

# **U.S.-CHINA CURRENT TRADE AND INVESTMENT POLICIES AND THEIR IMPACT ON THE U.S. ECONOMY**

**THURSDAY, JUNE 14, 2001**

U.S.-CHINA SECURITY REVIEW COMMISSION,  
*Washington, DC.*

The Commission met in Room 124, Dirksen Senate Office Building, Washington, D.C., at 9:00 a.m., James R. Lilley and Patrick A. Mulloy (Hearing Co-Chairs), presiding.

OPENING REMARKS OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. Good morning. This is the opening hearing of the newly formed U.S.-China Commission, which is a statutory permanent Congressional advisory body. We're privileged to have before us as our first witness today, the distinguished Chairman of the Appropriations Committee, the President Pro Tem of the Senate, Senator Robert C. Byrd.

This Commission, which was created by legislation authored by Senator Byrd, together with a number of other senators, including those who will be following Senator Byrd in their presentations this morning. The statute was passed on the Defense Authorization Bill, and its purpose of which is to conduct an integrated assessment of the U.S.-China relationship by investigating the relationships between our mushrooming economic flows and U.S. national security concerns.

In the past, efforts have been made to keep economic ties to some extent compartmentalized from overall relationship, but with China now becoming America's primary international protagonist and with America's focus shifting away from Europe and to the Pacific as our primary region of interest in the new century, all parts of the relationship are increasingly being related to each other.

China's position towards its neighbors, U.S. allies and friends, its military and political policies toward the U.S. will increasingly be affected by, and in turn will affect, the kind and size of our economic relationship.

The Commission is therefore approaching an understanding of the China connection in a newly comprehensive fashion. This Commission is seeking to fulfill its wide-ranging Congressional mandate and develop a fresh and holistic approach that makes sense regarding China and to understand the implications of the huge flow of economic resources going from the United States to the Chinese economy and government.

These resources take the form of very large trade surpluses, steeply growing sums of venture capital from our financial marketplace, and increasingly large investments by U.S. businesses. This also involves substantial transfers of advance technology.

We have scheduled three other hearings prior to the Congressional recess in August, including hearings on capital markets, on a wide range of specific sectors and on mutual perceptions in the security arena.

The Commission is required to provide a comprehensive annual report to the Congress in March of each year, in classified and unclassified forms, together with any recommendations for legislation and other actions as the Commission feels appropriate.

To help us sort out these questions we have a series of presentations by several senators who are involved in the creation of this Commission, followed by representatives of business and labor and former officials of the Executive Branch, including Admiral Joe Prueher, our outgoing Ambassador to China; and our former trade negotiator in the past administration, Ambassador Charlene Barshefsky.

[The statement follows:]

PREPARED STATEMENT OF CHAIRMAN C. RICHARD D'AMATO

This is the opening hearing of the newly formed U.S.-China Commission, a statutory permanent Congressional advisory body, and we are privileged to have before us as our first witness, the distinguished Chairman of the Appropriations Committee, the President Pro Tempore of the Senate, U.S. Senator Robert C. Byrd.

The purpose of this Commission, which was created by legislation authored by Senator Byrd, together with a number of other Senators, including those who will be making presentations this morning. The statute was passed last fall on the FY 2001 Defense Authorization Bill, is to conduct an integrated assessment of the U.S.-China relationship by investigating the relationships between our mushrooming economic flows and U.S. national security concerns. In the past, efforts have been made to keep economic ties to some extent compartmentalized from the overall relationship, but with China now becoming America's primary international protagonist, and with America's focus shifting away from Europe and to the Pacific as our primary region of interest in the new Century, all parts of the relationship are increasingly related to each other. Thus, Chinese policies toward its neighbors, U.S. allies and friends, its military and political policies toward the U.S. will increasingly be affected by, and in turn will affect, the kind and size of our economic relationship. I should think, for example, that China's uncooperative attitude on the important problem of global warming will begin to have an impact on other parts of our relationship. The Commission is therefore approaching an understanding of the China connection in a newly comprehensive fashion.

This Commission is seeking to fulfill its wide-ranging Congressional mandate and develop a fresh and holistic approach that makes sense regarding China, and to understand the implications of the huge flow of economic resources going from the United States to the Chinese economy and government. These resources take the form of very large trade surpluses, steeply growing sums of venture capital from our financial marketplace, and increasingly large investments by U.S. business. This also involves substantial transfers of advance technology.

We have scheduled three other hearings prior to the Congressional recess in August, including hearings on capital markets, a wide range of specific sectoral issues, and on mutual perceptions in the security arena. You can find the schedule on the press tables.

The Commission's mandate includes examining and reporting to Congress on a variety of specific areas, including:

- The portion of trade in goods and services with the United States that the People's Republic of China dedicates to military systems or systems of a dual nature that could be used for military purposes;
- The acquisition by the People's Republic of China of advanced military or dual-use technologies from the United States by trade (including procurement) and other technology transfers, especially those transfers, if any, that contribute to

- the proliferation of weapons of mass destruction or their delivery systems, or that undermine international agreements or United States laws with respect to nonproliferation;
- Any transfers, other than those identified under subparagraph (B), to the military systems of the People's Republic of China made by United States firms and United States-based multinational corporations;
  - An analysis of the statements and writings of the People's Republic of China officials and officially-sanctioned writings that bear on the intentions, if any, of the government of the People's Republic of China regarding the pursuit of military competition with, and leverage over, or cooperation with, the United States and the Asian allies of the United States;
  - The military actions taken by the government of the People's Republic of China during the preceding year that bear on the national security of the United States and the regional stability of the Asian allies of the United States;
  - The effects, if any, on the national security interests of the United States of the use by the People's Republic of China of financial transactions and capital flow and currency manipulations;
  - Any action taken by the Government of the People's Republic of China in the context of the World Trade Organization that is adverse or favorable to the United States national security interests;
  - Patterns of trade and investment between the People's Republic of China and its major trading partners, other than the United States, that appear to be substantively different from trade and investment patterns with the United States and whether the differences have any national security implications for the United States;
  - The extent to which the trade surplus of the People's Republic of China with the United States enhances the military budget of the People Republic of China, and;
  - An overall assessment of the state of the security challenges presented by the People's Republic of China to the United States and whether the security challenges are increasing or decreasing from previous years.

The Commission is required to provide a comprehensive annual report to the Congress in March each year, in classified and unclassified forms, together with any recommendations for legislative and other actions as the Commission feels appropriate.

All this economic activity is occurring is in the face of an uncertain security relationship and an open question of the willingness and capacity of the Chinese to truly work with the United States in a cooperative manner in the Pacific region. If our security interests are colliding, what should be the implications for the continuation of massive transfers of wealth for the use of the Chinese regime?

To help us sort out these questions, we have a series of presentations by several Senators who were involved in the creation of this Commission, followed by representatives of business and labor, and former officials of the Executive Branch, Admiral Joseph W. Prueher, our outgoing Ambassador to China, and the former trade negotiator in the past Administration, Ambassador Charlene Barshefsky.

We welcome you today, and it is an honor to hear from you, Senator Byrd.

Chairman D'AMATO. SENATOR BYRD, WE WELCOME YOU TODAY AND IT'S AN HONOR TO HEAR FROM YOU.

**STATEMENT OF ROBERT C. BYRD, U.S. SENATOR FROM THE STATE OF WEST VIRGINIA**

Senator BYRD. Thank you, Mr. Chairman, members of the Commission. I am pleased to participate in the initial hearing, the initial public hearing.

In your ongoing investigation of the U.S.-China trade and security relationship you have a very special responsibility and a unique opportunity to provide fresh insight into this key dimension of U.S. foreign policy. For the foreseeable future the People's Republic of China presents us with our most important and delicate foreign challenge. This is evident from at least two widely recognized phenomena.

First, with the end of the Cold War America, which continues to define its geo-political interests globally, is increasingly focusing its security resources on the Pacific Region. This focus is likely to

come into conflict with China's regional ambitions. Indeed we are a long way from the days when China's leaders took seriously the Maoist slogan "Seek no foreign entanglements."

Second, China has enormous, untapped economic resources under huge and complicated trade and investment relationship with the United States. In short, both countries face a complex array of bilateral opportunities and bilateral dangers. It would be a mistake to over simplify this situation by failing to recognize the interdependence between the economic and national security aspects of the relationship.

The task of the Commission is further complicated by the significance of a host of questions that may not be answered with perfect precision. I will cite just four:

First, to what extent is China's security apparatus involved in normal commercial transactions between Chinese and Western companies?

Second, how does any such involvement help the Chinese Communist Party to maintain its monopoly on political power?

Third, how will technology, especially communications technology, affect that monopoly?

Finally, in what way will internal political changes affect China's external orientation, especially it's regional, geo-political ambitions?

As each of you uses your historical knowledge and analytical expertise to sort through these issues, and as you develop your collective judgment about the myriad aspects of the U.S.-China relationship, your loadstone must always be the evolving long-term national security interests of the United States.

I know that your conclusions will help to guide Congress as it discharges its responsibilities under Article I of the Constitution. To regulate commerce with foreign nations; two, define and punish offense against the law of nations; and three, make rules for the government and regulation of the land and naval forces.

You, as members of the Commission, must apply your best judgment to issues that will often be difficult to precisely evaluate. As Aristotle pointed out in his *Nicomachian ethics*, and I quote: "Our discussion will be adequate if it has as much clearness as the subject matter admits of, for precision is not to be sought for a like in all discussions anymore than in all products of the crafts."

Now, fine and just actions which political science investigates, admit of much variety and fluctuation of opinion. We must be content then in speaking of such subjects and with such premises, to indicate the truth roughly and in outline, and in speaking about things which are only for the most part true and with premises of the same kind to reach conclusions that are no better.

Mr. Chairman, the statutory mandate that you have been given is intentionally broad. Little of importance has been left off the table, and you have been given the time and the resources to explore all productive avenues of inquiry. You must develop a full understanding of the complexities surrounding the transfer of economic resources from America to China, including the huge annual surpluses on China's trade account and the mushrooming infusions of U.S. capital onto Chinese soil.

An evaluation of this transfer of economic resources should include the impact on China's economic and political systems, its strategic planning, its military build up, and its regional behavior.

An assessment of the overall affect of the transfer of resources on the long-term security interests of the United States, particularly focusing on the U.S. role in supporting peace and stability in the Pacific Region, is what we are after.

In addition, your report must include a full investigation of China's acquisition of U.S. dual use and military technology. I believe that China is concentrating on technology acquisition from the United States and the West in lieu of fully marshalling its own domestic efforts in support of research and development.

Aside from the direct acquisition of technology by contract and government imposed offset requirements, China is utilizing the People's Liberation Army and Defense Ministry owned front companies operating in the United States to procure advanced dual use and military technology such as high performance computers and navigation and communications equipment. Some sources estimate that there are as many as 3,000 Chinese Government front companies operating in the United States.

Our need is for the Commission to provide us with quantitative and qualitative analyses of these trends, as well as your suggestions concerning appropriate policy responses. Are our current approaches to export control vis-a-vis China achieving our objectives? Should we develop new unilateral or a multi-laterally export control approaches? Are we devoting the necessary resources to this task?

We must try to view our relationship with China as a complex totality with economic, military, societal and environmental components. On climate change, for example, a topic of immense importance to the United States and to the world, China's refusal thus far to become a part of the Kyoto negotiations was a major factor in leading me to the conclusion that the then current version of the Kyoto protocol was flawed and unworkable. That's why I authored, along with Senator Hegel, the resolution. Resolution No. 98 I believe it was, passed the Senate, adopted by the Senate by a vote of 95 to 0.

The Chinese are second in the world in greenhouse gas emissions and are expected to become the world's leader in 2015. The Chinese must not walk away from their responsibility to become part of the solution to the global climate change problems of which they are a part.

As I have said in another context and in another forum, China is an industrial behemoth and must be regarded as such. We must not permit China to hide behind a developing national moniker. We have to wish to put a lid on China's economic future, yet we're all inhabitants of this planet and its environment must be protected by all of us for all of us.

On the trade side there are many bilateral and multi-lateral issues that the Commission will need to consider, but let it suffice for me to say that the Chinese leadership has an unfortunate tendency to refuse to abide by the understandings that have long formed the basis of America's bilateral trade relationships.

Now that China has come to an agreement with the United States on the terms and conditions of this accession to the World Trade Organization we must be alert to any return to China's most objectionable practices, such as export subsidization and predatory dumping.

Finally, it seems clear that the Chinese regime is testing the metal of this administration on the security side. Here we may face real danger insofar as the Chinese miscalculate American resolve to protect our interests and demand adherence to commitment, particularly in relation to Taiwan. Miscalculation must be avoided or at least minimized through threat reduction mechanisms and institutions such as those we put into place over several decades in our relations with the former Soviet Union.

The Chinese have written openly about new forms of warfare, such as information and cyber warfare, that they feel could serve to offset the United States' military and strategic advantages. The mandate of this Commission, Mr. Chairman, includes a requirement to examine China's intentions and programs in this area. The incident with our EP-3 reconnaissance plane, while disturbing and unfortunate, had the sanitary benefit of putting to rest the view that U.S.-China trade issues can be neatly separated from U.S.-China security issues.

The American public now understands, if it did not already understand, that China is engaged in a concentrated effort to acquire U.S. military and dual use technologies and that China's commercial relations must be consisted as part of this effort.

The Commission would serve our country, and the United States Senate, well if the Commission would determine:

One, the magnitude of the economic and military resources China has accumulated through trade and investment flows with the West; and two, the extent to which those resources are being presently used and China's future plans for that use over the next generation to challenge U.S. interests and policies in the Pacific Region.

This analysis should include details on the types of military useful technologies that the Chinese are acquiring and the strategic objectives that drive such acquisitions.

The Commission's first required report is due next March. In the interim period, however, if events arise that in your judgment compel an interim report, I and I'm sure my colleagues on both sides of the aisle who support this Commission through the action by the Senate on the resolution, I would urge you to communicate this need to the Senate leadership and to appropriate Congressional committees of which the committee which I chair is one.

I see from your hearing schedule today that you have included influential officials from the last administration, such as Ambassador Barshefsky and Ambassador Prueher, and I understand that you're inviting a wide range of officials from the current administration for your hearings this summer, along with a variety of experts from the business, labor and academic communities. Congress will surely benefit from your effort to take in the widest possible range of views and information.

In sum I would leave you with this. The problems we face with China go much deeper than the usual trade frictions. We're talking

about a country that already has a demographic and geographic magnitude beyond the comprehension of the average person. A country that is growing in economic power and influence. A country that has an agenda. Its leaders are Communist.

That means that they are to a considerable extent immune to the moderating influence of an informed public opinion. They will be working while we are sleeping. You can bet on that. Working to maximize their power on all fronts. We need this Commission.

In formulating your governing statutory provisions, I and other senators, endeavored to ensure that in opening the door to expanded trade with China we do not close our eyes to serious concerns about our national security. You have a difficult burden to lift. You have a very different assignment. Your findings and your proposals will mean much to the future of the United States, to its security, to its economic welfare, and I want you to know, Mr. Chairman, that as the chief author of the resolution, I stand ready to be helpful on when the Commission calls for help.

We want to hear from you, we want to work with you, and we look forward to your reports, to your proposals, to your guidance, to your leadership, and I wish you success in this all important endeavor. I know, Mr. Chairman, from my previous associations with you and several of the members of this Commission, that you will approach your task with great dedication, with knowledge and with wisdom and with common sense, and always with your guard up. I wish you success.

[The statement follows:]

PREPARED STATEMENT OF ROBERT C. BYRD

I am pleased to participate in the initial hearing in your ongoing investigation of the U.S.-China trade and security relationship. You have a special responsibility and a unique opportunity to provide fresh insight into this key dimension of U.S. foreign policy.

For the foreseeable future, the People's Republic of China presents us with our most important and delicate foreign policy challenge. This is evident from at least two widely recognized phenomena. First, with the end of the Cold War, America—which continues to define its geopolitical interests globally—is increasingly focusing its security resources on the Pacific region. This focus is likely to come into conflict with China's regional ambitions. Indeed, we are a long way from the days when China's leaders took seriously the Maoist slogan "seek no hegemony." Second, China has enormous untapped economic resources and a huge and complicated trade and investment relationship with the United States. In short, both countries face a complex array of bilateral opportunities and dangers. It would be a mistake to oversimplify this situation by failing to recognize the interdependence between the economic and national security aspects of the relationship.

Your task is further complicated by the significance of a host of questions that may not be answered with perfect precision. I will cite just four. First, to what extent is China's security apparatus involved in normal commercial transactions between Chinese and Western companies? Second, how does any such involvement help the Chinese Communist Party to maintain its monopoly on political power? Third, how will technology, especially communications technology, affect that monopoly? Finally, in what way will internal political changes affect China's external orientation, especially its regional geopolitical ambitions?

As each of you uses your historical knowledge and analytical expertise to sort through these issues—and as you develop your collective judgment about the myriad aspects of the U.S.-China relationship—your loadstone must always be the evolving long-term national security interests of the United States. I know that your conclusions will help to guide Congress as it discharges its responsibilities under Article I of the Constitution, to (1) "regulate Commerce with foreign Nations," (2) "define and punish . . . Offenses against the Law of Nations," and (3) "make Rules for the Government and Regulation of the land and naval Forces."

You must apply your best judgment to issues that will often be difficult to precisely evaluate. As Aristotle pointed out in his *Nicomachean Ethics*:

Our discussion will be adequate if it has as much clearness as the subject-matter admits of, for precision is not to be sought for alike in all discussions, any more than in all products of the crafts. Now fine and just actions, which political science investigates, admit of much variety and fluctuation of opinion. . . . We must be content, then, in speaking of such subjects, and with such premises, to indicate the truth roughly and in outline, and in speaking about things which are only for the most part true, and with premises of the same kind, to reach conclusions that are no better.

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In addition, your report must include a full investigation of China's acquisition of U.S. dual-use and military technology. I believe that China is concentrating on technology acquisition from the United States and the West in lieu of fully marshaling its own domestic efforts in support of research and development. Aside from the direct acquisition of technology by contract and government-imposed offset requirements, China is utilizing the Peoples Liberation Army and Defense Ministry-owned front companies operating in the United States to procure advanced dual-use and military technology, such as high-performance computers and navigation and communications equipment. Some sources estimate that there are as many as 3,000 Chinese government front companies operating in the United States.

