia-Pacific region, including deployments of advanced systems such as the Littoral Combat Ship and F-35 Joint Strike Fighter. The Army announced plans to align 70,000 troops to Asia missions, while the Marines announced plans for rotational deployments of 2,500 Marines to Australia. Secretary of Defense Ashton Carter described a three-part Department of Defense approach to the “next phase” of the rebalance that includes investing in future capabilities relevant to the Asia-Pacific security environment, fielding key capabilities in quantity, and adapting the U.S. defense posture to be “geographically distributed, operationally resilient, and politically sustainable.”¹⁸ A significant part of the rebalance involves efforts to expand military cooperation with traditional allies such as Australia, Japan, and South Korea, while using exercises and dialogues to reach out to nontraditional partners such as India, Malaysia, and Vietnam.¹⁹

While the President’s remarks set out a comprehensive strategy toward the region, the initial public diplomacy rollout focused on the military aspects, unfortunately playing into the Chinese conceit that U.S. policy is aimed at containing China. Beijing has subsequently gone a step further, blaming the rebalance for increasing tensions in the region even though it was partly a response to regional concerns about increasing Chinese assertiveness.

Asia-Pacific Security Challenges

Asia’s economic dynamism, China’s rising power, and the U.S. rebalance are broad trends that are having a major impact on the Asia-Pacific region as a whole. These trends co-exist with a number of specific security challenges in Northeast Asia, the Korean Peninsula, the China-Taiwan relationship, and the South China Sea, including unresolved territorial disputes, competition to secure natural resources, and freedom of navigation issues that present complex challenges to regional stability and security.

Northeast Asia

Even 75 years after the end of World War II, tensions over the history of Japanese colonialism and aggression continue to complicate Tokyo's relations with Beijing and Seoul. The Japan-China relationship is also marked by conflicting territorial claims in the East China Sea, including disputes over possession of the Senkaku/Diaoyu Islands, an unresolved maritime boundary, and resource competition for fish, oil, and natural gas. Both China and Japan claim the islands (as does Taiwan) and tensions over them have flared periodically since the late 1970s.²⁰ The United States does not take a position on the sovereignty dispute but recognizes Japanese administrative control and has stated that the unpopulated islands are covered under the U.S.-Japan Security Treaty.

In September 2010, a Chinese fishing trawler operating within Japan's exclusive economic zone north of the Senkaku Islands collided with two Japanese coast guard ships. The ships pursued and boarded the trawler, taking into custody the captain and crew. Tokyo took the position that the coast guard's actions were correct, taking place in Japanese waters and based on Japanese law. Beijing's response was to call on Japan to refrain from taking "so-called law enforcement activities" in Chinese waters. To have accepted the legality of the coast guard's action would have been to compromise China's claim to sovereignty over the islands. The rapid deterioration of relations that followed, China's suspension of rare-earth metal exports to pressure the Japanese business community, widespread anti-Japanese demonstrations across China, and small-scale anti-Chinese protests in Japan all underscored the sensitive nature of the territorial issue.

Two years later, in September 2012, the Japanese government purchased ("nationalized") three of the five Senkaku islands from their private-sector owner. Widespread anti-Japanese demonstrations spread across China, and Beijing suspended all high-level political and diplomatic contacts. To assert its claims to the islands, China stepped up patrols of white-hulled paramilitary ships (now consolidated into the Chinese coast guard) into Japan's contiguous zone around the islands, establishing an almost daily presence in the area. Chinese ships also entered Japan's territorial waters in the Senkakus. By the end of 2013, Chinese coast guard ships had entered Japan's territorial waters in the Senkakus 256 times. Of the incursions, 68 took place in the period September–December 2012 and 188 in 2013.²¹ In November 2013, China declared an Air Defense Identification Zone that extended over the Senkaku Islands. The following month the government of Prime Minister Shinzo Abe, in its national security strategy, defined Japan's security environment as "ever more severe."²²

Japan and China also hold conflicting claims over the maritime boundary in the East China Sea. Japan claims a mid-line boundary in the East China Sea, while Beijing's claim is based on the continental shelf and extends beyond the mid-line to the Okinawa trough. In the context of this unresolved boundary, exploration for oil and natural gas has also served as a flashpoint. In June 2008, Japanese and Chinese diplomats reached agreement on the joint development of resources in the East China Sea; implementing details were left to follow-on talks, which have failed to resolve outstanding issues. In June 2013 China began the construction of large exploration platforms on the Chinese side of the mid-line boundary. Tokyo considered the Chinese action to be at odds with the 2008 agreement and an "attempt to change the status quo unilaterally." Beijing's response was to make clear that exploration was taking place within China's sovereign waters, that China and Japan have yet to reach agreement on the maritime boundary, and that China does not recognize Japan's unilateral boundary demarcation. The Japanese press reported that Prime Minister Abe has raised the issue twice with President Xi at the November 2014 and April 2015 meetings.

North Korea

North Korea, as it has for decades, remains the most destabilizing element in the Asia-Pacific security environment. Pyongyang's growing nuclear and missile arsenal poses a direct threat to U.S. national security interests. Senior U.S. defense officials have stated that North Korea, within a decade, will be able to deploy intercontinental ballistic missiles capable of reaching U.S. territory in the Pacific and the homeland itself.²³

North Korea's estimated 1.2 million-man conventional army also continues to pose a direct threat to the Republic of Korea, a treaty ally of the United States. North Korean provocations, such as the sinking of the ROK navy's warship *Cheonan*, in March 2010, the shelling of Yeonpyeong Island in November 2010, and the August 2015 incident at the demilitarized zone (DMZ), risk escalation into a wider conflict. Pyongyang remains committed to the unification of the Korean Peninsula on its terms.