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We must try to view our relationship with China as a complex totality—with economic, military, societal, and environmental components. On climate change, for example, a topic of immense importance to the United States and the world, China's refusal to become a part of the Kyoto negotiations was a major factor in leading me to the conclusion that the then-current version of the Kyoto Protocol was flawed and unworkable. The Chinese are second in the world in greenhouse gas emissions and are expected to become the world's leader in 2015. The Chinese must not walk away from their responsibility to become part of the solution to the global climate change problems of which they are a part. As I have said in another context, China is an industrial behemoth and must be regarded as such. We must not permit China to hide behind a "developing nation" moniker. We have no wish to put a lid on China's economic future. Yet, we are all inhabitants of this planet and its environment must be protected by all of us for all of us.

On the trade side, there are many bilateral and multilateral issues you will need to consider, but let it suffice for me to say that the Chinese leadership has an unfortunate tendency to refuse to abide by the understandings that have long formed the basis of America's bilateral trade relationships. Now that China has come to an agreement with the United States on the terms and conditions of its accession to the World Trade Organization, we must be alert to any return to its most objectionable practices, such as export subsidization and predatory dumping.

Finally, it seems clear that the Chinese regime is testing the mettle of this Administration on the security side. Here, we may face real danger insofar as the Chinese miscalculate American resolve to protect our interests and demand adherence to commitments, particularly in relation to Taiwan. Miscalculation must be avoided or at least minimized, through threat-reduction mechanisms and institutions, such as those we put into place over several decades in our relations with the former Soviet Union.

The Chinese have written openly about new forms of warfare such as information and cyber-warfare that they feel could serve to offset the United States' military and strategic advantages. Your mandate includes a requirement to examine China's intentions and programs in this area.



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You would serve our country—and the U.S. Senate—well if you would determine (1) the magnitude of the economic and military resources China has accumulated through trade and investment flows with the West and (2) the extent to which those resources are being presently used and China's future plans for that use over the next generation to challenge U.S. interests and policies in the Pacific region. This analysis should include details on the types of militarily useful technologies that the Chinese are acquiring and the strategic objectives that drive such acquisitions.

The Commission's first required report is due next March. In the interim period, however, if events arise that, in your judgment, compel an interim report, I would encourage you to communicate this need to the Senate leadership and to appropriate Congressional committees.

I see from your hearing schedule today that you have included influential officials from the last Administration, such as Ambassador Barshefsky and Ambassador Prueher, and I understand that you are inviting a wide range of officials from the current Administration for your hearings this summer, along with a variety of experts from the business, labor, and academic communities. Congress will surely benefit from your effort to take in the widest possible range of views and information.

In sum, I would leave you with this: the problems we face with China go much deeper than the usual trade frictions. We are talking about a country that already has a demographic and geographic magnitude beyond the comprehension of the average person; a country that is growing in economic power and influence; a country that has an agenda. Its leaders are communists. That means that they are, to a large extent, immune to the moderating influence of an informed public opinion. They will be working while we are sleeping—working to maximize their power on all fronts. We need this Commission. In formulating your governing statutory provisions, I endeavored to ensure that, in opening the door to expanded trade with China, we do not close our eyes to serious concerns about our national security.

I wish you success in this all-important endeavor.

Chairman D'AMATO. Thank you very much, Senator Byrd and Mr. Chairman, for your time in coming and for authoring the resolution and your confidence in the Commission. We're going to be working very hard to match that with a good product and we certainly will come to you if we need help, and we might need help. But it's a great challenge and we thank you for putting it to us.

Senator BYRD. Thank you very much.

Chairman D'AMATO. Thank you very much for coming. We have also with us this morning Senator Thompson, who has been involved in the creation of this Commission as well, and we look forward to hearing from you, Senator Thompson, whose work last year on proliferation matters was instrumental in fashioning some of the provisions of the statute in the area of proliferation, an area that Senator Thompson has taken tremendous effort and time to investigate, and we look forward to your remarks, Senator.

**STATEMENT OF FRED THOMPSON, U.S. SENATOR FROM THE STATE OF TENNESSEE**

Senator THOMPSON. Thank you Mr. Chairman and members of the Commission. I want to first thank Senator Byrd and Senator Warner for being the moving and primary force behind what we're doing here today. I think it is absolutely essential that you do what you're doing.

I come before you today as someone who does not claim to be a China expert, but as a Member of the United States Senate who has been chairman of a committee with some jurisdiction in the proliferation area, also serving on the Intelligence Committee, who

has become increasingly concerned about the issues that you're going to be dealing with. I think it is clear that this is probably is the most important bilateral relationships this country has, the one with China. Looking into the future, it is clear that it is in our self interest to have a peaceful and productive relationship with China.

It is clear that diplomacy and engagement must play a large part in this relationship, but it is also clear that it's not totally within our control. We have to ask ourselves about certain things that try as we might, if the relationship doesn't work out, what are the ramifications. Quite frankly, I have been concerned that it has been very difficult to get an independent assessment of some of the things that the United States is doing. No one is more committed to the notion of free trade than I am. I've supported permanent normal trade relations with China every time, and I've supported China's entry into the WTO. But it seems to me that our investments in China—now we're the second in the world in terms of foreign investment in China and even though we run a substantial deficit with China, that trade is becoming so important to our country that sometimes it's difficult to get an independent assessment of the significance of entire relationship with the PRC.

This is no reflection on anyone in particular. It's just that you can pick a side and have a logical argument for any side, and there have not been very many people coming to Congress and lobbying on behalf of being careful in terms of the national security implications of U.S. engagement with China, quite frankly, and you know what I'm talking about.

So thank you for what you're doing. I think that, as I look at the situation from an overview and the context in which we must put the trade and security issues, I hear a lot of things to be optimistic about from people who go over there all the time. Obviously things are changing in China. Obviously there is freedom in areas where none existed before, as long as it does not threaten the Communist leadership. Obviously they've made tremendous strides economically. China will be, in all likelihood, an economic and military power in the future.

The Chinese have begun to do more and more in terms of a freer markets and are struggling mightily to do the things necessary to allow them to be a full participant in the WTO and to fulfill their obligations there.

On the other hand, we cannot ignore the fact that the PRC is engaging in a significant military build-up. They do not pose a threat to the U.S. now and it's not a question of whether or not we would win an all-out engagement with China. The question is, obviously, what their intentions are in terms of the part of the world that they live in, and it seems to me that they intend to be the predominant power in Asia, and that's probably to be expected.

Beijing has announced a 17 percent military build-up; I assume nobody really knows what that is. They have 300 or so missiles along the coast pointed toward Taiwan. We've see that there seems to be growing nationalism among the younger people, whom we would hope that we would have been able to reach a little better. They continue to detain American citizens. They are doing things in the South China Sea that indicate that they want a permanent

presence there, and they don't want us to be there. That's an inherent, potential difficulty for a long time to come and it's going to give rise to lots of different kinds of incidents there. Their new relationship with Russia, which seems to be in large part based upon military cooperation and arms sales is of concern to us. Obviously, the Taiwan situation is a continuing issue. So there's reason for optimism and there's reason for concern in our relationship with China.

It seems to me that in terms of trade, that both the United States and China are engaged in a substantial gamble, as it were. I think that we're gambling on the idea that if we engage, if we do not make an enemy out of this country, if we trade, if we invest, that with the advent of the Internet and the rest of the high tech world we live in, that China will gradually open up further and further and will probably democratize, or at least be more and more interested in a peaceful role than they otherwise would be.

We're gambling because we are in the process of assisting them, directly and indirectly, in terms of their economic and military capabilities. So wherever they go we will have helped them get there. The Chinese, on the other hand I think, are gambling that they can open up and do the things necessary to be a prosperous and growing country, while still keeping the lid on and holding onto power.

My concern is that not that this gamble is not worth the taking, but that we make sure we think through it in terms of what if we're wrong. If we're right, then we're in pretty good shape; but if we're wrong, we need to think about the implications of that. It does seem to me that we need to settle in for the long-term, and hope for the best.

I was talking to a leader of one of the countries in Asia and who is a friend of the United States, he is obviously interested in China being as happy as it can. But he said don't worry about this next group of leaders coming on, worry about the ones after them. This next group is going to be pretty much like the ones you're seeing now, so look down the road a bit. That makes sense to me.

The problem to me in the meantime, the various things that can happen, how do we handle those issues, whether it be with Taiwan or some other matter when they arise. Even though we're willing to take this gamble, is there anything to be said for not enhancing their military, or even perhaps their economic growth in the meantime. I don't pretend to have an answer to the economic part.

But in terms of the military aspect, I would certainly think that it would be in our interest to slowly proceed particularly as China proliferates weapons of mass destruction around the world. They've made it quite clear to this country that they intend on violating international norms. They intend on assisting nations of concern around the world. As long as we insist on things like a missile defense system for defensive purposes, they're going to do these things that would assist these rogue nations with regard to their offensive WMD and ballistic missile ambitions.

We are now in the strange position of trading quite freely with two or three countries—such as China and Russia, sending them dual-use technology that is very highly debated on this side of the Pacific in terms of its military significance and the wisdom of selling it, while China is in turn sending technology (missile tech-

nology, nuclear technology, expertise, etc.) to these rogue nations, who we use in return as a reason why we need a national missile defense system.

So you know it doesn't make a whole lot of sense to me, and I can understand why some of our friends are a little skeptical with regard to a national missile defense system, why we are not behaving in a manner that indicates that we really do think that a real, strategic threat is out there and that we ought to be very, very careful not to enhance it.

One of the issues, of course, that's on the table is what our export control policies should be. Again, my primary concern is not that we adopt some kind of detailed approach that I'm advocating. I don't pretend to be able to have all those answers. I do have a deep feeling that no one else does either really, and that we have not had an objective analysis of all the implications of some of the proposed and enacted changes to our export control policies. We've had a lot of people look at this issue, but quite frankly, I think it's too commercially oriented in many cases.

It's easy to make the case that the genie's out of the bottle and we can't stop everything so we shouldn't try to stop anything. There's a certain logic to that until you get beneath the surface of it and realize that, even though we live in a different world technologically, and that we are ahead in many areas, that there is something to not only the transfer of hardware or even the software, but the long term maintenance and support that takes place after the sale. With regard to high performance computers, the king of dual use items, many are now advocating the abolition of any controls on computer hardware. We do know that the GAO has compiled a list of potential things that might be looked at other than, for example, concentrating on the MTOP levels (which measures computer spreads) which is probably outdated and that have not been looked at. So we need to be careful about what technologies we sell to China and others.

And do we want the Department of Commerce making these decisions? We have a system now where that is the case. In the current legislation being proposed to re-authorize the Export Administration Act, the Department of Commerce can make a determination of mass marketing, and other examination foreign availability, things of that nature, and unilaterally control sensitive items. The Department of Commerce must notify the other departments, but essentially they make the determination. Furthermore, as you go along in this process, the President can step in and override a decision, but it's been set up so that he cannot delegate any of it, and that he's got to report to Congress every time he turns around, and then jump through all kinds of hoops in order to override what the Secretary of Commerce does. I think that bears close analysis in terms of whether or not, at a minimum, it's in our interest to be more careful regarding some of these activities, and how do we all—we all seem to agree that we need to build "higher fences" around fewer things, but I don't know anyone who's really taken an objective look as to what those items are and where those fences are, because I don't see any higher fences.

There are related issues concerning our capital markets. I think that we should also look at the transparency of our capital markets

and see whether or not it makes sense for us to open our stock and bond markets to the raising of billions of dollars when we do not know what the monies are going for.

So I think that as you deal with this important set of issues, it's important that you really look at some of the assumptions that are going around that may or may not be true. It is taken as gospel, for example that unilateral sanctions never work. I don't know whether that's true or not, but I think you ought to take a look at it.

The Congress is about presumably about to pass the Iran-Libya Sanctions Act again, apparently unanimously, while still saying that sanctions don't work. I don't understand the logic there.

The other concept that holds weight in Washington is that trade and engagement promote democratization and help avoid conflict. Ironically, that's what we thought right before World War I and World War II. It makes a certain amount of sense at face value, and perhaps we don't have any choice but to try it. But to be unduly optimistic or say that it is a foregone conclusion that this kind of engagement is going to lead to good and peaceful things is irresponsible. I think this is another issue that needs to be looked at. You can call on the historians perhaps to help you out with regard to question and get technical experts to tell you what high-tech, dual-use are uncontrollable, and if they are uncontrollable and to what extent. If they are uncontrollable I see no reason for having the country tier system. And if that's true, I don't see any reason why we don't go ahead and sell these items to Iran, Iraq, and Libya, and cut out the middle man, if the technologies are truly "uncontrollable".

So I think those issues might be subject to inquiry. These are just some rambling thoughts of mine, of someone whose been somewhat involved in the national security area and has major concerns. I know that once you do your work and come to your conclusions and I am going to feel a lot better about these matters, regardless of what your conclusions are, because I know that there will at least have been an objective, thoughtful analysis of the situation.

Thank you very much.

Chairman D'AMATO. Thank you very much, Senator Thompson. Thank you for your leadership and for that menu of items.

Just two points I might make that you made on the Chinese budget, the 17 percent increase. An increase of 17% of something that's unknown is a 17% larger unknown, so we're going to take on a project to try to get our hands around the Chinese budgeting system which has not yet been really identified in precise detail.

Senator THOMPSON. That's a good idea. Lots of luck to you. I hope you're able to do that, but it reminds me of one more thing that I think is important for all of us, and that is to acknowledge what is unknowable. And I think just admitting sometimes that we don't know what's going on here is helpful to us as policy makers.

Chairman D'AMATO. Yes, sir.

Senator THOMPSON. If that is the case.

Chairman D'AMATO. Yes, sir. One other item that you mentioned was threat reduction measures, and Senator Byrd mentioned that also. We had a closed session with officials that have been attempt-

ing to develop threat reduction mechanisms with the Chinese with singular unproductivity over the last few years. We've been very, very unable to engage the Chinese in the threat reduction mechanism that we developed with the Russians over the years, and one of the things we're going to look into is why are we not able to succeed in that area. We have no circuit breakers in the relationship and it seems like the Chinese don't at this point yet want to do that and we don't know why. So there are a lot of unknowns here.

We have Senator Sarbanes with us again this morning. Senator Sarbanes was involved in helping to draft the original legislation and shepherding it through the Senate and is the Chairman of the Senate Banking Committee. A number of issues before the Senate Banking Committee dealing with capital markets that this Commission is going to look into.

We welcome you, Senator Sarbanes.

**STATEMENT OF PAUL S. SARBANES, U.S. SENATOR FROM THE STATE OF MARYLAND**

Senator SARBANES. Thank you very much, Mr. Chairman. I am very pleased to join Senator Byrd and Senator Thompson and have this opportunity to participate in the first public hearing of the U.S.-China Security Review Commission.

I joined with Senator Byrd and Senator Dorgan in sponsoring the legislation which established the Trade Deficit Review Commission, which was in a sense a predecessor to this Commission. I think the report produced by that Commission did an excellent job of laying out the challenges posed by the trade deficit. It laid out competing views on how that challenge might be met. While, they did not reach a unanimous conclusion, but on balance I thought that the report performed a very useful public service, and I am hopeful that the work of this Commission will be equally valuable.

According to the legislation establishing this Commission, its purpose is to monitor, investigate and report to Congress on the national security implications of a bilateral trade and economic relationship between the United States and the Peoples Republic of China. We look forward to the annual report that is called for under the statute.

I strongly believe that the U.S.-China trade relationship should be considered in the context of our overall relationship with China, including national security, foreign policy, human rights, labor rights and the environment. I strongly support permanent, normal relations with China which would link all of our diverse interest with China into an integrated policy. I did not support permanent, normal trade relations with China which is, of course, one of the issues under your consideration, because in my view it would have separated trade from our other important concerns with China. I think it should all be dealt with in an overall context and the objective should be to move to permanent, normal relations across the board in all of these areas. I do not support taking trade outside and separating it.

For that reason I believe the Commission has a very important role to play in shining a light on the impact of the U.S.-China trade relationships on our national security relationship with China. I

am very supportive of the work that you have to do and I look forward to reviewing your reports.

The subject that you are hearing today is U.S.-China Trade and Investment Policies and their Impact on the U.S. Economy. This is a matter of grave concern to me and I'd like to make a few comments. I'm going to shorten my prepared statement, Mr. Chairman, which I think everyone has before them, and try to move through this very quickly. However, there are several points I really want to highlight.

The U.S. bilateral trade relationship with China is arguably our most one-sided bilateral trade relationship in the world. We've been running a steadily increasing trade deficit with China. Every year we set a new record for our trade deficit with China and in 2000 the Commerce Department reported that the trade deficit had reached 83.8 billion. Last year the U.S. trade deficit with China surpassed the U.S. trade deficit with Japan about which we've heard so much. Of course, I hasten to point out that the trade deficit with Japan at least is within the context of a relationship in these other areas—security, foreign policy, human rights—in which we have a very positive and constructive situation.

Although the U.S. trade deficit with China is only slightly larger than our deficit with Japan, it's important to recognize how one-sided the China relationship is relative to the size of our overall volume of trade with China.

The trade deficit with Japan was based on the total trade of about \$212 billion. The trade deficit with China, slightly larger than Japan, was based on a total volume of trade of \$116 billion. I love to watch these commentators say well we have \$116 billion trade situation with China. 16.3 of it are our exports to China and a hundred billion of it are the imports that we take from China.

Now this pattern is, if you look at Canada, the European Union, Mexico, exports make up about 45 percent. We're running deficits with all those trading partners, but our exports are about 45 percent of the trade relationship and it fluctuates. It's not all necessarily on just a straight line progression as the trade relationship with China is. Even with Japan exports make up 30 percent of the total volume of trade. Exports make up 14 percent of our trade with China. Of this total 116 billion 14 percent is export to China. If you compare it with Korea, Taiwan, Singapore, we do much less trade but we have more exports than we send to China in absolute terms.

It could be argued that China runs a larger trade surplus with the U.S. because the U.S. market is more open than the markets of Japan and the EU and thus takes in a larger volume of exports from China. Now, while this may be true it is also true that China purchases a substantial volume of exports from Japan and the EU, even though overall it has a larger volume of trade with the United States.

In 2000, China took 30 billion in exports from Japan, 25 billion from the EU, 16 billion from the United States. It's a very one-sided relationship. It's very much a one-way street.

It's been argued that most exports from China to the United States are not made in the United States, and therefore do not compete with U.S. products. As a result some argue that some of

the increase in China exports to the U.S. has come at the expense of exporters in third countries such as Mexico, South Korea, Taiwan, and not at the expense of U.S. manufacturers. It's worth noting that although these other countries also run trade surpluses with the U.S., the U.S. balance of trade with those countries is not nearly as one-sided as it is with China. In fact, if our trade were higher with these other countries—people say it doesn't matter, China's simply supplanting them—but it's reasonable to presume if the trade were higher with these other countries our exports to those other countries would be higher. There's much more of a relationship than when it shifts to China where they send the imports in but don't take the exports back.

Furthermore, I think this analysis has limited validity. The Congressional Research Service reports that in 1999 the top six U.S. imports from China by dollar value were miscellaneous manufactured articles, footwear, office machines and automatic data processing machines, telecommunications and sound equipment, apparel and accessories and electrical machinery. Now, according to the CRS, while U.S. imports in all these categories have increased, the most dramatic percentage changes have not been in sectors such as footwear and apparel, traditional labor intensive industries in which China is quite competitive, but in high technology sectors such as office and data processing machines, electrical machinery and appliances and telecommunications and sound equipment. Now, according to the CRS this trend held up in 2000.

In other words, the character of imports from China is shifting to increasingly sophisticated categories of products which actually compete directly with goods made in the United States. So that's an important development that's now taking place and we keep in mind, because there's a tendency to sort of dismiss it and say well, it's in those areas and we wouldn't make it in the United States in any event. Of course, if it was made elsewhere and the country that made them then took our exports that would be one benefit to our trade relationship, but furthermore, the nature of their exports is changing to move into sectors that is directly competitive.

And I want to turn very quickly to the U.S. investment relationship with China and it's impact on trade. Some observers argue that the prospects for opening the Chinese market may actually be better than those of opening the Japanese or Korean markets at a comparable stage of development. These observers point out that China's much more open to foreign investment than Japan or Korea were at those earlier stages. In fact, China has actively sought foreign direct investment as sources of Western capital and technology, and foreign direct investment have been a key element in China's development strategy. But China's receptiveness to foreign investment does not necessarily mean openness to imports.

In fact, trade barriers in sectors such as automobiles have been part of China's strategy to encourage foreign investment. Since the Chinese market could not be accessed easily through exports Western automakers that want a portion of the Chinese market were effectively forced to invest in China. Once inside the market many Western companies took a different view of Chinese trade barriers because they were then also protected from competition from outside China. The unstated assumption that openness to foreign in-



vestment will eventually lead to openness in foreign trade I think needs to be carefully examined.

It is not clear that reforms undertaken to encourage foreign investment will inevitably lead to lower trade barriers and more imports. In fact, China's increasing demands for domestic production and for transfer of technology suggests that the opposite well may be true.

An article in the Wall Street Journal about a year ago, just after the House voted on PNTR, a focus on the investment aspect of the Chinese WTO agreement. The article stated, and I quote: "Even before the first vote was cast yesterday in Congress' decision to permanently normalize U.S. trade with China, corporate America is making plans to revolutionize the way it does business on the mainland. And while the debate in Washington focused mainly on the probable lift for U.S. exports to China, many U.S. multi-nationals have something different in mind."

"This deal is about investment, not exports," says Joseph Quinlan, an economist from Morgan Stanley Dean Witter. "U.S. foreign investment is about to overtake U.S. exports as a primary means by which U.S. companies deliver goods to China." A comparison of U.S. trade with China and U.S. investment in China over the past decade is instructive. U.S. exports from '91 to 1999 increased on an annual basis from 6.2 billion to 13.1 billion, slightly doubling, and imports from China, as I indicated earlier, rose from 20 billion to 81 billion over that same period of time, a fourfold increase.

During that same period U.S. foreign direct investment in China rose from 323 million in 1991 to 4.3 billion in 1999, a 13-fold increase. Whereas the U.S. ranked behind Japan, behind the European Union and behind Taiwan as a source of exports to China, it ranked ahead of all of them as a source of foreign direct investment in China. Rather than expanding exports and reducing the U.S. trade deficit with China, China's purpose in encouraging U.S. investment in China may be directly the opposite, and I think that assertion is consistently made and needs to be very carefully examined. My perception is they're following quite a different strategy which in a very tough calculation of their self interest sort of makes sense, but we ought to be comparable of calculations of self interest.

Let me conclude by reiterating my strong support for the work of the Commission. It is difficult to escape the conclusion that the large bilateral trade surpluses that China runs with the United States are used, at least in part, to bolster and support China's military establishment. China's policies for attracting foreign investment and technology also have significant national security implications, including of course their constant pressing for the transfer of technology. This Commission has an opportunity to make a major contribution and—to increasing understanding of this very important aspect of the U.S.-China relationship. I wish you the very best in your endeavors.

Thank you very much.  
[The statement follows:]

## PREPARED STATEMENT OF PAUL S. SARBANES

*Introduction*

I am pleased to have the opportunity this morning to participate in the first public hearing of the U.S.-China Security Review Commission.

I joined with Senator Byrd and Senator Dorgan in sponsoring the legislation which established the Trade Deficit Review Commission, which was the predecessor to this Commission. The report produced by that Commission did an excellent job of laying out the challenges posed by the trade deficit and the competing views of how that challenge could be met. On balance I thought the report performed a very useful public service.

I am very hopeful that the work of this Commission will be equally valuable. According to the legislation which established the Commission, its purpose is "to monitor, investigate, and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." The legislation requires the Commission to submit an annual report to Congress on its findings.

I believe that the U.S.-China trade relationship should be considered in the context of our overall relationship with China, including national security, foreign policy, human rights, labor rights, and the environment. I support Permanent Normal Relations with China which would link all of our diverse interests with China into an integrated policy. I did not support granting Permanent Normal Trade Relations (PNTR) to China, which is one of the issues under consideration in your hearing this morning, because in my view it would in effect separate trade from our other important concerns with China.

For that reason I believe the Commission has a very important role to play in shining a light on the impact of the U.S.-China trade relationship on our national security relationship with China. I am very supportive of the work you have to do, and I very much look forward to reviewing the reports you produce.

The subject of your hearing today is U.S.-China Trade and Investment Policies and Their Impact on the U.S. Economy. Since this is a subject of great concern to me, I would like to make a few comments about it.

*The U.S. Trade Relationship with China*

The United States' bilateral trade relationship with China is arguably our most one-sided bilateral trade relationship in the world.

It is well known that the U.S. has been running a steadily increasing trade deficit with China for nearly two decades. In 1983, the U.S. had a bilateral trade deficit with China of \$72 million. It fell to a deficit of \$9 million in 1985. Since then it has set a new record every year, rising from \$1.6 billion in 1986 to \$10.4 billion in 1990 to \$29.4 billion in 1994 to \$56.8 billion in 1998 to \$68.7 billion in 1999. The Commerce Department reported that in 2000 the U.S. trade deficit with China reached a record \$83.8 billion. Last year the U.S. trade deficit with China surpassed the U.S. trade deficit with Japan (\$81.3 billion).

Although the U.S. trade deficit with China is only slightly larger than our deficit with Japan, it is important to recognize that relative to the size of our overall volume of trade with China, the U.S. trade relationship with China is far more one-sided than our trade relationship with any other country in the world. For example, the U.S. bilateral trade deficit with Japan in 2000 was \$81.3 billion. That trade deficit was based on a total volume of trade with Japan of \$211.9 billion (made up of \$65.3 billion in exports and \$146.6 billion in imports). In contrast, the \$83.8 billion U.S. trade deficit with China was based on a total volume of trade of \$116.4 billion (made up of \$16.3 billion in exports and \$100.1 billion of imports).

Although Japan's total volume of trade with the U.S. is only about twice as large as China's, Japan bought four times more exports from the United States than did China. This is despite the well known trade difficulties the U.S. has experienced with Japan. This pattern is repeated to an even greater extreme with the other largest U.S. trading partners—Canada, the European Union, and Mexico. In 1999, exports made up 45.2% of total U.S. trade with Canada, 43.7% of our trade with the European Union, and 44.2% of our trade with Mexico. Even with Japan, exports made up 30% of our total volume of trade. Exports made up 13.8% of our trade with China.

Even compared to the other largest U.S. trading partners in Asia, the U.S. trade relationship with China is extraordinarily one-sided. In 2000, countries such as Taiwan, South Korea, and Singapore purchased more exports from the U.S. than did China, even though the U.S. volume of trade with Taiwan and South Korea is little more than half the volume of U.S. trade with China, and the U.S. volume of trade with Singapore is a little more than a third of its volume of trade with China.

It is also worth examining China's trade relationship with Japan and the European Union as compared with the United States. In 2000, China's total volume of trade with the U.S. it was \$116.4 billion, with the EU it was \$94 billion, and with Japan it was \$85.7 billion. Thus the U.S. is China's largest trading partner in the world.

While China ran trade surpluses with all three of its major trading partners, its surpluses with the U.S. were by far the largest not only in absolute terms but also relative to the overall volume of trade. China ran a surplus with the U.S. of \$83.8 billion, with Japan of \$24.9 billion, and with the EU of \$44.9 billion. Thus China's surplus with the U.S. was more than three times the surplus with Japan and nearly than twice the surplus with the EU, far out of proportion to China's overall volume of trade with each of its three major trading partners.

It could be argued that China runs a larger trade surplus with the U.S. because the U.S. market is more open than the markets of Japan and the EU, and thus takes in a larger volume of exports from China. While this may be true, it is also true that China purchases a substantially larger volume of exports from Japan and the EU, even though overall it has a larger volume of trade with the U.S. In 2000 China purchased \$30.4 billion of exports from Japan, \$24.5 billion of exports from the EU, and \$16.3 billion in exports from the U.S. While the U.S. was by far the largest market for exports from China, China purchased more exports from Japan, the EU, and Taiwan than from the U.S.

It has been argued that most exports from China to the United States are not made in the United States and therefore do not compete with U.S. products. As a result, it is argued, some of the increase in Chinese exports to the United States has come at the expense of exporters in third countries, such as Mexico, South Korea, and Taiwan, not at the expense of U.S. manufacturers. It is worth noting that although these other countries also run trade surpluses with the U.S., the U.S. balance of trade with these countries is not nearly as one-sided as with China.

However, this analysis has limited validity. The Congressional Research Service reports that in 1999 the top six U.S. imports from China by dollar value were miscellaneous manufactured articles, footwear, office machines and automatic data processing machines, telecommunications and sound equipment, apparel and accessories, and electrical machinery. According to CRS:

While U.S. imports in all these categories have increased, the most dramatic percentage changes have not been in sectors such as footwear and apparel—traditional labor intensive industries in which China is quite competitive—but in high technology sectors, such as office and data processing machines (up 1,404% from 1992–99), electrical machinery and appliances (up 430%), and telecommunications and sound equipment (up 316%).

According to CRS, this trend held up in 2000. The character of imports from China is shifting to increasingly sophisticated categories of products which compete directly with goods made in the U.S.

#### *The U.S. Investment Relationship with China and Its Impact on Trade*

Some observers have argued that the prospects for opening the Chinese market may actually be better than those of opening the Japanese or Korean markets at a comparable stage of development. These observers point out that China is much more open to foreign investment than Japan or Korea were. In fact, China has actively sought foreign direct investment as sources of western capital and technology. Foreign direct investment has been a key element of China's development strategy.

China's receptiveness to foreign investment does not necessarily mean, however, openness to imports. In fact, trade barriers in sectors such as automobiles have been part of China's strategy to encourage foreign investment. Since the Chinese market could not be accessed easily through exports, western automakers that wanted a portion of the Chinese market were effectively forced to invest. Once inside the market, many western companies took a different view of Chinese trade barriers because they now also protected them from competition from outside China.

The unstated assumption is that openness to foreign investment will eventually lead to openness to foreign trade. It is not clear, however, that reforms undertaken to encourage foreign investment will inevitably lead to lower trade barriers and more imports. In fact, China's increasing demands for domestic production and transfer of technology suggest that the opposite may be true.

An article in the Wall Street Journal on May 25, 2000 the day after the House voted on PNTR, focused on the investment aspect of the China WTO agreement. The article stated:

Even before the first vote was cast yesterday in Congress's decision to permanently normalize U.S. trade with China, Corporate America was

making plans to revolutionize the way it does business on the mainland. And while the debate in Washington focused mainly on the probable lift for U.S. exports to China, many U.S. multinationals have something different in mind. 'This deal is about investment, not exports,' says Joseph Quinlan, an economist with Morgan Stanley Dean Witter & Co. 'U.S. foreign investment is about to overtake U.S. exports as the primary means by which U.S. companies deliver goods to China.'

A comparison of U.S. trade with China and U.S. investment in China over the past decade is instructive. From 1991 to 1999, U.S. exports to China increased on an annual basis from \$6.2 billion to \$13.1 billion, slightly more than doubling. Imports from China during that same period rose from \$20.3 billion to \$81.7 billion, more than a four-fold increase. During that same period U.S. foreign direct investment in China rose from \$323 million in 1991 to \$4.3 billion in 1999, a thirteen-fold increase. Whereas the U.S. ranked behind Japan, the European Union, and Taiwan as a source of exports to China, it ranked ahead of all of them as a source of foreign direct investment in China.

Rather than expanding exports and reducing the U.S. trade deficit with China, China's purpose in encouraging U.S. investment in China may be the opposite.

#### *Conclusion*

Let me conclude by reiterating my strong support for the work of the Commission. It is difficult to escape the conclusion that the large bilateral trade surpluses that China runs with the United States are used at least in part to support China's military establishment. China's policies for attracting foreign investment and technology also have significant national security implications. This is an important area that perhaps has not received sufficient attention and study. The Commission therefore has an opportunity to make a major contribution in increasing understanding of this important aspect of the U.S.-China relationship.

Chairman D'AMATO. Thank you very much, Chairman Sarbanes, for your leadership on this. The whole question of exporting productive facilities from the United States as opposed to exporting goods in the Chinese consumer market, as you've mentioned, that seems to—

Senator SARBANES. The jobs are then in China, not in the U.S.

Chairman D'AMATO. We're exporting the facilities but not the goods.

Senator SARBANES. Right.

Chairman D'AMATO. Getting the goods back here from those facilities.

Senator SARBANES. That's right; exactly.

Chairman D'AMATO. So that whole dynamic is something that really isn't quite in focus yet, so thank you for your thoughts on that one.

We also have with us today the distinguished senator from Nebraska, Senator Hagel, who's been a leader in this area and a leader in the global warming area and in trade. We look forward to your testimony.

#### **STATEMENT OF CHUCK HAGEL, U.S. SENATOR FROM THE STATE OF NEBRASKA**

Senator HAGEL. Mr. Chairman, thank you, and I too add my thanks and good wishes to each of you for your important tasks ahead in this very relevant assignment that has been given you. I don't know if there is an issue that wraps around as many dynamics of our future, and future of the world than our relationship with China.

Mr. Chairman, as you all recognize, your Commission is charged with the task of assessing the impact of the U.S.-China economic relationship upon our national security. This is critical work be-

cause national security is the most fundamental consideration of any foreign policy. It is also difficult work because the many factors that influence national security are interconnected, uncontrollable and difficult to assess on an individual basis. That is especially true for economic factors in this interconnected global economy.

Compounding the problem is the fact that our relationship with China is the most complicated bilateral relationship we have today, and that is likely to remain true for many years. China is a rising power increasingly capable of challenging U.S. interests in Asia. Domestically Chinese society has been undergoing significant and fundamental change. It is impossible to predict what China will look like in 10 years, much less 20 years. Only one thing is certain. Our national security interests and those of our friends and allies in Asia will be best served, in my opinion, if we find ways to establish a working relationship with China that allows us to peacefully work through our differences, of which there are many and of which there will be many.

The United States has and will continue to have serious differences with China, including human rights, religious freedoms, threatening military posturing toward Taiwan, proliferation of missile technology, and the most recent example, how the Chinese handled the P-3 incident.

The P-3 incident is a good reality test, however. It demonstrates the hard work that lies ahead for all of us if we are to forge a relationship between our two countries that allows us to manage our differences peacefully. The challenge of injecting some stability and predictability into U.S. China relations is considerable. However, the opportunities are also considerable, and the alternative is unacceptable and dangerous.

A working relationship must be founded on common interests. One such shared over arching interest with the people of China is trade. Trade is the biggest common denominator between our two countries. It is not a panacea or an excuse to defer the tough decisions, but rather it offers the mutual benefits necessary to constructing a stable relationship for the future. For that reason I believe the economic engagement with China strongly serves our national security interests.

It is clearly in America's economic interest to open up China's markets and increase trade opportunities. Trade is increasingly important to our own economic growth. You all know the numbers. Senator Sarbanes recited some. I suspect other witnesses this morning have recited numbers.

Last year's Congressional vote on permanent normal trade relations was a good start. If Congress had not voted to grant PNTR to China we would have put our American businesses and farmers at a disadvantage compared to their competitors from Europe and Asia. In this increasingly competitive global economy it would not have made sense to penalize our own national interest.

When China accedes to the World Trade Organization American businesses and farmers will begin to have a fair shot at China's market. It will take years to realize that potential. For example, the USDA estimates that China's WTO accession could triple U.S. agriculture exports by 2005, and there are other projections for all industries, all services.

It is also clearly in the interest of the Chinese people for China to open up its markets. The beneficiaries of increased trade are the Chinese people. Trade and foreign investment have been the engines of economic growth in China and have helped pull millions in China out of poverty. Chinese citizens benefit from the jobs created by American investors who seek to establish a domestic presence in China. America's markets and capital are vital, of course, to China's continued economic growth and increased prosperity for its people. Senator Sarbanes touched on that rather clearly.

This in turn is very important for American's long-term economic and geo-political interests not only in China but in all of Asia. Trade, investment and economic growth can help improve personal liberty and quality of life for millions of Chinese. History records that economic growth helps promote freedom. The alternative is also clear. During the decades that China shut itself off from the rest of the world, the Chinese people suffered terribly from campaigns that ruined the economy, starved the people, and suppressed all forms of personal freedom, including religious freedom. Tens of millions of people lost their lives during those decades. It is no coincidence that the strongest advocates for political change in Beijing are also the strongest proponents of continued U.S.-China trade and China's accession to the WTO.

Leaders in Taiwan, Hong Kong's democratic activist and Legislative Council Member, Martin Lee; the Dalai Llama and many prominent Chinese dissidents like Dai Ching, are pushing for China's accession to the WTO. They understand the link between an open economy and an open political system. They understand that shutting down the millions of exchanges that trade entails plays into the hands of the Chinese hardliners.

China has a long way to go, but trade with other nations will move it in the right direction and help sustain the momentum for change.

In summary, Mr. Chairman, for all these reasons and more the current U.S. policy of economic engagement with China serves American national security interests. However, we must also address the need to get our own house in order in terms of the export of dual-use technologies and goods to China. The Export Administration Act Reauthorization Bill, yet to be considered in the Senate, will help achieve more practical controls on potentially dangerous goods going to China by focusing our resources on the truly critical technologies key to weapons proliferation, and not on goods easily available now in the global marketplace.