Diplomatic efforts to address North Korea's nuclear program have a long history. Beginning in 1991, then–Undersecretary of State Arnold Kanter met with North Korean diplomats in New York and proposed the basic tradeoff that has marked diplomatic efforts since: abandonment of North Korea's plutonium-based nuclear program in exchange for an array of security guarantees and economic benefits. The initiative eventually played out into the 1994 Agreed Framework, which offered Pyongyang two light water reactors, a security guarantee, and moves toward normalized relations. Profound distrust on both sides gradually

unraveled the accord, which collapsed in 2002 when the George W. Bush administration discovered that Pyongyang was secretly pursuing uranium enrichment as an alternative path to the bomb.

In September 2003, China launched the Six Party Talks to reduce the risk of unilateral U.S. military action and to keep denuclearization of North Korea on the security agenda. The talks produced the September 19, 2005, agreement, yet another attempt at a grand bargain. The Six Party Talks collapsed in December 2008 when North Korea failed to produce details of its nuclear activities that would verify compliance with the agreement. Efforts to revive the Six Party Talks have proved unavailing.

In 2009 the Obama administration attempted to break the diplomatic deadlock, offering to extend an open hand to North Korea. North Korea answered with ballistic missile and nuclear weapon tests. Nevertheless, the administration continued to pursue a diplomatic opening to Pyongyang, which resulted in the February 29, 2012, Leap Day agreement, a mini-grand bargain in which the United States would provide food in return for North Korea's freezing of its missile and enrichment programs. Pyongyang responded with another ballistic missile test.

In 2012 the nuclear and missile programs were enshrined in North Korea's revised constitution. Today, under the leadership of thirty-something Kim Jong-un, North Korea is pursuing *byungjin*, a two-track policy aimed at sustaining its nuclear weapons and missile programs and simultaneously promoting economic growth—in short, guns *and* butter. Pyongyang has made very clear that it has no interest in surrendering its nuclear program, even for an economic windfall. Instead it seeks international recognition as a nuclear weapons state.

Uncertainties about the long-term life expectancy of the regime under Kim Jong-un, including the prospect of instability or regime collapse, raise daunting security challenges.²⁴ China might intervene to prop up a failing regime, prevent a refugee crisis from spilling over its borders, or secure North Korea's weapons of mass destruction. Similar conditions could prompt the ROK to cross the 38th parallel in an effort to unify the peninsula or the United States to intervene to secure North Korea's weapons of mass destruction. The prospects for strategic miscalculation in a fast-moving, dynamic environment are extremely high, especially given the absence of substantive dialogue between the United States and China about contingency responses.

China-Taiwan

The political dispute between Mainland China and Taiwan remains an unresolved legacy of the Chinese civil war. The People's Republic of China

(PRC) claims Taiwan as an inherent part of Chinese territory. While pursuing a policy of unification through peaceful development, Beijing has refused to renounce the use of force if Taiwan should pursue *de jure* independence. Even as economic integration has deepened to the point where Mainland China is now Taiwan's number one export market and the main destination for Taiwan investment, political trends have continued to diverge.

On the mainland, the narrative of a “century of humiliation” at the hands of foreign powers makes Taiwan reunification a benchmark goal for Chinese nationalism and a domestic political third rail where top leaders have little room to compromise. Conversely, democratization and social changes on Taiwan have reduced the political dominance of the mainlanders who fled the Communist takeover in 1949 and produced a population with less sense of a Chinese identity and little desire for closer political relations with Mainland China, much less unification with a country led by a Communist government. Despite an increasing sense of an identity separate from the Mainland, the pragmatic population on Taiwan prefers to maintain the political status quo and avoid pro-independence actions that might provoke hostile PRC responses.

U.S. policy is based on three communiqués signed with the People's Republic of China and the 1979 Taiwan Relations Act. U.S. policy recognizes the PRC government as the sole legal government of China, acknowledges the Chinese position that there is but one China and that Taiwan is part of China, and maintains cultural, commercial, and other unofficial relations with the people on Taiwan. At the same time, U.S. policymakers have clearly and consistently stated that the United States does not support Taiwan independence. The Taiwan Relations Act provides the legal basis for U.S. unofficial relations with Taiwan and enshrines a U.S. commitment to assist Taiwan in maintaining its defensive capability. It also states that peace and stability in the Western Pacific area “are in the political, security, and economic interests of the United States, and are matters of international concern” and that U.S. policy is to “maintain the capacity of the United States to resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people on Taiwan.”

U.S. policy is focused on maintaining a framework within which the two sides of the strait can work out their political differences rather than on achieving specific outcomes. Accordingly, the United States insists on peaceful resolution of cross-strait differences, opposes unilateral changes to the status quo by either side, and encourages cross-strait dialogue to help advance a peaceful resolution. This approach has helped the United States cooperate with the PRC on a range of global, regional, and bilat-

eral economic and security issues while maintaining robust unofficial ties with the people on Taiwan. However, the growing imbalance in economic and military power between China and Taiwan poses challenges for the viability of this policy framework, especially as Chinese military modernization expands the coercive tools available to PRC leaders.

Contentious cross-strait relations improved considerably from 2008 to 2016 under Taiwan President Ma Ying-jeou, whose willingness to endorse the so-called 1992 consensus (which he interpreted as “one China, separate interpretations”) reduced tensions and permitted a major expansion of cross-strait economic ties, establishment of direct air and sea links, and the signing of 23 cross-strait agreements. Ma resisted pressure from Mainland China to engage in talks on political issues or to define Taiwan’s status more precisely. Although this period saw stability and a significant expansion in cross-strait contacts, many on Taiwan claimed that the economic benefits went largely to politically connected big businesses and that the Ma administration did not stand up enough for Taiwan’s interests.

Opposition Democratic Progressive Party candidate Tsai Ing-wen won a decisive victory in January 2016 elections; her party won control of the legislature for the first time and she took office as president on May 20, 2016. Mainland China is suspicious of Tsai because of her party’s pro-Taiwan independence stance and her service in former president Chen Shui-bian’s government, although she has pledged not to challenge the status quo and has made subtle policy adjustments to reassure Beijing that she will not take pro-independence actions that might disrupt stability.²⁵

Nevertheless, Mainland China officials have insisted that Tsai explicitly acknowledge that Taiwan is part of China and endorse the 1992 consensus, a concession she is unwilling (and perhaps unable) to make. A March 2016 Center for Strategic and International Studies delegation to China and Taiwan concluded that China is deliberately setting the bar high because it wants Tsai’s term in office to be considered a failure. To that end Beijing has severed semi-official cross-strait dialogue mechanisms, reduced the flow of tourists to Taiwan, and may take additional actions to curtail Taiwan’s international space, including by inducing some of Taiwan’s 21 diplomatic allies to shift recognition to the PRC. Beijing’s strategy appears to be to blame Tsai for a downturn in cross-strait relations that damages Taiwan’s economy, and to hope that Taiwan voters choose a candidate committed to improving cross-strait relations in the 2020 election.

This all suggests that cross-strait relations will enter a period of greater turbulence with Beijing seeking to depict Tsai as challenging the status

quo by refusing to endorse the 1992 consensus and Tsai and her government looking to Washington for support in the face of increasing Chinese pressure. At the same time, Beijing knows that any attempt to resolve the Taiwan issue with force would have extremely high costs and risks (including the likelihood of U.S. military intervention) and would severely damage China's relations with the United States and other major countries in the region.

South China Sea

In contrast to the East China Sea, competing territorial claims and maritime boundaries in the South China Sea involve multiple parties. The disputes center on three sets of overlapping claims. China, Taiwan, and Vietnam all claim the Paracel Islands, which China occupied in 1974 during the last days of the Republic of Vietnam. China, the Philippines, and Taiwan claim Scarborough Shoal, site of a 2012 dispute between Beijing and Manila. China, Taiwan, and Vietnam claim all the land features in the Spratly Islands, while Brunei, Malaysia, and the Philippines each claim a number of specific features. China has not clarified the exact nature or legal basis of its claim to land features and adjacent waters inside the "nine-dash line" that it inherited from the Republic of China. The nine-dash line overlaps with part of Indonesia's exclusive economic zone claim, including part of the Natuna natural gas field.

In 2002, the member states of ASEAN and China adopted the "Declaration on the Conduct of Parties in the South China Sea" to address conflicting claims. In the document, the parties:

- reaffirmed "their respect for and commitment to the freedom of navigation in and overflight above the South China Sea as provided for by the universally recognized principles of international law, including the 1982 UN [United Nations] Convention on the Law of the Sea"
- undertook "to resolve their territorial and jurisdictional disputes by peaceful means, without resorting to the threat of or use of force"
- undertook "to exercise self-restraint in the conduct of activities that would complicate or escalate disputes and affect peace and stability including, among others, refraining from . . . inhabiting . . . the presently uninhabited islands, reefs, shoals, cays, and other features and to handle their differences in a constructive manner."²⁶

Finally, the parties reaffirmed that “the adoption of a code of conduct in the South China Sea would further promote peace and stability” and agreed “to work, on the basis of consensus, toward the eventual attainment of this objective.”

A binding code of conduct today stands as a distant vision, and much has transpired that is at odds with the spirit of the Declaration of Conduct. Claimants have used a variety of tactics to reinforce their claims, with a significant increase in activity since 2009.²⁷ Tactics to assert sovereignty include patrols by coast guard and naval forces, occupying land features, enforcing fishing regulations in disputed waters, oil and natural gas exploration, harassment of military ships and aircraft operating in disputed areas, and using legal means (such as the case the Philippines brought against China in the International Tribunal of the Law of the Sea). None of the claimants has clean hands, but China has been the most active in using military and paramilitary means to assert its claims, including by coercion of other claimants.²⁸ Since 2009 China has become more assertive in enforcing its claims, including harassment of U.S. military ships and aircraft operating legally in international waters or within China’s exclusive economic zone. In May 2014 China deployed an oil rig into waters in the Paracels claimed by Beijing and Hanoi, raising tensions and setting off collisions between Chinese and Vietnamese coast guard ships and virulent anti-Chinese demonstrations in Vietnam.

In 2013 China began land reclamation projects in the South China Sea on several low-tide elevations, geologic features that do not extend above water at high tide. China’s efforts at land reclamation were not unprecedented: Malaysia, the Philippines, Taiwan, and Vietnam have also engaged in such projects since the 1980s. The U.S. Department of Defense *Maritime Security Strategy* notes that, in the period from 2009 to 2014, Vietnam “was the most active claimant in terms of both outpost upgrades and land reclamation,” adding “approximately 60 acres of land at 7 of its outposts and [building] at least 4 new structures as part of its expansion efforts.”²⁹

However, China’s land reclamation activities dwarf those of other claimants. By June 2015 China’s land reclamation projects totaled “more than 2,900 acres, or 17 times more land in 20 months than the other claimants combined over the past 40 years, accounting for approximately 95 percent of all reclaimed land in the Spratly Islands.” In comparison Vietnam had reclaimed “a total of approximately 80 acres, Malaysia, 70 acres; the Philippines 14 acres; and Taiwan, 8 acres.”³⁰ Beijing’s position remains that “China has indisputable sovereignty over the Nansha islands and their adjacent waters,” with “sovereignty and relevant rights . . . formed over the long course of history and upheld by successive Chinese

governments.”³¹ In October 2015 President Xi pledged that China would not “militarize” the islands that it had constructed, but the exact nature of this commitment is vague and most observers expect China to use the airfields and port facilities that it is building for both military and civilian purposes.