A transparent, efficient and realistic system of export controls will encourage the full participation and attention of the business community and enhance its ability to comply with all export requirements. We must also work with our allies and our friends in this effort. The effectiveness of unilateral controls is limited and will only go so far. Unilateral sanctions in today's world do not serve the economic, geo-political or security interests of this country. They are the lazy, unimaginative and self defeating approaches to difficult and complicated problems. It is the easy, simple way to defer the tough decisions. We are better than that.

We must also recognize the limits of our ability to influence Beijing's behavior. We cannot control the decisions of Chinese leaders.

We do not know if they will be wise enough to meet us and the world halfway and search for opportunities for cooperation rather than focusing on our differences.

The mutual benefits of trade and investment may not be enough to outweigh those differences and prevent our countries from engaging in serious clashes. We can however control our own approach. As the Congress once again approaches the yearly debate on granting normal trade relations to China we should remember that withholding NTR would represent a deliberate move to destroy the trade relationship. Would this make Asia more stable? Would our national security interests be better served? Would it advance all of our interests? Would it further human rights in China? The answer to all of these questions, Mr. Chairman, is a very clear resounding no. It would deal a blow to one of the single most important common interests of our two countries. That would be short sighted and unwise.

Mr. Chairman, I believe the most important dynamic in our relationship in China is to always frame up the issues, our policies and our actions from the perspective of the big picture focusing on long-term consequences as well as short-term consequences. The long-term view must always be our paramount view in dealing with China.

Mr. Chairman, I appreciate an opportunity to appear before your Commission and I wish you all much success with this important assignment.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF CHUCK HAGEL

I would like to thank Chairman D'Amato and the members of the U.S.-China Security Review Commission for an opportunity to present some thoughts this morning.

This Commission is charged with the task of assessing the impact of the U.S.-China economic relationship on our national security. This is critical work, because national security is the most fundamental consideration in any foreign policy. It is also difficult work, because the many factors that influence national security are interconnected, uncontrollable and difficult to assess on an individual basis. That is especially true for economic factors in this interconnected global economy.

Compounding the problem is the fact that our relationship with China is the most complicated bilateral relationship we have today, and that is likely to remain true for many years. China is a rising power increasingly capable of challenging U.S. interests in Asia. Domestically, Chinese society has been undergoing significant change. It is impossible to predict what China will look like in ten years, much less twenty. Only one thing is certain—our national security interests, and those of our friends and allies in Asia, will be best served if we can find ways to establish a working relationship with China that allows us to peacefully work through our differences.

The United States has, and will continue to have, serious differences with China. We do not agree with the Chinese government's domestic suppression of freedom of speech, or of peoples' religious rights. We do not agree with China's threatening military posturing towards Taiwan. We do not agree with Chinese proliferation of missile technology. The Chinese behavior following the collision between the American EP-3E surveillance plane and the Chinese fighter jet was very troubling. The Chinese violated all rules of international engagement and international norms in holding the American crew for 11 days. It took weeks to come to an agreement on the return of our plane.

The EP-3E incident is a good reality test. It demonstrates the hard work that lies ahead if we are to forge a relationship between our two countries that allows us to manage our differences peacefully.

The challenge of injecting some stability and predictability into U.S.-China relations is considerable. However, the opportunities are also considerable, and the alternative is unacceptable and dangerous. A working relationship must be founded on common interests. One such shared overarching interest with the people of China is trade. Trade is the biggest common denominator between our two countries. It is not a panacea, or an excuse to defer tough decisions, but rather it offers the mutual benefits necessary to constructing a stable relationship for the future. For that reason, I believe that economic engagement with China strongly serves our national security interests.

It is clearly in America's *economic* interests to open up China's markets and increase trade opportunities. Trade is increasingly important to our own economic growth. Expanded exports of U.S. goods and services accounted for more than 21 percent of GDP growth in 2000. U.S. exports to China have also grown steadily since 1985 (including a jump of nearly 24% from 1999 to 2000) but have failed to keep pace with imports. It is in our best interest to adjust this imbalance.

Last year's Congressional vote on Permanent Normal Trade Relations (PNTR) was a good start. If Congress had not voted to grant PNTR to China, we would have put our American businesses and farmers at a disadvantage compared to their competitors from Europe and Asia. In this increasingly competitive global economy, it would not have made sense to penalize our own national interests.

When China accedes to the World Trade Organization (WTO), American businesses and farmers will begin to have a fair shot at China's markets. For example, the USDA estimates that China's WTO accession could triple U.S. agricultural exports by 2005. Our services sector has consistently enjoyed a trade surplus with China. This sector, together with other competitive sectors of our economy, is in a good position to take advantage of the opportunities that China's WTO accession presents.

It is also clearly in the interests of the Chinese people for China to open up its markets. The beneficiaries of increased trade are the Chinese people. Trade and foreign investment have been the engines of economic growth in China, and have helped pull millions out of poverty. Chinese citizens benefit from the jobs created by American investors who seek to establish a domestic presence in China. America's markets and capital are vital to China's continued economic growth and increased prosperity for its people. This in turn is very important for America's long-term economic and geo-political interests in China.

Trade, investment and economic growth can help improve personal liberty and the quality of life for millions of Chinese. History records that economic growth helps promote freedom. The alternative is also clear. During the decades that China shut itself off from the rest of the world, the Chinese people suffered terribly from political campaigns that ruined the economy, starved the people and suppressed all forms of personal freedom, including religious freedom. Tens of millions of people lost their lives during those decades.

It is no coincidence that the strongest advocates for political change in Beijing are also the strongest proponents of continued U.S.-China trade and China's accession to the WTO. Leaders in Taiwan, Hong Kong's democratic activist and Legislative Council member Martin Lee, the Dalai Lama, and many prominent Chinese dissidents like Dai Qing are pushing for China's accession to the WTO. They understand the link between an open economy and an open political system. They understand that shutting down the millions of exchanges that trade entails plays into the hands of China's hard-liners. China has a long way to go, but trade with other nations will move it in the right direction, and help sustain the momentum for change.

For all these reasons, the current U.S. policy of economic engagement with China serves American national security interests. However, we must also address the need to get our own house in order in terms of the export of dual-use technologies and goods to China. The Export Administration Act reauthorization bill, yet to be considered in the Senate, will help achieve more practical controls on potentially-dangerous goods going to China by focusing our resources on the truly critical technologies key to weapons proliferation and not on goods easily available in the global marketplace. A transparent, efficient and realistic system of export controls will encourage the full participation and attention of the business community, and enhance its ability to comply with export requirements. We must also work with our allies and friends in this effort. The effectiveness of unilateral controls is limited and will only go so far. Unilateral sanctions in today's world do not serve the economic, geo-political or security interests of this country. It is the lazy, unimaginative and self-defeating approach to difficult and complicated problems.

We must also recognize the limits of our ability to influence Beijing's behavior. We cannot control the decisions of China's leaders. We do not know if they will be wise enough to meet us half-way, and search for opportunities for cooperation rather



than focusing on our differences. The mutual benefits of trade and investment may not be enough to outweigh those differences and prevent our countries from engaging in serious clashes.

We can, however, control our own approach. As the U.S. Congress once again approaches the yearly debate on granting Normal Trade Relations to China, we should remember that withholding NTR would represent a deliberate move to destroy the trade relationship.

Would this make Asia more stable? Would it advance our own national security interests? Will it further human rights in China? The answer to all of these questions is "no." It would deal a blow to one of the single most important common interests our two countries share. That would be short-sighted and unwise.

The most important dynamic in our relationship with China is to always frame up the issues, our policies and our actions from the perspective of the "big picture," focusing on long-term consequences as well as short-term consequences. The long-term view must always be our paramount view in dealing with China.

Chairman D'AMATO. Thank you very much, Senator Hagel, for coming down and sharing your views with us. You remind us that the challenge is a big one for the United States. It's probably our most important challenge as a world leader in this new century and for this Commission and for the Senate to handle it appropriately to engage this country in a way that's going to maximize all the facets of the relationship and our own leadership and our own economy and national security.

Senator HAGEL. Thank you.

Chairman D'AMATO. I look forward to seeing you again. Thank you very much for coming.

We're going to be moving into our first panel, and as Chairman I have—I'm engaging in a practice of asking various Commissioners to organize and chair our various hearings. The Commissioners Mulloy and Lilley have taken the responsibility of organizing this upcoming hearing, and I'm going to turn the gavel over to Commissioner Mulloy to chair the rest of today's events.

Thank you.

#### OPENING REMARKS OF CO-CHAIRMAN PATRICK A. MULLOY

Co-Chairman MULLOY. I am very pleased to have been asked by Chairman D'Amato and my fellow Commissioners on the United States-China Security Review Commission to co-chair, along with Ambassador Jim Lilley, the Commission's first public hearing.

Congress created this Commission last October for the purpose of monitoring, investigating and reporting to it on, among other things, the national security implications and impact of the bilateral trade and economic relationship between the United States and the People's Republic of China. It is charged to provide its first report to Congress by March 2002 on its findings, along with recommendations, if any, for legislative or executive action.

This bi-partisan Commission is composed of 12 Commissioners, three of whom were appointed by each of the Congressional leaders in both the House and the Senate. I feel fortunate to have been appointed by Majority Leader Daschle to take part in the work of the Commission.

Now, to assist it in carrying out its duties the Commission has planned out a series of hearings over the next several months to hear testimony from a variety of witnesses on various aspects of the U.S.-China relationship that we are tasked to examine by our Congressional charter. We decided that we should begin our work

by first taking a broad look at the rationale for our current trade and investment policies toward China. We are very fortunate to have assembled a group of quite distinguished witnesses today who have very different views as to whether the economic policies we now pursue toward China serve the long-run interests of our nation.

Hearing these contrasting views on the issues we are charged to examine will help this Commission sharpen its own inquiry and internal discussions.

Our first panel today is comprised of Mr. Richard Trumka, the Secretary-Treasurer of the AFL-CIO; Mr. Gary Benanav, the President and CEO of the New York Life International Company; and Mr. Robert Kapp, the President of the U.S.-China Business Council.

Now, on our second panel we have The Honorable Charlene Barshefsky, the former United States Trade Representative who negotiated the November 1999 Bilateral Market Access Agreement with China that prepared the way for China's entry into the WTO which could happen later this year. In addition to Ambassador Barshefsky we feel very fortunate to have with us Admiral Joseph W. Prueher who was our Ambassador to China from December 1999 through May of this year. Previously the Admiral served as our Commander in Chief of the U.S. Pacific Command, so he brings an expertise on China and national security matters that we very much welcome.

This afternoon the Commission will hear from Mr. William Wolman, the Chief Economist of Business Week Magazine, who is accompanied by his wife and New York financial journalist Anne Colamosca.

In addition other testimony will be presented by Professor Jerome Cohen, a Professor of Chinese Law at New York University Law School; Mr. Kevin Kearns, President of the U.S. Business and Industry Council; and Rupert Hammond Chambers, President of the U.S. Taiwan Business Council.

We appreciate very much the excellent prepared testimony that witnesses have already submitted to the Commission, and we thank all of our witnesses for taking time to come in and express their views on the important matters that this Commission has been charged by Congress to study.

Before I go through the procedures we're going to follow, let me turn to my co-chair, Ambassador Lilley and see if there's anything he wishes to say at this point.

[The statement follows:]

PREPARED STATEMENT OF CO-CHAIRMAN PATRICK A. MULLOY

I am very pleased to have been asked by Chairman D'Amato and my fellow Commissioners on the United States-China Security Review Commission to co-chair, along with Ambassador Jim Lilley, the Commission's first public hearing. Congress created this Commission last October for the purpose of monitoring, investigating, and reporting to it on, among other things, the national security implications and impact of the bilateral trade and economic relationship between the United States and the People's Republic of China. It is charged to provide its first report to the Congress by March 2002 on its findings along with recommendations, if any, for legislative or executive action. This bipartisan Commission is composed of twelve Commissioners, three of whom were appointed by each of the Congressional leaders in

the House and Senate. I feel fortunate to have been appointed by Majority Leader Daschle to take part in its work.

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We appreciate the excellent prepared testimony these witnesses have submitted and thank them for taking time to come in and express their views on the important matters that this Commission has been charged by Congress to study.

Before I turn to Mr. Trumka, let me ask my co-chair Ambassador Lilley if there is anything he wants to say at this time.

#### OPENING REMARKS OF CO-CHAIRMAN JAMES R. LILLEY

Co-Chairman LILLEY. Oh, just a few comments. It's very odd for me to be on this side being queried. It's a new experience so bear with me.

I think the one thing that becomes apparent is the contradictions in China in the testimony that we've been getting and that we've just gotten. I think one of the difficulties we have is to stay away from anecdotal analysis, which tends to affect our objectivity on China. This challenging testimony from a lot of very smart and experienced people is a revelation and is illuminating, and reflects our problems in analyzing China. Some witnesses do a selling job, some offer loaded reading, others reflect certain biases, some give us objective facts.

These are very complex issues, as is spelled out in some of the testimony and I think Senator Thompson said it very well when he said this is not a game we're playing, we've got to get it right. It's a life and death business and it's the balance of trade and commerce with security, and the judgments we have to make on this are key.

I'll just raise one question, which will probably come up, as a result of our testimony today. Is the dynamic of the Taiwan-China commercial relationship strong enough to offset the security problems that everybody loves to talk about in mentioning flash points? Is the economic dynamism more important than our security

framework, are we living in the new era or do we need to put both in balance?

So I just end on that note. Let's proceed.

Co-Chairman MULLOY. Okay. Now, the procedures we're going to follow is each witness will have 10 minutes to make a prepared statement. At that point the red light will go on and you should cease your statements. Each Commissioner will then have seven minutes to ask his questions and then the red light will go on and we'll move on to the next Commissioner and we'll alternate between Republican and Democratic appointees.

So if I could first call on Mr. Richard Trumka, Secretary-Treasurer of the AFL-CIO.

PANEL I: CURRENT U.S.-CHINA TRADE AND INVESTMENT POLICIES:  
IMPACT ON THE U.S. ECONOMY

**STATEMENT OF RICHARD L. TRUMKA, SECRETARY-TREASURER,  
AMERICAN FEDERATION OF LABOR, AND CONGRESS OF INDUS-  
TRIAL ORGANIZATIONS**

Mr. TRUMKA. Thank you, Mr. Chairman, members of the Commission. I want to thank you for the opportunity to speak to you today on behalf of 13 million working men and women of the AFL-CIO about U.S. trade investment policies toward China. This Commission is charged with a very important task; to study, evaluate and report to Congress on the economic and security implications of a bilateral economic relationship between the United States and the People's Republic of China.

Our economic relationship with China is one of the most controversial and complicated relationships that we have with any country, and for good reason. The AFL-CIO recognizes that refusing to engage with China is not an option in today's interconnected global economy. The question is thus not whether to engage with China but how to engage with China. How do we trade with China without sacrificing our own manufacturing sector and forcing workers worldwide into a downward spiral for ever lower wages and ever more aggressive assaults on worker rights? How do we invest in China without providing unconditional support to a government that routinely violates the human rights of its citizens? How do we help reform its economy in a way that promotes freedom, not just for the multinational companies that do business with China, but for the ordinary Chinese men and women? Unfortunately the policy options Congress and the Administration may employ to address these difficult questions will be severely limited once China becomes a member of the World Trade Organization and enjoys permanent normal trade relations with the United States.

The AFL-CIO has supported a policy that maximizes the benefits of trade and investment with China, but also recognizes the risks of allowing rampant violations of human and worker rights to go unchecked. WTO rules do not allow such a policy of responsible engagement because they prohibit any linkage between trade and human rights. Thus the already limited tools to which we have access in the past to address violations of human rights and unfair trade practices, tools such as our unilateral trade laws and annual reviews, will no longer be available to use once China's accession to the WTO is complete.

Last year, Mr. Chairman, we urged Congress not to grant permanent normal trade relations precisely because we did not want to give up the leverage while so many of our differences with China remain unresolved, but we gave up this leverage even before the commercial terms of China's accession to the WTO were complete, which is one of the main reasons we've had to endure nearly a year of deadlock to hammer out an acceptable accession agreement with the Chinese Government.

Now, many argue that these tools are unnecessary, that as U.S. companies invest and produce more in China and as U.S. consumers buy more goods made in China we will automatically be contributing to the country's economic development and political opening by exporting American values. But these promised benefits are far from guaranteed.

In fact, our own State Department reports that the human rights situation in China deteriorated markedly in '98, in '99 and again in 2000, despite record growth in our trade and investment with China over the same period. This environment of repression envelops workers as well. The Chinese government continues to systematically deny workers their fundamental rights—universal human rights defined in the ILO Declaration of Fundamental Principles and Rights at Work as freedom of association, the right to organize and bargain collectively, the right to reject child labor, refuse forced labor, and to be free from discrimination in the work place.

Independent trade unions are illegal in China. Chinese workers who try to form independent unions risk their jobs, their freedom and sometimes their lives. U.S. multinationals directly profit from this abuse.

Over the past year reports of labor protests, arrests and violence have become more frequent as economic transformation and dislocation have left many Chinese workers without jobs and without any legal recourse to press their claims for compensation. As China struggles to live up to its WTO obligations these pressures will intensify.

Meanwhile, child labor and forced labor continue. Just this May 39 Chinese men died while performing forced labor at a prison run mine when the coal shaft they were working in flooded. In March of this year 42 people, including 38 children, were killed in an explosion at a school where children between the ages of 9 and 11 were forced to manufacture fireworks. Finally, China still refuses to allow inspection by U.S. Customs officials of facilities suspected of exporting prison labor products to the U.S. in direct violation of numerous agreements already signed between the Chinese and U.S. governments.

Our current trade and investment relationship with China, marked by exploding flows of money and goods and increasing corporate freedom on the one hand and the drastically unequal distribution of wealth and severe constraints on human freedom on the other, has profound implications for our own economy and for our national security. This Commission is uniquely positioned to spell out these implications and to suggest policies to address them.

There are many aspects of our relationship with China that merit your attention, but I want to focus my remarks on two: The unique nature of our trade deficit with China and the impact of

U.S. investment in Chinese export production on workers in the U.S. and other countries. If we value human rights, and hope for democracy and stability in China and the Asian region, the U.S. must use our bilateral economic relationship to press the Chinese government to pursue an economic development model that is based on respect for workers' rights and human dignity, not just compliance with investor rights and WTO rules.