U.S. policy has been to avoid taking sides in the sovereignty disputes, but to stress the importance of respect for international law and peaceful resolution of disputes without coercion. China’s successful use of incremental salami tactics to expand its effective control of disputed maritime territory in the South China Sea has brought this approach into question, as Beijing has been able to “work around” the United States to gradually expand its naval and coast guard presence and power projection capabilities while avoiding the use of lethal force. More recently, the United States has adjusted its policies to increase security assistance to help improve maritime domain awareness of U.S. allies and partners and has also reinvigorated its Freedom of Navigation program, which challenges excessive or illegitimate maritime claims.³²

U.S. Policy Responses: Sustaining the Rebalance

U.S. policies must take the broad trends of Asia’s economic dynamism, China’s rising power, and the U.S. rebalance into account even as they grapple with specific regional security challenges. We believe the correct strategy is to work with U.S. allies, partners, and multilateral organizations to build a rules-based regional order that includes China and advances U.S. national interests. This requires sustaining the U.S. rebalance to the Asia-Pacific and intensifying cooperation with other regional actors to shape China’s choices and make it pay a price for aggressive actions that violate international rules and norms.

For over a half century, the U.S. system of bilateral security alliances (with Australia, Japan, the Philippines, the Republic of Korea, and Thailand) has served as the informal security architecture of the Asia-Pacific region, underpinning stability and enhancing economic prosperity. Although most countries in the region share concerns about how China is using its power (and especially about its aggressive pursuit of its maritime territorial claims), they are reluctant to choose between China (a critical economic partner) and the United States or to participate in security cooperation aimed against China. Given the diversity of the region in terms of political culture and security interests, a formal alliance system such as the North Atlantic Treaty Organization has been widely recognized as impractical.

The best approach is to build on the existing bilateral alliance system by encouraging increased cooperation between U.S. allies, engaging other regional security partners, and shaping the evolution of regional organizations through active U.S. participation. U.S. policymakers must recognize China is a powerful country that is also attempting to reshape the regional order in directions favorable to its interests. An open, rules-based regional order that includes the United States will be more attractive to Asia-Pacific countries than Chinese-backed alternatives.

Strengthening Alliances

To address the security challenges in 2017–2021 and beyond, a critical first step for the next administration is to focus on strengthening the bilateral alliance structure. This starts with the U.S.-Japan Alliance.

Japan. For over half a century, the alliance with Japan has served as the foundation of U.S. strategy toward the Asia-Pacific region and an integral element of U.S. global strategy. Elements of the Seventh Fleet based in Yokosuka, Japan, were among the first U.S. units to support coalition efforts in the Persian Gulf War in 1991 and Operation *Enduring Freedom* in 2001.

Under the government of Prime Minister Abe, Japan has taken steps to enhance security cooperation with the United States. In December 2013, the Abe government released Japan's first-ever national security strategy, which defined Japan as a "Proactive Contributor to Peace" in support of international stability and security. The document set out three objectives for Japan's security policy: to strengthen deterrence, to strengthen the Japan-U.S. Alliance, and to strengthen the rules-based international order. In July 2014 a decision by the Japanese government cabinet reinterpreted Japan's constitution to allow for the exercise of the right of collective self-defense.

In April 2015 the Obama administration and the Abe government released the Revised Guidelines for Defense Cooperation. The new guidelines aim to enhance U.S.-Japan Alliance cooperation by providing for an Alliance Coordination Mechanism; closer operational coordination; a whole-of-government, upgraded bilateral planning mechanism; seamless coordination of efforts "to ensure Japan's peace and security in all phases, from peacetime to contingencies"; and defense equipment and technology cooperation as well as cooperation in space and cyberspace. The limiting geographic reference to "Situations in Areas Surrounding Japan" in the 1997 guidelines was omitted, theoretically expanding the scope of alliance-based security cooperation.

Of increasing concern to Japan is the potential for “gray zone” activities, attempts to change the status quo by force or coercion such as China’s frequent incursions into Japan’s sovereign waters and air space that could cause “unexpected situations” and challenge the alliance in response. In April 2014 President Obama made clear that Article 5 of the alliance extends to the Senkaku Islands given Japan’s administrative control. To strengthen deterrence, it is critical for the new administration to be seen actively planning and exercising with Japan’s Self-Defense Forces to deal “seamlessly” with gray zone situations that could arise in the Senkaku Islands.

With respect to North Korea’s growing missile threat, Japanese strategists are concerned with the potential for “decoupling,” the result of a North Korea inclined to engage in provocations, confident that its nuclear arsenal would preclude a U.S. response. Japanese strategists are also concerned with the deterrence challenge posed by China at both the regional and strategic levels.

Implementation of the new defense guidelines, in particular the U.S. commitment “to extend deterrence to Japan through the full range of capabilities, including U.S. nuclear forces” and to continue forward deployment in the Asia-Pacific region will be critical to sustaining Japanese confidence in the alliance. Implementation of the guidelines will be a critical test both of the new administration’s commitment to the alliance and to the rebalance.

Across the region, the strength of the U.S.-Japan Alliance as well as the U.S. commitment to the defense of the Republic of Korea are widely perceived as a barometer of the U.S. security commitment to the Asia-Pacific region.

The Republic of Korea. For over 60 years, the U.S alliance with the Republic of Korea has succeeded in deterring North Korea from again attempting to unify the Korean Peninsula by force of arms. The resulting armed peace has allowed for a political evolution to take place in which the Korean people have transformed an authoritarian political system into a vibrant democracy, while allowing the native energies of the Korean people to flourish and develop a dynamic market economy with an international presence.

At the same time, the threat posed by North Korea to the security of the ROK and the broader international community remains. The sinking of the ROK navy corvette *Cheonan* in March 2010 and the shelling of Yeonpyeong Island in November 2010 and the August 2015 landmine incident at the DMZ underscore North Korea’s continuing hostility.

While North Korea's conventional capabilities have continued to degrade, the threat posed by its nuclear weapons and missiles is increasing at an accelerating pace. Since the September 19, 2005, Six Party Talks agreement on denuclearization, North Korea has conducted five nuclear tests (in October 2006, May 2009, February 2013, January 2016, and September 2016). The UN Security Council imposed sanctions after the first four tests and is currently considering additional sanctions. Meanwhile North Korea continues to develop and test a ballistic missile arsenal. In October 2014, U.S. Forces Korea (USFK) commander General Curtis Scaparrotti, USA, cautioned that North Korea may have developed a miniaturized nuclear warhead and mated the warhead to missiles capable of striking U.S. territory.

North Korea's evolving nuclear and missile capabilities raise issues related to deterrence and defense, affecting both the ROK and Japan.³³ Defense planners are concerned that "newly nuclear states often are more assertive at the conventional level because of their confidence in being able to deter a strong adversary response with their nuclear means."³⁴ To address this potential risk, the ROK and the United States reached agreement on a Counter-Provocation Plan in March 2013. The plan was employed during the August 2015 DMZ landmine incident. Updating the Counter-Provocation Plan to deal with the evolving threats posed by North Korea will be an important alliance management instrument for the new administration.

Enhancing missile defense will also be a critical alliance issue for the new administration. In July 2016 the United States and the ROK agreed to deploy the Terminal High Altitude Area Defense (THAAD) system to the ROK. The deployment will defend against North Korean missile attacks and open the door to the development of an interoperable U.S.-ROK-Japan multilayered missile defense system that would enhance defense and deterrence in Northeast Asia. China, however, has expressed concerns that the U.S. deployment of the THAAD system in South Korea could put China's nuclear deterrent at risk and aggravate tensions on the peninsula. In July 2014 President Xi Jinping reportedly told President Park Geun-hye that THAAD deployment on the peninsula "went against China's security interests."³⁵ After the deployment decision, China expressed "firm opposition" and has applied economic and diplomatic pressure on the ROK to reconsider. U.S. and ROK policymakers will need to stand firm in the face of Chinese pressure.

Meanwhile, efforts to implement the September 19, 2005, Six Party agreement on the denuclearization of North Korea remain on diplomatic life support. In April 2009 North Korea announced its withdrawal from

the Six Party Talks and subsequently made clear that its nuclear arsenal will not be used as a bargaining chip to secure economic benefits.

The next administration should take the long view with respect to North Korea—not all problems will be solvable within its term in office. An effective policy will aim to strengthen deterrence and defense of the ROK, maintain the external pressure of economic sanctions, and keep the door open to dialogue and diplomacy.

To deal with the possibility of instability or regime collapse, the next administration should work to closely coordinate U.S. and ROK objectives, endstates, and policy responses and, at the same time, make every effort to bring China into the conversation. To date China has considered such official-level discussion to be premature.

The Philippines. In 1992, after the Philippine senate rejected an extension of the basing agreement, the United States closed Clark Air Base and the Subic Bay Naval Base and withdrew its military forces from the Philippines. U.S. military assistance resumed after 9/11, directed to support Manila's counterterrorism efforts in Mindanao and the southernmost islands.

As Philippine concerns about China have increased, Manila has become more willing to expand security cooperation. In 2011, the United States agreed to support programs aimed at enhancing its maritime security capabilities. In 2012, the Balikatan joint exercise took place off Palawan Island, near the contested Spratly Islands in the South China Sea. The United States also transferred two former Coast Guard ships to the Philippines. In 2014, Washington and Manila signed the Enhanced Defense Cooperation Agreement, aimed at “addressing short-term capability gaps, promoting long-term modernization, and helping maintain and develop additional maritime security, maritime domain awareness, and humanitarian assistance and disaster relief capabilities.”³⁶ During his visit to the Philippines in 2014, President Obama made clear that the U.S. commitment “to defend the Philippines is ironclad and the United States will keep that commitment because allies never stand alone.” Obama reiterated the “ironclad commitment” formulation during his 2015 visit to the Philippines. Despite new Philippine President Rodrigo Duterte's recent remarks questioning the value of security cooperation with the United States, U.S. policymakers should exercise patience and remain focused on the long-term interests of both countries.

Moving Beyond the Hub-and-Spokes Alliance System

Since the turn of the century, the U.S. alliance structure has been evolving from the Cold War bilateral hub-and-spokes construct toward a

more open architecture that includes increased cooperation between U.S. allies and active efforts to engage other regional security partners. The United States has supported increased bilateral security cooperation between U.S. allies, most notably between Australia and Japan and Japan and the Philippines; trilateral cooperation among Australia, Japan, and the United States and among Japan, the ROK, and the United States; and quadrilateral engagement involving the Australia, India, Japan, and the United States. Exercises that began in the context of U.S. bilateral alliances have expanded to include a wide range of regional participants, including China (which participated in the 2014 and 2016 Rim of the Pacific exercises).

At the same time, the United States has developed Comprehensive Partnerships with Indonesia, Malaysia, and Vietnam and a Strategic Partnership with Singapore. Japan and Australia, both U.S. allies, have developed similar partnerships with Indonesia, Malaysia, Singapore, and Vietnam. These non-alliance partnerships help to enhance broad-based regional security cooperation and contribute to stability.