Our trade relationship with China is severely unbalanced and still deteriorating. In 2000 our trade deficit with China continued to break records, jumping more than 20 percent above the level in 1999 and zooming past the \$80 billion mark. China replaced Japan as the country with which we hold the largest single bilateral trade deficit. Not only is our trade deficit huge and growing, but the ratio of exports to imports is grossly lopsided. For every dollar of goods we send to China, China sends more than six dollars worth of goods to us. Figures this year show that despite the slowdown in our economy our trade deficit with China is set to rise again and may top \$90 billion.

Just as exports can generate new jobs for American workers, import competition often displaces American jobs. When consumer demand is met with imports instead of domestic production, existing jobs can be lost, and new manufacturing jobs are not created in the U.S.

Since July of 2000 we've lost 675,000 manufacturing jobs in this country. In fact, the '90s boom is the only recovery in modern history during which we actually lost manufacturing jobs. This loss means that we now have fewer manufacturing workers in the United States than we did in 1965. These are good jobs, Mr. Chairman, family supporting jobs, and as U.S. workers lose manufacturing jobs due to imports they normally take a large cut in pay, 9 percent on average, when they're lucky enough to find a new job.

Many people know that China enjoys a huge trade surplus with the United States but they don't know the goods that we buy from China are not just inexpensive toys and clothes we see on the shelves. In fact, in 2000 the two largest single categories of products we imported from China were electronics and machinery.

I assume, Mr. Chairman, that the red lights tells me that—

Co-Chairman MULLOY. Yes. If you would want to finish up shortly and then we'll move on to the next witness. Thank you, Mr. Trumka.

Mr. TRUMKA. Other developed nations do not have the same kind of lopsided trade that we do with China. While reliable figures on international trade with China are hard to come by, statistics from the International Monetary Fund show that the United States is the single biggest market for China goods, buying anywhere from 25 to 50 percent of China's exports to the world.

We import two to three times more from China than either Europe or Japan does, while Europe and Japan each export more than we do to China. As a result, the European Union enjoyed a trade surplus with China of almost \$5 billion in 1999, and Japan had a trade deficit with China of less than \$20 billion, about a quarter of our deficit.

These figures show that U.S. consumers are a huge source of growth for the Chinese economy and a significant source of hard currency for the Chinese government.

The Commission must decide if the U.S. government should use the leverage of our massively imbalanced trade relationship to support the Chinese people and press the Chinese government to respect basic rights like freedom of speech and freedom of association, or if this leverage should only be used to enforce WTO rules and extract further concessions from our investors.

[The statement follows:]

PREPARED STATEMENT OF RICHARD L. TRUMKA

Mr. Chairman, members of the Commission, I thank you for the opportunity to speak to you today on behalf of the thirteen million working men and women of the AFL-CIO about U.S. trade and investment policies toward China. This Commission is charged with a very important task: to study, evaluate and report to Congress on the economic and security implications of the bilateral economic relationship between the United States and the People's Republic of China.

Our economic relationship with China is one of the most controversial and complicated relationships we have with any country, and for good reason. The AFL-CIO recognizes that refusing to engage with China is not an option in today's interconnected global economy. The question is thus not whether to engage with China, but how. How do we trade with China without sacrificing our own manufacturing sector and forcing workers worldwide into a downward spiral of ever lower wages and ever more aggressive assaults on worker's rights? How do we invest in China without providing unconditional support to a government that routinely violates the human rights of its citizens? How do we help China reform its economy in a way that promotes freedom, not just for the multinational companies that do business with China, but for ordinary Chinese men and women? Unfortunately, the policy options Congress and the Administration may employ to address these difficult questions will be severely limited once China becomes a member of the World Trade Organization and enjoys Permanent Normal Trade Relations with the United States.

The AFL-CIO has supported a policy that maximizes the benefits of trade and investment with China, but that also recognizes the risks of allowing rampant violations of human and worker's rights to go unchecked. WTO rules do not allow such a policy of responsible engagement, because they prohibit any linkage between trade and human rights. Thus the already limited tools to which we had access in the past to address violations of human rights and unfair trade practices, tools such as our unilateral trade laws and annual reviews, will no longer be available to us once China's accession to the WTO is complete.

Many argue that these tools are unnecessary, and that as U.S. companies invest and produce more in China, and as U.S. consumers buy more goods made in China, we will automatically be contributing to the country's economic development and political opening by "exporting American values." But these promised benefits are far from guaranteed.

In fact, our own State Department reports that the human rights situation in China deteriorated markedly in 1998, in 1999, and again in 2000, despite record growth in our trade and investment with China over the same period. According to the State Department's most recent human rights report for China, in 2000 "the authorities were quick to suppress any person or group, whether religious, political, or social, that they perceived to be a threat to government power or national stability, and citizens who sought to express openly dissenting political and religious views live in an environment filled with repression."

This environment of repression envelops workers as well. The Chinese government continues to systematically deny workers their fundamental rights—universal human rights defined in the ILO *Declaration of Fundamental Principles and Rights at Work* as freedom of association, the right to organize and bargain collectively, the right to reject child labor, refuse forced labor, and be free from discrimination in the workplace.

Independent trade unions are illegal in China. Chinese workers who try to form independent unions risk their jobs, their freedom, and sometimes their lives. U.S. multinationals directly profit from this abuse. They can pay workers depressed wages, force them to work long hours, and expose them to unsafe working conditions without ever having to worry about organizing drives in their factories or the prospect of facing independent worker's representatives at the bargaining table.

Over the past year, reports of labor protests, arrests, and violence have become more frequent as economic transformation and dislocation have left many Chinese workers without jobs and without any legal recourse to press their claims for compensation. As China struggles to live up to its WTO obligations, these pressures will only intensify.

Meanwhile, child labor and forced labor continue. Just this May, 39 Chinese men died while performing forced labor for a prison-run mine when the coal shaft they were working in flooded. In March of this year, 42 people, including 38 children, were killed in an explosion at a school where children between the ages of 9 and 11 were forced to manufacture fireworks. Finally, China still refuses to allow inspection by U.S. Customs officials of facilities suspected of exporting prison labor products to the U.S., in direct violation of numerous agreements between the Chinese and U.S. governments.

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Our trade relationship with China is severely unbalanced and is still deteriorating. In 2000, our trade deficit with China continued to break records, jumping more than 20% above its level in 1999 and zooming past the \$80 billion mark. China replaced Japan as the country with which we hold the largest single bilateral trade deficit. Not only is our trade deficit huge and growing, but the ratio of exports to imports is grossly lopsided. For every dollar of goods we send to China, China sends more than six dollars worth of goods to us. Figures for this year show that, despite the slowdown in our economy, our trade deficit with China is set to rise again and may top \$90 billion.

Just as exports can generate new jobs for American workers, import competition often displaces American jobs. When consumer demand is met with imports instead of domestic production, existing jobs can be lost, and new manufacturing jobs are not created in the U.S.

Just since July of 2000 we have lost 675,000 manufacturing jobs in this country. In fact, the '90's boom is the only recovery in modern history during which we actually lost manufacturing jobs. This latest loss means that we now have fewer manufacturing workers in the United States than we did in 1965. U.S. workers who lose manufacturing jobs due to import competition take a pay cut of over 9% on average—when they are lucky enough to find a new job.

Many people know that China enjoys a huge trade surplus with the United States, but they do not know that the goods we buy from China are not just the inexpensive toys and clothes we see on store shelves. In fact, in 2000 the two largest single categories of products we imported from China were electronics and machinery. Tellingly, these are also the sectors in which we have been losing the most manufacturing jobs. While our largest deficit with China is in electronics, some of our largest surpluses with China are in raw materials like seeds, fertilizers, and wood pulp. American companies are leaving to manufacture relatively high-tech products in China and export them back to the U.S.

Other developed countries do not have the same kind of lopsided trade relationship with China. While reliable figures on international trade with China are hard to come by, statistics from the International Monetary Fund show that the United States is the single biggest market for China's goods, buying anywhere from 25 to 50% of China's exports to the world. We import two to three times more from China than either Europe or Japan does, while Europe and Japan each export more than we do to China. As a result, the European Union enjoyed a trade surplus with China of almost \$5 billion in 1999, and Japan had a trade deficit with China of less than \$20 billion, about a quarter of our deficit.

These figures show that U.S. consumers are a huge source of growth for the Chinese economy, and a significant source of hard currency for the Chinese government. Since this trade relationship is not likely to become more balanced anytime soon, the real question is how the U.S. will use the enormous leverage this trade



relationship gives us. The U.S. International Trade Commission predicted that China's accession to the WTO will not improve our bilateral trade balance over the medium term. What China's accession to the WTO will do is make it much more difficult, although not impossible, to use this trade leverage to promote human rights and democracy in China.

This Commission must decide if the U.S. government should use the leverage of our massively imbalanced trade relationship to support the Chinese people and press the Chinese government to respect basic human rights like freedom of speech and freedom of association, or if this leverage should only be used to enforce WTO rules and extract further concessions for U.S. investors.

The second issue I would like to address is U.S. foreign direct investment in China. Like our trade deficit, U.S. investment in China has been on the rise. In 1999, U.S. companies had \$7.8 billion invested in China, up almost 20% from the year before and nearly three times what the U.S. had invested in China in 1995. During this same period, U.S. direct investment in manufacturing in China grew even faster than overall direct investment. Total stock of U.S. investment in manufacturing in China nearly quadrupled from 1995 to 1999; and while investment in manufacturing represented 46% of total investment in China in 1995, it now accounts for more than 60% of our total investment in the country.

From 1995 to 1999 the total stock of U.S. investment in China grew twice as fast as our foreign direct investment in the rest of the world. The picture for investment in manufacturing is even starker, with U.S. investment stock in the manufacturing sector in China rising three times as fast as our investment in this sector in the rest of world. In fact, as the portion of total investment in China devoted to manufacturing has been growing during the second half of the 1990s, the share of manufacturing investment in total U.S. foreign direct investment to the world has actually been declining. In 1999, only 28% of our investment stock worldwide was in manufacturing (compared to 62% in China).

This disproportionate rise in investment is directly linked to the rise in our trade deficit. In China, many U.S. companies are manufacturing for export back to the U.S. The sectors where we import the most from China, electronics and machinery, are also the manufacturing sectors where U.S. companies invest the most. Investment in these two sectors increased five-fold from 1995 to 1999, together accounting for more than two-thirds of all of our manufacturing investment in China.

It was only after the House passed permanent normal trade relations for China last year that the news media began to report on the real motivations of the U.S. companies that lobbied hardest for the new trade status. Companies such as GE, IBM, and Motorola are much more interested in China's WTO membership as a way to increase their use of China an export platform than they are in selling more American-made goods to China. The day after the House vote, the Wall Street Journal reported, "this deal is about investment, not exports . . . U.S. foreign investment is about to overtake U.S. exports as the primary means by which U.S. companies deliver goods to China" ("House Vote Primes U.S. Firms To Boost Investments in China." The Wall Street Journal, May 25, 2000).

Increased U.S. investment in export manufacturing in China not only contributes to our bilateral trade deficit, but also to a race to the bottom in labor standards around the world. U.S. investors argue that the pay and working conditions in their factories are much better than in other Chinese factories. Reports on the behavior of U.S. investors in China reveal a much less rosy picture. In a report released last year, the National Labor Committee found that American companies doing business in China "continue to systematically violate the most fundamental human and worker's rights, while paying below subsistence wages."

—Workers making Kathie Lee handbags for Wal-Mart at the Qin Shi factory, for example, are forced to work 12 to 14 hours a day, seven days a week, with only one day off a month. Yet after months of work, 46 percent of the workers actually owed money to the company. And when the workers protested these conditions, 800 were fired.

—Nike workers at the Keng Tau Handbag company sew Nike bags and backpacks from 8 a.m. to 10 p.m., with just one day off a month. Some workers earn as little as 8 cents an hour. Factory managers instructed workers not to punch their time cards for night or Sunday work, to hide the illegal overtime.

—When workers making New Balance sneakers at the Lizhan factory went on strike to protest the grueling overtime and low pay, they were all fired. Factory management explained to the remaining workers that they would not tolerate unions, strikes, bad behavior, or the raising of grievances.

—Finally, in a white paper distributed to Chinese government officials, the American Chamber of Commerce in China actually advised the Chinese government

to cut labor costs, because the “high labor costs ha[d] already discouraged some potential investors.”

It is clear that American companies doing business in China are not just “bringing American values” to China. Some investors unscrupulously take advantage of the lack of worker’s rights, and all investors, no matter how noble their intentions, directly profit from the official suppression of worker’s rights in China. As long as Chinese workers are systematically denied their fundamental rights to organize and bargain collectively, Chinese workers will not enjoy their fair share of the bounty of new investment, and the price of Chinese labor and thus Chinese goods will be artificially depressed.

The denial of worker’s rights in China does not just affect the livelihoods of Chinese workers. It creates a standard of treatment so low that workers in the U.S. and other countries simply cannot compete. Redirection of manufacturing investment from the U.S. to China and the resulting job loss for American workers is a familiar story, but the more immediate victims of China’s accession to the WTO and aggressive penetration of global markets may be those workers in other developing countries who are struggling to exercise their core rights, demand a fair wage, and secure decent working conditions.

Once China becomes a WTO member, developing countries that respect worker’s rights and thus pay higher wages will be scrambling to compete with China. This will only be exacerbated with the expiration of the textile and apparel quota system (the Multi-Fiber Arrangement) in 2005. As foreign investors leave other developing countries that respect worker’s rights to take advantage of China’s potent combination of guaranteed access to rich markets and a disenfranchised and vulnerable work force, developing country workers that have fought successfully for recognition of their fundamental rights will suffer the most.

An article in the *Korea Times* that appeared shortly after Congress’s grant of permanent normal trade relations to China voiced this concern, “Multinational corporations are only turning China into a low wage production base. How can Korea, with its high wage structure, compete with China?” Mexico’s border assembly plants (maquiladoras) are losing thousands of apparel jobs to China in anticipation of China’s WTO accession (“Economic Changes Said Leading to Loss of Border Jobs,” Associated Press, June 5, 2001).

The trade and investment relationships that I have outlined are profoundly troubling. Whether you are a worker in Detroit or Beijing or Seoul, China’s pending accession to the WTO and permanent normal trade relations status present an uncertain future. Workers in all three countries may face economic dislocation, mistreatment on the job, and threats to their rights. Workers in China face even graver challenges: if they attempt to organize an independent union, and bargain with their employers for better pay and working conditions, will they be arrested and jailed without trial? If they dare to criticize the government or join with others to promote political reform, will they be risking their freedom and even their lives? Most importantly, if they take these risks—risks that must be taken if China is going to develop a mature economy and a vibrant democracy—who will lend them support? Many U.S. investors have more economic interest in stability and docility than in democracy and freedom; when these goals come into conflict, the U.S. government will have to decide whether to support our investors’ desire for profit or the struggles of the Chinese people.

It is in the interests of the United States to promote sound economic development and a just and open political system in China. But unfettered trade and investment alone will not bring equitable, sustainable, or democratic development to China. They have not done so in the past, and they will not do so in the future.

We must use the leverage of our trade relationship and the influence of our investors to support the rights of Chinese workers and citizens, and to challenge the Chinese government to participate in a serious dialogue about reform. This challenge will only be taken seriously if it is backed by the threat of economic consequences, just as WTO rules are backed up by economic consequences. This challenge will only be productive if it is focused on allowing the Chinese people to exercise their fundamental human rights, both in the workplace and outside of it, and aims at opening up the space for democracy in China. I hope this Commission will recommend new policy tools aimed at fostering such responsible engagement with China.

Thank you for this opportunity to present the views of the American labor movement on this important issue. I look forward to your questions.

Co-Chairman MULLOY. Mr. Trumka, thank you very much. Now, I want you to know that your whole statement will be in the record of the Commission, and most Commissioners, I think, took time to

read all of these statements, so you can be assured that we're familiar with everything you had to say.

Mr. TRUMKA. Thank you, Mr. Chairman, I appreciate that.  
Co-Chairman MULLOY. Mr. Benanav?

**STATEMENT OF GARY BENANAV, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, NEW YORK LIFE INTERNATIONAL**

Mr. BENANAV. Thank you, Mr. Chairman and members of the Commission. I'm the Chairman and CEO of New York Life International and Vice-Chairman of New York Life Insurance Company. In addition to my corporate responsibilities I serve as the Chairman of the U.S. Committees of the Pacific Basic Economic Council, known as PBEC-US, and the Pacific Economic Cooperation Council, known as US-PECC. I appreciate this opportunity to appear before you during the first open hearing of the U.S.-China Security Review Commission.

I'll summarize my remarks and ask that my formal statement be made part of the record.

Co-Chairman MULLOY. It will be.

Mr. BENANAV. As our nation embarks on the new millennium the rapid economic and political evolution of the People's Republic of China will remain among the most critical international variables for us to consider.

It's my strong belief that we must find a way to deal with China, which advances American national interests while recognizing that both countries' political and economic security are inexplicably linked. Over 30 years ago President Nixon and Henry Kissinger were at crossroads; isolate or integrate with China. I think we all know that they chose the integration path and since that time Presidents and Congresses have had the challenge of how to integrate, not whether to integrate.

My company and its policyholders and employees, like workers and farmers and businesses throughout the country, have a great deal at stake in the way that we as a nation deal with China and the Chinese people.

I'd like to cover three areas in my testimony: The challenge of compliance which China's WTO accession will present, the effects of economic engagement with China, and an assessment of China's domestic political evolution.

Mr. Chairman, as Representative Levin, noted in his March 6th speech at the Center for Strategic and International Studies, "When China ultimately does accede to the WTO, our work will not have ended, it will have just begun." The business community is under no illusion about China's WTO accession.

WTO implementation will not be easy or automatic, just as negotiations between the United States and China were neither easy nor automatic, and the battles for WTO compliance will recur.

It will not be easy because Chinese institutions in many manufacturing and service sectors are still in their formative stages and have not been exposed to competitive market forces. This is certainly true of the insurance industry where the legal structures for regulation are less than a decade old and the China Insurance Regulatory Commission is only three years old.

It will not be automatic because China has not yet developed the full range of institutions needed to underpin the efficient operations of a competitive marketplace. In many cases China's implementation of its market opening commitments will trigger social and economic dislocations and associated adjustment costs. The Chinese recognize this and are prepared to take those pains for the benefit that WTO will bring to them. Government, business and NGOs must be prepared to monitor China's implementation of its WTO commitments and must be willing to work with determination with our counterparts in China to help increase the institutional capacity of China to meet its WTO obligations.

The issue of institution building is critical to China's ability to live up to its market opening commitments. In his recent book "The World Economy: A Millennial Perspective", Angus Madison has identified one of the central factors for successful economic growth, namely the development of strong legal protections for property rights and the establishment of institutions that foster entrepreneurial activity.