Australia, Japan, and the United States are focusing on maritime issues in Southeast Asia and the South China Sea, including maritime capacity-building, maritime domain awareness, joint training and exercising, and port calls. In 2013 the United States committed \$156 million (2014–2015) to support maritime capacity-building in Southeast Asia, including \$18 million to Vietnam.³⁷ In November 2015, the White House announced its intention to enhance capacity-building efforts by committing more than \$250 million over the 2015–2016 period, focused on Indonesia, Malaysia, the Philippines, and Vietnam.³⁸

In November 2015 Japanese and Vietnamese ministers of defense agreed to strengthen defense cooperation, including joint maritime exercise and a 2016 port call at Cam Ranh Bay by Japan's Maritime Self-Defense Force. Earlier, in 2006, Japan, making strategic use of its Official Development Assistance program, sent three patrol boats to Indonesia and in 2012 transferred 10 Japanese Coast Guard ships to the Philippines. Similarly, Australia has used the Pacific Patrol Boat Program to donate aging Australian ships to South Pacific and Southeast Asian neighbors.

One of the most difficult regional security issues is maritime territorial disputes, which are sensitive domestic political issues (but not existential interests) for all the claimants. China's efforts to use military and paramilitary means to expand its effective control of disputed territories and waters pose a challenge to key U.S. interests and principles such as peaceful resolution of disputes, respect for international law, and freedom of navigation. The United States should continue to resist pressure

to take sides in sovereignty disputes and maintain an even-handed approach. However, when countries, including China, take actions that we view as inconsistent with international law, the United States should impose costs, including via official statements, diplomatic efforts to organize opposition to illegal or destabilizing actions, and enhancing security cooperation with regional allies and partners. The United States must maintain its military capabilities and be willing to act to assert its own interest in freedom of navigation, including by military activities that challenge excessive maritime claims. If carried out on a routine basis, there will be less need to publicize each freedom of navigation operation.

Enhancing the rebalance's focus on maritime capacity-building in Southeast Asia will be an important benchmark of the next administration's commitment to regional stability and security. At the same time, given the diversity and complexity of the Asia-Pacific region, alliances and partnerships should not be viewed as being exclusively threat-centric. They can also play an important role in building regional order by strengthening cooperation in dealing with nontraditional security issues, thereby enhancing confidence among states. Efforts to work with allies and partners in enhancing regional security cooperation will strengthen U.S. political and diplomatic leadership in the region.

Shaping the Asia-Pacific Order

Scholars have long argued that the Asia-Pacific region lacks the web of multilateral organizations that have facilitated European integration. Explanations for Asia's under-institutionalization include the region's economic and cultural diversity, mutual suspicions between countries, and the impact of Cold War political divisions. In 1967, the governments of Indonesia, Malaysia, the Philippines, Singapore, and Thailand came together to create ASEAN. For over two decades, ASEAN stood as the lone multilateral institution in the region. However, recent decades have seen the creation of new regional organizations and meetings that may become building blocks for a new regional order.

As the Cold War was ending in 1988, Malaysia's Prime Minister Mohammed Mahathir advanced the concept of an East Asia Economic Caucus that would exclude the United States. U.S. opposition doomed the caucus, but in 1989 Australia, with strong U.S. support, established the Asia-Pacific Economic Cooperation to advance regional trade liberalization. With the establishment of APEC, Asian multilateralism gathered momentum. In 1993, ASEAN created the ASEAN + 3 (China, Japan, South Korea) format, followed by the ASEAN Regional Forum in 1994, the East Asian Summit in 2005, and the ASEAN Defense Ministers Meeting Plus in 2010—ASEAN + Australia, China, India, Japan, New Zea-

land, the ROK, Russia, and the United States. In addition, the annual Shangri-la Dialogue sponsored by the International Institute for Strategic Studies in Singapore has served as a high-level multilateral forum for the discussion of political and security issues.

In 2008, the Bush administration appointed the first U.S. Ambassador to ASEAN, a clear recognition of the growing importance of ASEAN and of the region's expanding multilateral, diplomatic, economic, and security forums. One explicit goal of the rebalance was to increase the U.S. ability to help shape the emerging multilateral architecture in the Asia-Pacific region. The Obama administration has paid particular attention to high-level participation in the region's multilateral institutions and dialogues, with the President, Secretary of State, and Secretary of Defense regularly attending meetings in Asia. Countries across the region have welcomed the Obama administration's sustained high-level attention, but are concerned whether the next administration will place an equally high priority there. U.S. interests would be best served by continued high-level U.S. participation and active U.S. engagement in efforts to shape the regional order.

The Trans-Pacific Partnership

The priority that almost all Asia-Pacific governments place on economic growth means that trade and investment agreements are a critical aspect of international relations in Asia and important building blocks for the emerging regional order. If the United States is not actively engaged, other countries will be allowed to shape regional economic rules, norms, and standards in ways that may work against U.S. interests. The centerpiece of the Obama regional economic agenda has been the Trans-Pacific Partnership, a "gold-standard" free trade agreement. Ten countries reached agreement on the deal in October 2015, but Congress will need to approve the agreement in an up-or-down vote.

Ambassador Michael Froman, the U.S. official in charge of negotiating the agreement, told a Center for Strategic and International Studies audience:

TPP is a critical part of our overall Asian architecture. It is perhaps the most concrete manifestation of the President's rebalancing strategy toward Asia. It reflects the fact that we are a Pacific power and that our economic well-being is inextricably linked with the economic well-being of this region. . . . TPP's significance is just not economic, it's strategic—as a means of embedding the United States in the region.³⁹

Asia Pacific

Similarly, Assistant Secretary of State for East Asian and Pacific Affairs Daniel Russel cast TPP as a “strategic agreement . . . the economic leg and ‘crown jewel’ of the Obama Rebalance Strategy . . . one that convincingly demonstrates that sustained engagement by the U.S, as a Pacific nation, is shaping an open, prosperous, rules-based region.” Russel went on to state, “That’s why TPP is worth as much to Defense Secretary Carter as a new aircraft carrier, as he recently said.”⁴⁰

In interviews across the region over the past 2 years, political leaders, diplomats, and military officials all underscored the strategic importance of TPP as a benchmark of long-term U.S. commitment to the region and the cornerstone to securing a rules-based, open international trading order in Asia. Failure to enact TPP would be viewed as a sign of U.S. strategic withdrawal from the region. Beyond TPP, negotiations with the European Union on the Trans-Atlantic Trade and Investment Partnership (TTIP) will provide the next administration an opportunity to structure a rules-based trade and investment order that includes more than one-third of global gross domestic product. Taken together, TTIP and TPP provide the United States an opportunity to shape a rules-based international economic order that advances its long-term economic and strategic interests.

China Policy: Managing a Mixed Relationship

One of the most difficult policy challenges will be dealing with China, which has the ability to affect a range of U.S. global, regional, and domestic interests. The U.S.-China relationship is marked by a mix of cooperation and competition; the policy challenge is to maximize cooperation in areas where common interests exist, while competing successfully in areas where U.S. and Chinese interests are opposed. Both countries have a strong interest in maintaining an effective bilateral working relationship in order to pursue important global, regional, and domestic goals. High-level leadership will be needed on both sides to keep the competitive and cooperative aspects of the relationship in balance.⁴¹

Cooperation is important for the United States because China has become an important global actor, with the ability to influence the effectiveness of global institutions such as the UN Security Council and World Trade Organization. On some issues, such as climate change and dealing with North Korea’s nuclear and missile ambitions, progress is impossible without cooperation with China. While Chinese leaders view some aspects of global institutions as unfair and are not interested in shoring up U.S. hegemony, they like a rules-based global economic system and view the United Nations as the most legitimate institution of global governance.⁴² China has been one of the biggest beneficiaries of

the open global trade system established by the United States after World War II, which facilitated its economic rise. Beijing seeks to wield greater influence within global institutions, and where possible to work with other countries to adjust international rules and norms to better reflect its own interests and perspectives. Nevertheless, China remains reluctant to take on the costs, risks, and commitments necessary to play a global leadership role; its actions are usually focused on defending narrow Chinese interests rather than aspiring for global leadership. Given that China's main interest in most parts of the world is to maintain stability and secure access to resources and markets, its interests will often be relatively compatible with those of the United States.⁴³

U.S. and Chinese interests are less aligned at the regional level, where there is increasing competition for influence. Over the last decade Beijing has become more critical of the U.S. alliance system, arguing that it reflects Cold War thinking and emboldens U.S. allies to challenge Chinese interests. The U.S. rebalance to the Asia-Pacific and increased U.S. regional security cooperation have stoked Chinese fears of U.S. encirclement or containment. Beijing's proposed alternatives emphasize nontraditional security cooperation and the importance of resolving disputes through peaceful dialogue. Beijing has resisted making any binding commitments that might restrict its military capabilities or ability to employ military power to defend its core interests. Its increasing military capabilities and more assertive approach to maritime territorial disputes have heightened regional concerns about how a strong China will behave, leading most countries to improve their security ties with the United States. If the United States emphasizes its alliances, expanding security cooperation with other partners, and active engagement with regional multilateral institutions, it will be able to deal with Chinese regional security initiatives and actions from a position of strength and successfully resist Chinese efforts to erode the U.S. alliance system.

Although cooperation with China is important, U.S. policymakers should be careful to resist Beijing's efforts to create a U.S.-China condominium or "G-2"-like arrangement. Such an arrangement would be unlikely to last and would probably require unacceptable compromises to accommodate China's so-called core interests (including accepting China's territorial claims to Taiwan and in the South China Sea and East China Sea). Accepting a Chinese sphere of influence or giving the appearance of siding with Beijing against U.S. allies would damage U.S. credibility and compromise the U.S. position in the Asia-Pacific region.

The next administration will have the opportunity to develop a new label for the U.S.-China relationship to replace Beijing's preferred formulation of a "new type of major country relationship." It will be important

to adopt a label that reflects the importance of the U.S.-China relationship but does not suggest that the United States values its relationship with China above its relationships with its treaty allies.

China's more assertive regional behavior is partly the product of misreading global power trends (including the mistaken assessment that the 2008 global financial crisis marked a fundamental shift in the relative balance of power between the United States and China). Current Chinese Communist Party efforts to tighten political control over the Chinese population and restrict the flow of information into China reflect increasing concerns about domestic stability in the face of slowing economic growth. China's successful economic model needs to be adapted to place more weight on markets and domestic demand, but there are widespread concerns that the political system may not be able to push through the necessary reforms. Moreover, past efforts to stimulate the economy in the wake of the financial crisis have created debt burdens at various levels of the Chinese financial system that increase the risk of a major financial crisis.

Although an economic collapse that brings down the Chinese regime is unlikely, the next U.S. President will likely face a Chinese leadership more focused on maintaining domestic stability and less inclined to engage in provocative international behavior. This will heighten the importance of a cooperative working relationship with the United States to give China the space to deal with its internal problems and should give U.S. policymakers more leverage. China will continue its military modernization and regional infrastructure investments through the Asian Infrastructure Investment Bank and One Belt, One Road initiative but may have fewer resources to devote to these efforts. Chinese leaders are unlikely to engage in provocative international behavior to divert attention from domestic problems but will be concerned that other countries may seek to exploit a distracted Chinese leadership.⁴⁴ The result may be an increased interest in stabilizing maritime territorial disputes and avoiding challenges to Chinese sovereignty claims. This approach might also spill over into more interest in engaging with the Democratic Progressive Party on Taiwan to work out an acceptable formulation for cross-strait relations.

Conclusion

Over the next 4 years, the United States will be challenged to maintain its leadership of a rules-based order in the Asia-Pacific region. U.S. diplomacy must play a leading role in strengthening our alliances, partnerships, and regional institutions that widely share the U.S. commitment

to a rules-based order as the foundation of regional peace and stability. The engagement of the highest levels of U.S. leadership with the region will be critical. Allies, partners, and potential challengers will all judge the regular presence of the President, Secretary of State, and Secretary of Defense in the region as a key indicator of U.S. commitment.