China certainly doesn't lack entrepreneurial spirit. If you've ever walked the Bund in Shanghai or visited a factory in Guangzhou or talked to students at Beijing University, you know the natural entrepreneurial spirit of the Chinese people. But China does lack the institutional foundations on which that entrepreneurial spirit can flourish.

Professor Waldron at the American Enterprise Institute has written eloquently on this point describing his concern, that China's economic growth "rests on shaky foundations—and these grow more shaky, not less, as the growth continues in a political and institutional vacuum." And I share Professor Waldron's concern.

Building institutional capacity is essential if China is to meet successfully the challenge of implementing its WTO commitments. If we can assist the development of durable rules of law in China one can only imagine how much more entrepreneurial the Chinese people could be. That's why New York Life, like many other companies in trade industry associations, has been actively helping to train Chinese officials about international standards and providing information about the changes needed in Chinese law to meet WTO obligations.

Mr. Chairman, it's in everyone's interest that China grow in a balanced manner, in a manner that promotes its own internal stability and furnishes a market for other countries. Experience points to the key requirements for balanced growth. First and foremost is a system of contractual and intellectual property that allows people to accumulate capital. Developed countries that have advanced economically while maintaining social stability have this in common. China's high domestic savings rate, nearly 40 percent of GDP, allows for significant accumulation of capital.

The second requirement is an efficient and multifaceted financial system, which mobilizes savings and channels them efficiently by offering a range of investment products. In addition, the middle class requires financial instruments that permit individuals to manage risks by pooling their resources.

Foreign insurance and other financial service firms provide a source of expertise, backed by capital resources, needed to meet

these two requirements. By participating in the Chinese market, U.S. firms furnish the institutional prerequisites for balanced growth in China, while increasing value for their U.S. shareholders.

The world community has devised institutions to form a system of multilateral rules based on cooperation. The result is a set of building blocks for a global system that can secure and sustain political and economic stability. China needs to have a stake in this global system if it's to realize its growth potential and expand its middle class.

Moreover, the more China is rooted in the international rules-based trading system the greater the cost to China's own economy of taking political or military steps that undermine this system. In short, China's stake in the smooth operation of a global economic system and the interdependence of the global system act as constraints on China's ability to adopt political or military postures that will have the consequence of slowing down or damaging its domestic economic growth opportunities, or at the extremes even impoverishing its own people.

During last year's debate on PNTR, several commentators predicted that opening China's domestic market would inevitably lead to the opening of China's domestic political systems.

I don't believe that this is an issue of simple cause and effect. Open economic systems do not, in and of themselves, inevitably lead to open political systems. But I do believe that without an open economic system there can be no hope of developing an open political system. As China moves towards a more open, less centrally controlled economy, the government will play a diminished role in the operation of the market. A more open economy will stimulate the growth of the private sector. Trade liberalization will allow foreign competition and challenge the efficiency of state owned enterprises. This is exactly what is happening in the insurance sector in China today.

But the effect goes beyond the economic arena. The energized private sector and expanded middle class in China is already demonstrating increased interest in democratic structures and understanding of international norms and values.

I also believe that increased private sector activity will put additional pressure on the People's Liberation Army to follow through on President Jiang's mandated reforms. For this reason we need to support wider interaction between civil society groups in both countries.

U.S. businesses can also help shape a stable and prosperous China by bringing to the Chinese economy their corporate values, world class standards for treatment of workers, commitment to safety in the work place, codes of conduct for business operations, and support for the rule of law and campaigns against fraud and corruption. I believe that the infusion of international standards and values into the Chinese economy will influence the opening of China's political process in a positive manner.

I want to emphasize three points in closing:

First, we must devise a long-term framework for U.S.-China relations which advances our national interest while recognizing that both countries' political and economic security are inextricably linked.

Second, we must in the near term complete China's WTO accession, monitor China's implementation of its WTO commitments, and work with China to build its capacity to comply with WTO obligations.

Finally, to be successful in both the near and long-term we must establish a political consensus domestically that trade with China is a win-win proposition economically and politically for the United States, China and the entire Asia Pacific region.

Thank you, Mr. Chairman.

[The statement follows:]

PREPARED STATEMENT OF GARY BENANAV

Mr. Chairman, members of the Commission, I am Gary Benanav, the Chairman and CEO of New York Life International and Vice-Chairman of the New York Life Insurance Company. In addition to my corporate positions, I serve as the Chairman of the U.S. Committees of the Pacific Basin Economic Council (PBEC-US) and the Pacific Economic Cooperation Council (US-PECC). I appreciate this opportunity to appear before you during the first open hearing of the U.S.-China Security Review Commission.

Mr. Chairman, there is no need to outline for the Commission the fundamental importance of the issues Congress has asked you to consider. As our nation embarks on a new millennium, the rapid economic and political evolution of the People's Republic of China will remain among the most critical international variables for us to consider.

Any evaluation of issues affecting our immediate and long-term national security and economic prosperity must include China. It is my strong belief we must find a way to deal with China which advances our national interests while recognizing that both countries' political and economic security are inextricably linked.

In managing the international business of New York Life, I find myself regularly involved in debates on various public policy issues that have a significant bottom-line effect on our company and to our policyholders. Our country's current trade and investment policies toward China and China's entry into the WTO certainly fall into a high priority category for my company. My company and its policyholders and employees, like workers, farmers and businesses throughout our county have a great deal at stake in the way we as a nation deal with China and the Chinese people.

This morning, I would like to cover three areas in my testimony. First, I will address the challenge of compliance which China's WTO accession will present. Second, I will discuss the effects of economic engagement with China and China's entry into the global economic system. Finally, I would like to conclude with an assessment of China's domestic political evolution.

*The Challenge of Compliance*

Mr. Chairman, as Representative Sandy Levin noted in his March 6 speech at CSIS, "when China ultimately does accede to the WTO, our work will not have ended, it will just have begun." The business community is under no illusions about China's WTO accession. WTO membership will represent a substantial and significant opening of China's domestic market and will have far-ranging domestic economic and political consequences for China. In many cases, China's implementation of its market opening commitments will trigger social and economic dislocations and associated adjustment costs.

WTO implementation will not be easy or automatic, just as the negotiations between the United States and China were neither easy nor automatic.

The transition to a market economy will not be easy because Chinese institutions in many manufacturing and services sectors are still in their formative stages and have not been exposed to competitive market forces. This is certainly true of the insurance industry, where the legal structures for regulation are less than a decade old, and the China Insurance Regulatory Commission is only three years old.

The transition to a market economy will not be automatic because China has not yet developed the full range of institutions needed to underpin the efficient operation of a competitive marketplace. China's trading partners will need to be vigilant and work with patient determination to ensure compliance with WTO agreements. Government, business, and NGOs must be prepared to monitor China's implementation of its WTO commitments and must be willing to work with our counterparts in China to help increase the institutional capacity of China to meet its WTO obligations.

The issue of institutional building is critical to China's ability to live up to its market opening commitments. In his recent book, *The World Economy: A Millennial Perspective*, Angus Madison has identified the central factors in a country's growth. He concludes that societies achieving successful economic growth have tended to develop stronger legal protections for property rights and to build institutions that foster entrepreneurial activity.

China does not lack entrepreneurial spirit. If you have ever walked the Bund in Shanghai or visited a factory in Guangzhou or talked to students at Beijing University, you know the natural entrepreneurial spirit of the Chinese people. But China does lack the institutional foundations on which that entrepreneurial spirit can flourish.

In a recent AEI (American Enterprise Institute) paper, Professor Waldron writes eloquently on this point describing his concern that China's economic growth "rests on shaky foundations—and these grow more shaky, not less, as that growth continues in a political and institutional vacuum." I share Professor Waldron's concern.

Mr. Chairman, if we can assist the development of durable rule of law intuitions in China, one can only imagine how more entrepreneurial the Chinese people could be. New York Life, like many other companies and trade and industry associations, has been active in training Chinese officials about international standards and providing information about the changes needed in Chinese law to meet WTO obligations. Building institutional capacity is essential if China is to meet successfully the challenge of implementing its WTO commitments.

#### *Effect of Economic Engagement*

Mr. Chairman, globalization presents the United States and China an opportunity to cooperate to achieve greater economic growth in both countries. Current conditions in the U.S. economy have tangible effects on the domestic economies of our trading partners. In the same vein, conditions in China's domestic economy influence growth in the Asia Pacific region and globally. It is in everyone's interest that China grows in a balanced manner, a manner that promotes its own internal stability and furnishes a market for other countries.

#### *China's Domestic Economy*

For balanced political and economic growth, China needs to encourage the expansion of its middle class. This group will stimulate the robust domestic demand needed for long term growth of the Chinese economy. China's long term economic development cannot be achieved simply through growing exports to the markets of its trading partners.

Experience points to the key requirements for balanced growth and a middle class. First and foremost is a system of contractual and intellectual property rights that allows people to accumulate capital. Developing countries that have advanced economically while maintaining social stability have this in common. China's high domestic savings rate, about 40 percent of GDP, allows for accumulation of significant amounts of capital.

The second requirement for balanced growth is a sophisticated financial system, which mobilizes savings and channels them efficiently by offering a range of investment products. In addition, a burgeoning middle class requires financial instruments that permit individuals to manage risk by pooling their resources.

Foreign insurance and other financial services firms provide a source of expertise, backed by capital resources, needed to meet these two requirements. By participating in the Chinese market, U.S. firms furnish the institutional prerequisites for balanced growth in China, while increasing value for their U.S. shareholders. This is an important contribution to the process of drawing China into the world economic community.

#### *China and the World Economic System*

Mr. Chairman, most nations of the world have realized that joining the global economic system brings political and economic stability and prosperity. Those that have not participated in the world economic system, either by choice, by chance or by mismanagement, find the cost of staying outside the system is accelerating every year.

The world community has devised institutions, some more formal and developed than others, to form a system of multilateral rules-based cooperation. The result, although a sometimes bewildering array of acronyms, is a set of building blocks for a global system which can secure and sustain political and economic stability. China needs to have a stake in this global system if it is to realize its full growth potential.

Moreover, the more China is rooted in the international rules-based trading system, the greater the cost to China's own economy of taking political or military steps that undermine the system. In short, China's stake in the smooth operation of the global economic system and the interdependence the global system creates, act as

a constraint on China's ability to adopt political or military postures that will have the consequence of slowing down or damaging its domestic economic growth opportunities.

There is no doubt the deeper integration of China in the global economy serves U.S. national security and economic interests. China's membership in the WTO is one important element in the overall process of rooting China more firmly in the international rules-based system.

*China's Domestic Political Evolution*

Mr. Chairman, last year our country undertook a national debate on the merits of granting China permanent normal trading relations (PNTR) as part of the WTO accession process. During that debate, several commentators predicted opening China's domestic market would inevitably lead to the opening of China's domestic political system.

I do not believe this is an issue of simple cause and effect. Open economic systems do not, of and in themselves, inevitably lead to open political systems. But I do believe that without an open economic system there can be no hope of developing an open political system. As China moves towards a more open, less centrally controlled economy, the government will play a diminished role in the operation of the market. A more open economy will stimulate the growth of the private sector. Trade liberalization will allow foreign competition and challenge the efficiency of state owned enterprises. This is exactly what is happening in the insurance sector in China today.

But the effect goes beyond the economic arena. The energized private sector and expanded middle class in China already is demonstrating increased interest in democratic structures and understanding of international norms and values. For this reason, we all need to support wider interaction between civil society groups in both countries.

Many variables affect the evolution of political systems. We cannot control the evolution of any one political system. But we can influence the direction any particular country will take.

I mentioned earlier in my statement that opening China's market would not be automatic. It will take effort on China's part and vigilance on our part. I believe this is a safe prediction for me to make. I also believe increased private sector activity will put additional pressure on the Peoples Liberation Army to follow through on President Jiang's mandated reforms requiring the military to shed its business operations. That also is a safe prediction, and it will be a healthy result for both the United States and China.

The leaders of China face the monumental task of constructing a productive, stable future for the world's largest nation. China's future will determine in no small measure the future of the entire Asia Pacific region. To shape a stable and prosperous future for itself, China must engage in the rules-based institutions formed by the community of nations and must commit domestically to the formation of a robust middle class. U.S. business can contribute to both of those efforts, to the benefit of both nations.

In particular, American and other foreign businesses will bring to China their corporate values, which include among others, standards for treatment of workers, commitments to safety in the workplace, codes of conduct for business operations, support for rule of law and campaigns against fraud and corruption. The presence of foreign firms in China will increase and accelerate the pace at which international business standards, transparency and accountability permeate the Chinese economy. This infusion of international standards and values will influence the opening of China's political processes in a positive manner.

I want to emphasize three points in closing.

—In the long term, we must devise a framework for U.S.-China relations which advances our national interests while recognizing that both countries' political and economic security are inextricably linked.

—In the near term, we must complete China's WTO accession, monitor China's implementation of its WTO commitments and work with China to build its capacity to comply with WTO obligations.

—To be successful in the near and long term, we must establish a domestic political consensus that trade with China is a win-win proposition, economically and politically for the United States, China and the entire Asia Pacific region.

Thank you, Mr. Chairman.

Co-Chairman MULLOY. Thank you, Mr. Benanav.  
Mr. Robert Kapp, please.



**STATEMENT OF ROBERT A. KAPP, PRESIDENT, UNITED STATES-CHINA  
BUSINESS COUNCIL**

Mr. KAPP. Thank you, Chairman Mulloy. Friends, I've asked you to wade through a long piece of testimony, and I even attached some reading, so I won't perhaps take all of my time in this oral section of the meeting.

Let me just say a few things without reading from the text and then we can move to a discussion.

We've all noted that in the last few days the United States and China appear to have reached agreement in Shanghai on the five principal remaining issues that stood in the way of American support for China's accession to the WTO. We don't have all the details on exactly what was agreed to yet. The briefings are now going on on the Hill and elsewhere.

I do think that this last round of discussion between Ambassador Zoellick and his Chinese counterpart is a reminder of the fact that with intense effort, concentrated attention, mastery of the facts, and a real commitment to engage, it is possible for the United States and China to find common ground even in areas of significant dispute. I think we should all take heart from the fact that in spite of the problems that have beset this relationship for so long, and again in recent months, the two sides were able to turn their attention in a very business like way to resolving these difficult issues and were successful in doing so.

The purpose of my testimony today was to attempt, at the beginning of your work, to raise broader issues of context. This hearing has occasioned for me a fair amount of thinking and reading, and I have been struck by the rigidity of so many of the positions that have been taken on the issues that you will be taking up. My hope in raising these contextual issues before turning to the questions that Commissioner Mulloy asked me to address was that I could at least introduce into your dialogue some sense of the richness of the debates and the discussions that are already out there.

The readings that I have appended are items that I felt perhaps were most important to bring into the arena at this time, as were the readings that I put into a list of suggested offerings that I hope the Commission might want to find time to acquire and members might have a chance to look at.

I do feel that to answer the question, "Is it good for the national security or not?" without first addressing key questions of definition at the beginning of the Commission's work was to put the cart a little bit before the horse; I tried to speak to that in my first remarks.

I might also say that the U.S.-China Business Council is a private, non-profit, 501(c)(6) organization. All Council money comes from annual corporate memberships, except for a little bit of money earned from Council events or from interest accrues in the bank. I hope that all witnesses before the Commission will be equally forthcoming as to their funding sources. I speak as the representative of the Council and not of any one company. It is in the nature of our organization that we are not party to individual corporations' decision making and deal making with regard to the way they proceed with China. So, even if I wanted to, I am not able to discuss the nuisances or the subtleties or the details of individual corporate

engagements that have been made with China on particular products or anything of that sort.

Some of you, of course, have followed the case of Taiwan for many years, and as I thought about Taiwan's trade with the world and China's trade with Taiwan, it did occur to me that we should at least ask ourselves whether on this, as on so many other things, Taiwan offers a sort of glimpse of what could be in China. I think the business community's tendency, as you've seen in my testimony is to take the glass as more than half full as the observation of reality. Business people are on the ground in China. They look around at what it was like doing business there 20 years ago and they see a China that is unthinkably different, and mostly in positive ways. They perceive that the Chinese situation will get even more positive with WTO, though it will take time for all of the things that China has agreed to be fully implemented.

Mr. Benanav has said, and I would agree, that we need to be a part of that effort, as the Europeans and others are, to help the Chinese to become fully compliant in their WTO commitments as rapidly possible. But our broad sense is that indeed this place is changing in many, many ways for the better, and would have changed far less for the better had it not been for the basic decision to become a part of the world economy, as well as the decision by American and other private sector enterprises around the world to engage with China in those terms.

So we see in many ways harmonization and convergence. An example would be the labor market. I don't mean to offend Richard Trumka here when I speak of the labor market. By contrast to the earlier Chinese situation in which American companies used to find themselves completely unable to engage in at all because all hiring and firing and labor allocation was handled by the government, there is now in fact a much more functioning labor market in which Chinese people can look for jobs, choose their jobs, and relocate for jobs, while employers in some cases they can hire and can also dismiss in ways formerly beyond their prerogatives.

My point is that with China's growing economy, rising living standards, and growing markets, and with China's growing acclimatization to the standards and habits that tend to govern economic behavior in the developed nations and in market countries around the work, I think American business generally feel, that while there are many difficulties out there and plenty of people you don't like very much, China has come a long way already and will move even more rapidly now in the direction of commonly accepted standards that we find compatible and congenial, not just commercially but also ethically and we hope over the long haul legally. So in that sense I find Taiwan to be an example that is worthy of attention.

Taiwan has made an impressive transition from a one-party Leninist state borne out of the same revolutionary impulse as the Chinese Communist Party, and has moved over 50 years from tragedy and excess to something that every American celebrates, and we should ask ourselves as we go on whether there are lessons to be learned about China's future from this as well.

Co-Chairman MULLOY. I will have someone check.

Mr. KAPP. I will say one more thing before we finish.

Our Council is primarily in the business of helping companies figure out the answers to their questions in China and navigate the difficult and sometimes opaque Chinese landscape.

But I did intentionally mention our U.S.-China Legal Cooperation Fund at the beginning of my testimony. I mentioned that corporate members of the Council have contributed to a small, but we think constructive, effort to support bilateral U.S.-China programs in the broad area of the rule of law. Our programs are covering, as I mentioned, legal concerns ranging from translation of legal dictionaries, to WTO preparation, to legal services for the poor, even importantly two grants in the area of in the compatibility of Chinese labor laws and regulations with international standards.