The U.S. bilateral alliances with Australia, Japan, the Philippines, the Republic of Korea, and Thailand remain the foundation of our strategic presence in the Asia-Pacific region and need appropriate high-level attention. At the same time, the alliance structure is evolving toward a more open system, with new security partnerships forming across the region. This has been most noticeable in Southeast Asia, where Australia, Japan, and the United States are all engaged in maritime capacity-building with states bordering on the South China Sea. The United States should expand bilateral and multilateral security cooperation with its allies and partners and support their efforts to promote regional security cooperation. Given U.S.-China regional competition, initiatives from other countries may sometimes be the best means of moving forward.

The United States is best positioned to deal with China if it has devoted sufficient attention to its regional alliances, partnerships, and participation in multilateral organizations. The U.S. President will need to engage directly with his Chinese counterpart in order to keep both governments focused on a cooperative agenda and to manage the more competitive aspects of the relationship. The relationship with Beijing will be challenging, but Chinese internal economic and political problems are likely to give U.S. policymakers more leverage. Chinese leaders will remain suspicious about U.S. intentions to contain China. U.S. policymakers should stress that the United States supports open, rules-based regional and global organizations, which will require China's active participation and support if they are to achieve their goals and, at the same time, can help generate international pressure on China to be a constructive participant.

As it has since the turn of the century, U.S. trade and investment in the region will continue to expand. The U.S. economic presence is the ultimate foundation of long-term U.S. presence and commitment. Providing a rules-based order for commerce and investment and, in turn, sustained economic growth is the focus of the Trans-Pacific Partnership. Legislation to provide for U.S. accession is now before Congress. There are many competing studies on the effect of TPP on U.S. growth and employment, and political leadership will be faced with a truly historic decision in terms of U.S. participation. U.S. accession to TPP will be viewed as a test of U.S. leadership and commitment to a trade and investment rules-setting agenda.

Notes

¹ The Association of Southeast Asian Nations (ASEAN) is made up of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), the Philippines, Singapore, Thailand, and Vietnam.

² The World Bank, “East Asia Pacific Economic Update, October 2015: Staying the Course,” available at <www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update>.

³ U.S. Census Bureau, “Trade in Goods with Asia,” available at <www.census.gov/foreign-trade/balance/c0016.html>.

⁴ U.S. Census Bureau, “U.S. Direct Investment Abroad for 2012–2014,” September 2015, available at <http://bea.gov/scb/pdf/2015/09%20September/0915_outward_direct_investment_detailed_historical_cost_positions.pdf>.

⁵ East-West Center, “Asia Matters for America,” available at <<http://www.asiamatters-foramerica.org/overview>>. Note that the Asia Matters for America project includes 40 countries as comprising the Asia-Pacific region.

⁶ Walter Lohman, Olivia Enos, and John Fleming, *2014 Asia Update: What's at Stake for America*, Special Report No. 158 (Washington, DC: The Heritage Foundation, October 8, 2014), available at <www.heritage.org/research/reports/2014/10/asia-update-whats-at-stake-for-america-2014>.

⁷ China's official growth statistics for 1998 and 2008 do not fully reflect this slowdown, which was partly offset by large economic stimulus packages.

⁸ Bonnie S. Glaser, “China's Coercive Economic Diplomacy—A New and Worrying Trend,” *PacNet* 46 (Honolulu, HI: Center for Strategic and International Studies, July 23, 2012).

⁹ Christopher Bodeen, “China's Military Spending Increase to Be Smallest in 6 Years,” Associated Press, March 4, 2016.

¹⁰ State Council Information Office, “China's Military Strategy,” May 2015, available at <<http://eng.mod.gov.cn/Database/WhitePapers/>>.

¹¹ See *Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2015* (Washington, DC: Department of Defense, 2015).

¹² David Shambaugh, ed., *Power Shift: China and Asia's New Dynamics* (Berkeley: University of California Press, 2006); Evelyn Goh and Sheldon W. Simon, eds., *China, the United States, and Southeast Asia: Contending Perspectives on Politics, Security, and Economics* (New York: Routledge, 2008).

¹³ See David Shambaugh, *China Goes Global: The Partial Power* (New York: Oxford University Press, 2013); Phillip C. Saunders, “China's Role in Asia: Attractive or Assertive?” in *International Relations of Asia*, ed. David Shambaugh and Michael Yahuda, 2nd ed. (Lanham, MD: Rowman and Littlefield, 2014), 147–172.

¹⁴ “Remarks by President Obama to the Australian Parliament,” Canberra, Australia, November 17, 2011, available at <www.whitehouse.gov/the-press-office/2011/11/17/remarks-president-obama-australian-parliament>.

¹⁵ Hillary Clinton, “America's Pacific Century,” *Foreign Policy* 189 (November–December 2011), 56–63.

¹⁶ For an analysis of the origins of the rebalance, see Phillip C. Saunders, “China's Rising Power, the U.S. Rebalance to Asia, and Implications for U.S.-China Relations,” *Issues and Studies* 50, no. 3 (September 2014), 19–55.

¹⁷ See the fact sheets from the U.S. Trade Representative's Office, available at <www.ustr.gov/tpp>; Jeffrey Schott, Barbara Kotschwar, and Julia Muir, *Understanding the*

Przystup and Saunders

Trans-Pacific Partnership (Washington, DC: Peterson Institute for International Economics, 2013).

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¹⁹ For a recent overview of these activities, see Admiral Harry B. Harris, Jr., commander, U.S. Pacific Command, statement before the Senate Armed Services Committee hearing on U.S. Pacific Command Posture, February 23, 2016, available at <www.armed-services.senate.gov/imo/media/doc/Harris_02-23-16.pdf>.

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Asia Pacific

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