My point is that in the work of the Legal Cooperation Fund, and in the digital video conference series that I've enjoyed conducting this spring with our friends in Shanghai to help bring American expertise to an important audience in China on WTO issues and WTO compliance, we see examples of what all Americans, in the Congress, in the private sector, and in every part of civil society could and should become involved in.

We have a lot of work we can do with China. The Chinese welcome it. It is in our interest as a nation and it is in our interest as Americans, I think, to engage as heavily as possible. And if anyone wants to discuss these experiences that we've had, with a view towards perhaps starting programs of your own, we would be happy to share what we've learned with you.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF ROBERT A. KAPP

Ambassador Lilley, Commissioner Mulloy members of the Commission: Thank you for inviting me to appear today before the first full hearing of the U.S.-China Security Review Commission. I look forward to a productive discussion with you.

I. INTRODUCTION AND PRELIMINARIES

I am Robert Kapp, president of the U.S.-China Business Council. Founded in 1973 at the instance of key Nixon Administration officials at the beginning of modern contact between the United States and the People's Republic of China, the Council is the principal organization of U.S. companies engaged in trade and investment with China. The Council ([www.uschina.org](http://www.uschina.org)) currently serves approximately 230 leading companies, of all sizes, from headquarters in Washington and field offices in Beijing and Shanghai.

The Council is an independent, nonprofit, nonpartisan business association incorporated under Section 501(c)(6) of the Internal Revenue Code. Its funds come primarily from corporate memberships. The Council receives no financial support from any government and no money from private foundations or individual donors. Contrary to recent published reports, the Council provides no political support, financial or otherwise, to any incumbents or candidates for public office, and no one associated with the leadership of the Council, whether salaried staff or members of the Council's Board of Directors, provides support to any political figures in his or her Council capacity.

The Council's education and research arm, The China Business Forum (501(c)(3)) is the home base for The U.S.-China Legal Cooperation Fund. The Fund, created on the 25th anniversary of the U.S.-China Business Council in 1998 with charitable donations from a number of Council member companies, awards grants for joint U.S.-China programs in the field of law, in keeping with the 1997 and 1998 agreements of Presidents Clinton and Jiang Zemin to develop bilateral legal affairs cooperation. Fund grants have supported worthy projects including legal services for the indigent, research on the compatibility of Chinese labor law with international standards, dictionary translation projects, and improvement of Chinese administrative legal process, and improvement of Chinese compliance with WTO requirements,

to name a few. The Fund represents a corporate commitment to the long-term development of a more stable and productive U.S.-China relationship in the much-discussed area of “Rule of Law” at a time when the United States Congress has repeatedly refused to make available public funds for such positive U.S.-China cooperation.

## II. THE U.S.-CHINA SECURITY REVIEW COMMISSION: THE WORK AHEAD

The establishment of this Commission by Congress last year, just as the Congress completed its historic and spirited debate on the provision of full WTO-member treatment to China upon China’s accession to WTO membership, is a reminder of the importance that members of Congress have from time to time attached to the progress of U.S. relations with China. I wish the Commission well in its pursuit of a balanced, broadly informed understanding of the issues dealt with in its Congressional mandate. Before turning to the questions suggested to me in Commissioner Mulloy’s invitation to appear at this hearing, I would like respectfully to offer the Commission a few reflections.

The work of this Commission will not take place on a blank slate. Everything about this endeavor is rooted in larger contexts—historical, technological, economic, and political. From each of these contextual perspectives, a great body of research, writing, and practice has emerged over the years. I hope that Commissioners who have not spent much time in the past in these broader avenues of inquiry will do so now. In particular, I hope that Commissioners will want to establish a broad grasp on the wider issues of which the Commission’s work is a part, clearly establish the Commission’s starting assumptions and the boundaries of its concerns, and then proceed with a fairly strict sense of where it is headed. That way, the work of the Commission could contribute meaningfully to a larger and longer policy discourse.

## III. DEFINING THE GIVENS

Permit me respectfully to discuss a few of the starting points that I hope the Commission will address in the early days of its work, so that its continuing efforts and its later recommendations are based in meaningful contexts:

A. How does the Commission define “U.S. national security”? Does the term solely denote military strength in relation to threats or enemies? Does it include concepts of economic strength? Does it take into account multilateral as well as bilateral perspectives? The meaning of “national security” is less self-evident than it is sometimes said to be. The Commission should define its terms.

B. I would hope that the Commission would consider whether carefully executed policies of dispute management, tension reduction, and positive cooperation with China are feasible and would contribute to the U.S. national security. That is to say, does the Commission believe that “engagement” with China offers the possibility of greater security for the United States or not.

C. As it views U.S.-China relations from the standpoint of its chosen definition of national security, will it view U.S.-China relations only bilaterally, or in multilateral context? This Commission is a “U.S.-China” Commission. Some apparently bilateral U.S.-China issues, including security issues, may actually be narrowly defined cases of more transcendent problems relevant to many nations: export controls, trade policies, for example. Will the Commission concentrate entirely on China? How will the Commission blend its mandated bilateral focus with the actualities of globalized economic, strategic, environmental, and technological life?

D. What does the Commission see when it looks at China? Zbigniew Brzezinski writes, in “Living with China,” (The National Interest, Spring 2000):

It follows that the United States, in defining its longer term China policy and in responding to the more immediate policy dilemmas, must have a clearly formulated view of what China is, and is not. There is, unfortunately, enormous confusion in American on that very subject. Allegedly informed writings regarding China often tend to be quite muddled, occasionally even verging toward the hysterical extremes. As a result, the image of a malignant China as the inevitably anti-American great power of the 2020s competes in the American public discourse with glimpses of a benign China gently transformed by U.S. investors into an immense Hong Kong.

Having digested much of the available literature on Chinese political, economic and military prospects, and having dealt with the Chinese for almost a quarter of a century, I believe that the point of departure toward an answer has to be the recognition of an obvious by fundamental reality: China is too big to be ignored, too old to be slighted, too weak to be appeased, and too ambitious to be taken for granted.

In any case, whatever its political prospects, China will not be emerging as a global power in the foreseeable future. If that term is to have any real meaning, it must imply cutting-edge superiority of a truly global military capability, significant international financial and economic influence, a clear-cut technological lead, and an appealing social lifestyle—all of which must combine to create worldwide political clout. Even in the most unlikely circumstance of continued rapid economic growth, China will not be top-ranked in any of these domains for many decades to come.

One should note here that some of the current scare-mongering regarding the alleged inevitability of China's emergence as a dominant world power is reminiscent of earlier hysteria regarding Japan's supposedly predestined ascendancy to super-power status.

Today, with the Soviet Union gone, China is neither America's adversary nor its strategic partner. It could become an antagonist, however, if either China so chooses or America so prompts.

Thus Brzezinski: what is the Commission's view? I urge the Commission to state clearly, from the start, its assumptions as to the nature of the China facing the United States at the dawn of the 21st century and later on—China's political dynamics, its economic trajectory, the characteristics of its domestic and international conduct, its self-perception in world affairs, its strategic intentions, and so on. These crucial questions are not interpreted in one single way by American specialists, and I hope the Commission will want to inform itself deeply as to the variety of views informing these issues.

Bald assertions, for example, that China is somehow "hard wired" for a quest for regional or global domination, should not be uncritically accepted.

Interpretive suggestions that all economic activity, or for that matter all Chinese in contact with other countries, are somehow locked into a gigantic web of political control deftly manipulated by the Standing Committee of the Politburo, should be scrutinized with skepticism.

The implications for China's international behavior of its still-accelerating twenty-year movement toward the market economy and toward international economic integration need to be explored, and the Commission's views of them defined, before the Commission can effectively take on the specific targets placed upon its agenda by the Congress.

E. It would be very helpful for the Commission to determine its own views at the outset as to what would constitute Chinese domestic and international behavior fully compatible with its notions of U.S. national security. Expressions of fear over China's rising power or future prowess are everywhere; a thousand voices lament what China is and does, or say what China should not be and should not do. There are far fewer voices able to describe in detail what China should be and should do, from the standpoint of the United States. Prescriptions for U.S. policies aimed at eliminating threats or "changing China" must define both what changes the U.S. ought to pursue, and the feasibility and the costs of pursuing those changes.

In this connection, the familiar usage "a stable and prosperous China" might not suffice, even if all on the Commission could agree that "prosperous and stable" is better for U.S. security than "poor and unstable." Is continued Chinese economic growth compatible with or conducive to U.S. security? How much economic growth is too much (or, for that matter, not enough) for U.S. comfort?

Does the enhancement of the Chinese central government's ability to enforce its writ effectively across China's landmass and throughout China's million villages enhance U.S. security, or would the Commission hold that U.S. security would be better served by the dissolution of central authority?

Is PRC diplomacy aimed at developing cordial relations with the numerous states on its borders inimical to U.S. national security? Does PRC participation as a full member of international regimes like the UN or the WTO strengthen or threaten U.S. national security? Does the PRC's attractiveness as a site for foreign direct investment represent a threat to U.S. national security? Does any and every modernization of Chinese military capabilities threaten U.S. security? Does U.S. security require changes in China's force structure? On all of these questions, the Commission needs to ask itself: what would it want to see China be and do?

These are just a few of the fundamental definitional issues that, in my opinion, the Commission needs soberly to take up. As Commissioners are aware, none of those subjects is without widely divergent interpretation in American discussions, both among specialists and more generally. I have appended a short list of recommended readings and copies of a very few written pieces, primarily by way of illustrative examples of what can be found to assist Commissioners in this analysis.

While the members of this Commission probably will not want to plunge into the sectarian debates of international relations theorists over the intellectual schools that underlie various approaches to strategic thinking ("classical realism, which

stresses the struggle for power among states; neorealism, which emphasizes the search for security under conditions of anarchy; neoliberal institutionalism, which explores the evolution and influence of international cooperative regimes,” to quote Andrew J. Nathan and Robert Ross in *The Great Wall and The Empty Fortress: China’s Search for Security*, it is evident to the lay observer that a doctrinal debate informs much of the discussion of the future of U.S. foreign policy as a whole, of which China policy is, in some ways, only an example.

I hope that the Commission will want to examine the range of theoretical approaches that underlie different contemporary policy positions on China. Even if the Commission ultimately chooses to make its way through its mandate on the basis of nothing more than a declaration of faith, it would be well for the Commission to come to grips with the underlying debate over what the U.S. role in the post-Cold War world is or should be. Some of the readings that I am appending or recommending may be of value in this regard.

Inevitably, the Commission will take up some relatively familiar topics take export controls. This subject has been under intense expert discussion from well-defined perspectives for decades. Certain members of this Commission are among the most prolific and passionate discussants of U.S. export control policy, not only with regard to China but more generally.

Those of us who have not spent decades in this complex field, and who have not had the clearances and exposure to defense-related information that some of the members of this panel have had during their service in U.S. government agencies close to the center of this subject, can only observe from the sidelines. We observe:

- A prolonged debate over the balance between U.S. commercial interests and U.S. interests in controlling the flow of certain technologies to certain powers deemed potentially unfriendly to the U.S.;
- An almost equally durable conflict over administrative prerogatives in export control policy execution among U.S. government agencies and their respective supporters in the Congress and the policy community, a debate that is back in the hands of the Congress this summer;
- Timeless arguments about how to define acceptable and unacceptable levels of technology exports, and how to distinguish acceptable foreign recipients of technology exports from unacceptable ones;
- Hoary discussions of the utility and wisdom of preventing U.S. exports of technologies that are available from other international suppliers—the so-called “foreign availability” question;
- Plentiful commentaries on the implications of the collapse of the Soviet Union for the future of U.S. export control policy.
- Voluminous discussion about the implications of the Internet, electronic miniaturization, and other technological innovations for the preservation of American defense technology secrets.

I need not elaborate further, on the export control question or other major issues facing this Commission that have their own long histories. Inasmuch as the Commission will be dealing with topics that have been argued and explored extensively by others, I would hope that in the Commission’s early months a broad and open-minded “state of the field” effort would be undertaken, both to help the Commission move beyond what has been said and done by others and also to help ground the Commission’s work in the wisdom of those who have gone before.

I urge the Commission to think carefully about the domestic social implications of its concerns. Developments within the United States in the past few years, as related to the condition of U.S.-China relations, make this a matter of legal and ethical priority.

Commissioner Reinsch, shortly before leaving public office, commented in a particularly telling fashion on one such implication. As I recall the report of his remarks, his thinking was along these lines: If the acquisition in the United States, by Chinese citizens, of certain types of technical information represents a “deemed export,” even if the information is acquired in open intellectual settings such as professional meetings, academic conferences, university seminars or classes, etc., may the time come when United States policy or law might bar PRC citizens from those otherwise open scholarly activities, even as citizens of other foreign nations are welcomed to them? This and related questions ought to be grappled with forthrightly by this Commission. Will it be the Commission’s view that requirements of U.S. national security demand that our government take action to deny solely to “Chinese nationals” (if that term can be precisely defined) professional and intellectual opportunities denied to no others? What about American citizens born in China? Born of Chinese-born parents? What about people of Chinese ethnicity and culture in the United States with Taiwan or Hong Kong passports? This issue has loomed just be-

hind the screen in the U.S. debate over the threat from China in recent years, and the Commission should not avert its eyes. The potential for social injustice is clear.

Finally, I am sure the Commission will want to eschew exercises in wishful thinking or in symbolism.

—I would consider it wishful thinking to propose that the U.S. undertake to return China to the position of global isolation and insignificance, except as an object of others' ambitions, that it occupied throughout almost the entire U.S. national experience, from 1790 until the 1980s. The world may not know how to adjust to the presence of an economically vigorous and militarily improving China, but hoping to bring about China's return to the tea-pouring role at the councils of nations that Emerson once assigned to it is at best a chimera, and at worst a prescription for something far darker. That is my view; the Commission may agree or disagree.

—I would also suggest that "sending China a message" from Washington is an exercise in symbolism that normally proves irrelevant or counterproductive. "Sending messages to China" has a long history in Washington; the messages, by and large, go unheard, misunderstood, or unrespected. I would suggest that the Commission scrutinize very carefully any proposed policy recommendations that are built around "sending China a message;" the Commission may or may not concur.

I now turn to the specific points that the Commission's invitation asked me to discuss:

*"Whether our current trade and investment policies toward China serve the national security interests of the United States, and why or why not?"*

The answer is, by and large, yes, but of course the question is very stark and simplistic answers are of limited utility.

We believe that China's decision in 1978 to move away from Stalinist-Maoist models of development in the direction of the market economy and broad engagement with the world community is preferable, for the United States, to the orientation that obtained before 1978. We therefore believe that such basic building blocks of modern U.S.-China relations as the establishment of diplomatic relations (1979) the establishment of trade relations based on reciprocal extension of NTR (MFN), and the more recent completion of the U.S.-China Bilateral Agreement on China's WTO Accession (1999) as well as Congressional approval of Permanent Normal Trade Relations with China upon China's accession to the WTO are in the U.S. national interest. I would respectfully suggest that the broadest possible engagement of the U.S. and China is likely to prove more beneficial to the overall interests of the United States than would the attempt to design an exquisitely calibrated mixture of friendly and adversarial policies, defined through the political process, to meet an infinitely varied mix of exigencies, scenarios, reactions, and counterreactions. The United States does best, domestically and worldwide, when it pursue policies rooted in the assumptions of the market economy and the value of international communication and cooperation.

*Whether investment of American companies in China is principally designed to produce goods for sale in China or for sale in the U.S. and other markets.*

American companies invest in China for a wide variety of reasons. The growth of the Chinese economy, rise of Chinese incomes, concomitant expansion of Chinese consumer and industrial markets, and China's massive commitment to infrastructure development make China an important present and future market. As companies do in markets around the world, U.S. companies invest in China in order to succeed best in China's markets. Examples can be found in consumer products, telecommunications and information technologies, petrochemicals, agricultural and food processing, industrial inputs, autos, and other fields.

Sometimes, production in-country is tailored to specific country needs, especially in larger nations where the actual or potential market is large. Part of success in any market lies in selling products which that market wishes to acquire. Even the best pork in the world has limited prospects in Muslim countries; left-hand drive autos do not sell in Britain or Japan.

The earlier incentive to invest in China so as to gain access, through Chinese joint venture partners, to key resources allocated by central government economic plans has receded as the Chinese economy has become far more marketized and as the resources available within Chinese society have grown to meet the needs of global business.

Some foreign companies, including American ones, have committed to exporting a portion of the products of their invested enterprises as a condition for approval of their applications to invest in China, or found it necessary to export in order to

meet foreign exchange balancing requirements imposed by Chinese authorities. This has been the object of intense criticism, particularly from American groups deeply concerned about “economic disarmament” or the transfer to China of production skills that enhance China’s global economic competitiveness. At the insistence of the United States, China in its bilateral WTO accession agreement with the United States has committed to eliminating both the export requirement and the foreign exchange balancing requirements as conditions of investment.

Some companies produce subassemblies in China that return to the United States as inputs into final products produced in the U.S.

Some companies use production facilities in China as integrated elements in global production and marketing strategies, exporting a portion of their China production, for example, to Southeast Asian markets.

A high percentage of the textile, apparel, and footwear imports that enter the United States from China in large quantities are produced in plants built with Taiwanese, Korean, Japanese or Hong Kong investment.

*Reasons for the Chinese trade surplus with the U.S.; observations of any apparent differences between Sino-American trade and investment relations and those of China and other major trading partners; explanations for such differences.*

The Commission should familiarize itself with the work of Stanford University Economist Lawrence J. Lau, who has studied the U.S.-China trade deficit in great detail. Lau points out that, when appropriate adjustments are made for inconsistencies in the methods of measuring the merchandise trade deficit (U.S. exports are counted on an FAS basis, imports on a CIF basis; U.S. goods passing through Hong Kong on the way to China are counted as U.S. exports to Hong Kong, while Chinese goods passing through Hong Kong on the way to the U.S. are counted as Chinese, not Hong Kong, exports to the U.S., etc.), the actual merchandise trade deficit, while certainly large and bigger than Chinese figures would suggest, is more accurately shown to be about 30% lower than U.S. Commerce Department numbers disclose.

Economist Gary Hufbauer of the Institute of International Economics (Policy Briefing, April 2000) offers the following (excerpted) observations on the U.S.-China trade deficit:

China’s large bilateral trade surplus with the United States (correctly measured at \$43 billion, not \$68 billion) in 1999 represents neither a global pattern for China nor a net loss of production by the U.S. economy. Unlike Japan, China does not run large and chronic global surpluses. China’s bilateral surplus reflects China’s ability to compete against and win business with the United States from third countries that had been exporting to the U.S. market. China’s bilateral surplus represents a shift of suppliers rather than an overall increase in U.S. dependence on imports. . . . A larger U.S. trade deficit in manufactured goods is historically associated with higher manufacturing output, not the reverse. . . . Manufacturing output and the trade deficit both rise when the U.S. economy is doing well, and both fall when the economy is doing poorly. . . . Manufactures output increases virtually dollar for dollar with manufactures exports /in data since 1990/.../ C/ontrary to . . . mercantilist thinking . . . U.S. manufactures output is virtually unaffected by overall changes in manufactures imports. Why? Because many manufactured imports serve as inputs to U.S. manufactured goods. . . .

When the U.S. economy is exceptionally strong . . . the United States will have a larger trade deficit with the world. If the United States did not have a \$43 billion trade deficit with China, it would have a larger trade deficit with other countries, such as Mexico or Korea. Even if, contrary to evidence, the overall U.S. manufactures trade deficit was associated with lower manufactured output, the bilateral China deficit would have no independent significance.

From all of this, I would suggest the following as the key factors in the emergence and increase of the U.S.-China trade imbalance:

- The far greater size of the U.S. economy and market, including per capita income differences. (it is also notable that, given the sizeable imbalance that has existed for some years, the rate of growth of U.S. exports to China must be a substantial multiple of the rate of growth of Chinese exports to the U.S. before the absolute merchandise trade imbalance between the two countries can fall.)
- The exceptionally robust rate of U.S. economic growth throughout most of the 1990s, which occasioned a massive growth in U.S. imports from many countries;
- China’s success in displacing other developing country (and Asian) suppliers of imports to the U.S., and the repositioning of production facilities owned by Tai-



wanese, Hong Kong, Korean, Japanese, and other investors from those Asian production bases to the PRC.

—A range of Chinese trade and investment obstacles, from tariffs and non-tariff barriers to bureaucratic inefficiencies, which have long had a dragging effect on international exports to China. These barriers have been the object of American government and business concern for many years. Most were objects of successful U.S. negotiating efforts in the 1999 WTO Accession Agreement, and will be progressively reduced or eliminated following China's WTO accession.

As to the different size, content, and progression over time of China's bilateral trade balances with other major trading partners, I am not expert. Suffice it to say that in the Japanese case, factors of geographic proximity, prolonged stagnation in the Japanese economy, and relatively low levels of Japanese investment in China help to create a massive two-way trade relationship but a somewhat different profile. European Union trade with China has seen the sharp increase in the EU merchandise trade deficit with China in recent years, but again, one suspects that sluggish growth in the EU economies, the relatively low levels of Chinese trade with many EU members other than Germany, France, and Britain, and in some cases the relatively high barriers to Chinese imports erected by certain EU economies contribute to a unique Sino-European trade profile. Crude monocausal analyses of the differences between U.S.-China and Sino-European or Sino-Japanese trading patterns would be misleading.

*Whether differences are apparent in the pattern of merchandise trade between the U.S. and China, on the one hand, and China and other major trading partners on the other, and whether such differences have implications for U.S. national security.*

U.S. national security lies, in part, in successful competition by American companies in major international markets. To the extent that U.S. investment in China, directed toward the growing Chinese market, is replaced by European or Japanese investment; to the extent that the U.S. might fail to avail itself of market-opening opportunities made available to Europe and Japan as China enters the WTO; to the extent that U.S. providers of transportation equipment (including but not limited to aircraft and automobiles) telecommunications equipment, information technology products, industrial inputs, agricultural commodities, agricultural and other chemicals, financial services, distribution services, after-sales services for manufactured products, audio-visual services and other products of U.S. economic strength cede their opportunities in China to their European and Japanese competitors, the national security implications for the United States are unlikely to be positive. That is particularly true if Japanese and European corporations establish themselves as dependable, preferred, long-term suppliers to Chinese economic sectors whose development relies on twenty- or fifty-year supplier-customer relationships, such as the civil aviation sector, the energy sector, or the telecommunications sector.

*Observations on the status of China's WTO negotiations and the reasons for the delay in China's WTO entry.*

Sensitive engagements with China, whether in trade, political affairs, or military affairs, are arduous and labor intensive, sometimes excruciating. They require immense concentration and stamina on the part of skilled interlocutors from both sides who know one another well and operate in a stable environment characterized by policy continuity.

That, in turn, requires steadfastness at the political leadership level in both China and its negotiating partner nations. In a perfect world, the pursuit of complex trade agreements would be fully insulated from the storms of diplomacy or domestic politics, but this is not a perfect world.

We have learned over many years that there is no such thing as the moment when all the "political stars" are in perfect alignment for the achievement of U.S.-China agreements, commercial or otherwise. The U.S. is in nearly perpetual election mode. China is frequently adjusting to new leaders or in the throes of preparation for the anointing of new leaders. The U.S. is still going through the arrival of a new Administration and Congress; the Chinese are now said to be laying the groundwork for their next Party Congress and a wide-ranging change of both government and Party leadership. The exact effects of all this on the completion of China's WTO accession negotiations and the timing of its entry to WTO membership, if any, are not known.

The American business community, supportive of the integration of China into the system of international rules and obligations represented by the WTO, would have preferred to see China in the WTO by now. We view the remaining obstacles to final agreement in Geneva as significant to specific sectors of American business but not

insurmountable, if both the Chinese and non-Chinese negotiators receive marching orders that permit them to find appropriate compromises.

The repeated eruptions of tension between the U.S. and China cannot have made the task of negotiators from our two countries any easier. Moreover, there exists in China, a substantial body of opinion that stresses the threats of economic damage to the home country (e.g. to Chinese farmers) if China must throw open its economic doors upon entry in to WTO. Similar expressions of uneasiness have accompanied U.S. preparations for participation in numerous international or multilateral trade agreements.

While we may assume that bilateral tensions such as the 1999 bombing of the Chinese embassy in Belgrade, the spate of exacerbations of existing conflicts over Taiwan and other issues in recent months, and the recent EP-3 incident have clearly lowered the level of accumulated popular good will toward the U.S. in the Chinese reservoir, we have not concluded that China's WTO negotiations with the U.S. have been significantly delayed or altered as a result. We hope that remaining bilateral talks on WTO between the U.S. and China can be wrapped up quickly when both sides found it appropriate to conclude, and that the remainder of China's negotiations over accession with the WTO Working Party should conclude promptly. In the long run, we are not confident that U.S.-China trade agreements can be successfully consummated, and their benefits maximized, in isolation from an otherwise deteriorating and degrading U.S.-China relationship.

*China's ability to live up to the trade and investment obligations it is assuming as part of its entry into the WTO.*

It is not an exaggeration to say that China's signing on November 15, 1999 of the U.S.-China Bilateral Agreement on China's WTO Accession is the single most significant milestone in the process of Chinese economic reform since the inauguration of "Reform and Opening" in December 1978. It is also by far the most significant example of positive American influence on the course of China's domestic economic development, and, indirectly, on the evolution of the role of the state in Chinese society.

The Agreement, and the terms of the final accession documents now in the late stages of negotiation, provide for changes in Chinese commercial and legal practice that will have far reaching implications for China, for international business, and the world economy.

Some of these changes can be accomplished immediately by administrative action. China is required by its signed agreements to undertake a wide range of changes in its commercial behavior immediately upon WTO accession, while other changes must be enacted during relatively brief phase-in periods much of this will be very difficult. Perfect performance on Day 1 is almost inconceivable. Core WTO practices, such as transparency in law-making and regulation-making or providing of non-discriminatory "national treatment" to goods and services from foreign sources, will be unfamiliar and difficult to popularize at first. Vested interests in the status quo may seek to obstruct or delay the full implementation of WTO requirements. The Chinese central authorities will find very serious challenges as they attempt to educate, persuade, cajole or coerce affected parties at the provincial and local level into acting in a fully WTO-compatible manner. There will surely be numerous disputes between Chinese and foreign parties to commercial transactions on the ground in China. The judicial system remains ramshackle and understaffed with competent trade-knowledgeable personnel.

*U.S. actions if China fails to live up to its obligations.*

WTO dispute resolution mechanisms will be available to the U.S., as to all members. The U.S. also retains established instruments for the prosecution of trade disputes under U.S. law. In addition, the U.S. secured certain preferential concessions from China in the November 1999 bilateral agreement, both in the area of extended treatment of China as a non-market economy in dumping cases and in the care of safeguards on import surges in the area of textiles and apparel for a period lasting well beyond the WTO-mandated phaseout of textile quotas under the Multifiber Arrangement.

Having said that, however, there is a broad consensus among American business people that the U.S., China, and indeed the WTO itself should invest their resources and energies in what might be termed "preventive medicine," i.e., efforts to assist China in the immense process of economic and social change that will best guarantee the fullest Chinese compliance with its WTO obligations in the shortest possible time. The United States should commit public resources to this crucial effort, as other major trading nations have done. The promotion of compliance from the ground up, through monitoring and prosecution but also through close cooperation,

training, early-warning consultations, and other mechanisms, can make a signal contribution to the effective realization of U.S. national interests in China's WTO membership. Purely punitive measures, unaccompanied by efforts to build and maintain U.S.-China cooperation through both government-to-government channels and through private mechanisms, will be far less helpful to the United States.

One might note in passing that bilateral trade disputes, even in large numbers, have become a hallmark of mature international trading relationships between WTO members; the largest number of U.S. bilateral trade disputes is actually with Canada.

#### IV. CONCLUSION

Ambassador Lilley, Commissioner Mulloy: As I conclude this written testimony, let me reaffirm a few points.

1. This Commission's mandate focuses on the relationship of U.S. trade and economic engagement with China on the one hand, and U.S. national security on the other. Since in our country trade and economic activity is conducted by private bodies, mainly corporations, this Commission is legitimately interested in business, and business is legitimately interested in the work of this Commission, including any legislative or executive actions that the Commission proposes in the name of national security. Having appeared at the Commission's invitation today, I trust the Commission would agree with this view. If business is to be scrutinized with a view toward the making of policies on U.S.-China trade and economic relations in the name of national security, then, I am sure you would agree, business in the broadest sense has standing to participate in the dialogue over those policies, even if the policies are deemed to lie within the realm of "national security policy."

2. Our pluralistic society happily encompasses many social and economic interests, of which business is only one, and business itself is hardly a monolith. Our political system is also an open one. Businesses have the right to observe the activities and recommendations of this Congressionally-established Commission as closely as anyone else, and to express themselves if and when Commission recommendations become legislative proposals or administrative measures.

3. We are blessed with freedom of speech in the United States. Anyone can say, as so many have already done, that expressions of opinion on these issues by the American private sector are tantamount to "appeasement," "kowtowing to Chinese Communists," or betrayal of elemental U.S. security interests, American values, or both. American companies do not enjoy these assaults, and in general have tended to avoid responding in kind. But we have learned in recent years that there are times when trying to stay out of the line of fire provides no refuge. I believe I speak for the broad business community engaged so fully with China in expressing the fervent hope that this Commission will act to prevent its activities and the U.S. government secrets to which its twelve distinguished private citizen members will apparently have unique access from igniting yet another round of finger-pointing, name-calling, or demonization, of anyone, by anyone. Given the record of recent years, this will be a very tough challenge for the Commissioners, and we wish you every success in meeting it.

4. U.S.-PRC relations have never been static and have seldom been smooth. There have been countless irritations. In neither country do we find a massive base of vociferous public support for cooperation and cordiality between the two nations. The outward features of U.S.-China relations are pock-marked with irritations, disagreements, and conflicts. Since Tiananmen and the collapse of the Soviet Union, there have been almost no instances of durable, publicly celebrated cooperation between China and the United States. If anything, public attitudes in each country have hardened toward the other country with the passage of time.

5. That the PRC has changed and grown and in some ways become a stronger economic and military presence in the past decade is beyond doubt. Its integration into world systems, especially in trade, investment and technology, has proceeded apace. China has become a factor to be reckoned with in world affairs in ways different from any other time in modern history. In my view, neither China, with its fixation on past humiliations and victimization at the hands of the 19th-century Western industrial powers, nor the great nations of the world, who until twenty years ago had known only a China of collapsed institutions, foreign invasions, revolutionary violence, cult-driven social uprisings, and epochal natural or man-made catastrophes, knows quite how to come to terms with the reality of China's current emergence on the global stage. No one has a monopoly on the truth in all of this.

6. This dilemma is perhaps reflected in today's curious American paradox; the belief on one hand that the U.S. has focused excessively on China and should place a lower priority on dealing with the PRC (that can be called the "No more kow-

towing to Beijing” view), and on the other hand the assertion that the United States must rouse itself and mobilize its resources to deal with China as a fundamental threat to the United States—strategic, economic, ideological, cultural, “civilizational,” (a polite term for the less palatable “racial”). The dialogue over the Chinese security threat lurches and wobbles between the present tense and the conditional tense. Some policy advocates find that what China “is” has been vastly overestimated, and deserves far less American regard, but in dwelling on what China “could become,” they argue that the United States is already locked in mortal combat with China.

7. Given the long history of frictions and tensions, it would be easy—and in fact, it seems to have gotten much easier over the past six months—to conclude that the U.S.-China relationship is nothing more than the sum of accumulated irritations and conflicts. Taking that conclusion, and combining it with the worst-case approach to what China “could be,” will lead to a set of recommendations for U.S. policy, much of it unilateralist in nature, designed to prepare the people of this nation for a potentially boundless commitment of national treasure to an existential battle against China—a “clash of civilizations,” a battle against evil itself, and not just against the Chinese government of the moment.

8. There are, however, other ways to look at all of this. The extent to which the People’s Republic of China has moved in directions that Americans would normally welcome—toward the market economy, toward a vastly expanded realm of private life, toward adherence to international economic and commercial norms, toward the elaboration of a stable legal framework, away from the Stalinist command economy or the Maoist mobilizational model, and away from the state-sponsored human tragedies of the Mao era, to name just a few—is often obscured in the effort to sum up pluses and minuses and to view possibilities of China’s future. The extent to which China and the United States have drawn together in positive ways—not only commercially, but in the streams of education and scientific development and tourism and cultural exchanges and others—too often drops from view. Meanwhile, the internal stresses and fault lines which increasingly manifest themselves in China, whether acknowledged by the Chinese authorities or not, often go undiscussed in the debate over the security implications of China’s “rise.” Others have pointed out, with only small effect, that the challenges the United States and the world would face if China were to experience widespread social, environmental, or political crisis would themselves be very difficult to manage.

9. Broadly speaking, then, American businesses, who as a group have engaged more intensively with the People’s Republic of China, over a longer period, and have learned perhaps more about the ways of achieving one’s goals with China than any other sector of American life, would argue that the national interests of the United States are best served by the following:

- Energetic advancement, at the government to government level, of a positive agenda with China characterized by thorough discussion of areas of broadened cooperation and clear delineation of issues on which the two sides diverge;
- Maximization of U.S.-China interchanges outside of formal diplomacy, through broader commercial and economic engagement, continued educational and cultural cross-fertilization, and deeper people-to-people contacts in both directions;
- Establishment by the two governments of mechanisms for the orderly management of acute U.S.-China tensions, especially in their earliest hours;
- Continued integration of China into global and multilateral regimes, whose requirements China would agree to observe;
- Recognition that China is often better addressed multilaterally than unilaterally.

Thank you very much for the opportunity to meet with you today. Our Council is happy to continue a dialogue with the Commission if it chooses to engage with the U.S. business community in a spirit of cooperation and common interest in the welfare of our nation and the advancement of world peace and understanding.

(Note: Dr. Kapp’s written testimony was accompanied by reprints of several articles and essays by other observers. These materials were integral to the import of Dr. Kapp’s remarks.)

These essays and observations may be found at various web sites, as follows:

Charles William Maynes, “Contending Schools”, *The National Interest*—Spring 2001,

“<http://www.nationalinterest.org/issues/63/Maynes.html>” “American power—for what?”;

“<http://www.commentarymagazine.com/0001/symposium.html>” Living With China,

“<http://www.nationalinterest.org/issues/59/Brzezinski.html>” “Understanding the U.S.-China Balance of Trade”,

“<http://www.uschina.org/public/wto/uscbc/balanceoftrade.html>” “The Scratch Reflex”,  
 “<http://www.chinabusinessreview.com/0105/letter.html>” “Dear U.S. Presidential Candidates”,  
 “<http://www.chinabusinessreview.com/0009/letter.html>” “China’s Dialogue on the Coming of WTO”,  
 “<http://www.chinabusinessreview.com/0101/letter.html>” “The PRC at Fifty: Reflections on the United States and China”,  
 “<http://www.chinabusinessreview.com/9909/letter.html>”  
 Dr. Kapp’s written testimony was also accompanied by a list of Suggested Readings, as shown below:

## SUGGESTED READINGS

Abrams, Elliott et al. “American Power—For What?” *Commentary*, Jan. 1, 2000 (A very provocative conservative symposium.)

Barnes, Joe. “Slaying the Dragon: The New China Threat School.” In *China and Long-range Asia Energy Security: An Analysis of the Political, Economic and Technological Factors Shaping Asian Energy Markets*. James A. Baker Institute for Public Policy, Rice University. Online at <http://www.rice.edu/projects/baker/Pubs/workingpapers/claes/scd/scd.html>.

Brzezinski, Zbigniew. “Living with China.” *The National Interest*, Spring 2000.

Chao, Linda and Ramon Myers. *The Divided China Problem: Conflict Avoidance and Resolution*. Hoover Institution on War, Revolution and Peace, 2000.

Hufbauer, Gary and Daniel H. Rosen. “American Access to China’s Market: The Congressional Vote on PNTR.” *Institute of International Economics Policy Briefs*, April 2000.

Lampton, David M. *Same Bed, Different Dreams: Managing U.S.-China Relations, 1989–2000*. University of California Press, 2001. *Top Priority*.

Lasater, Martin L. *The Taiwan Conundrum in U.S. China Policy*. Westview, 2000.

National Intelligence Council and Federal Research Division of the Library of Congress. *China’s Future: Implications for U.S. Interests*. September, 1999.

Madsen, Richard. *China and the American Dream*. University of California Press, 1995.

Nathan, Andrew J. and Robert Ross. *The Great Wall and the Empty Fortress: China’s Search for Security*. W.W. Norton, 1997.

Oksenberg, Michel and Elizabeth Economy. *China Joins the World*. Council on Foreign Relations, 1999

Pollack, Jonathan D. “Chinese Military Power and American Security Interests.” *SAIS Policy Forum Series, Report Number 11*. May, 2000

Quinlan, Joseph, and Marc Chandler. “The U.S. Trade Deficit: A Dangerous Obsession.” *Foreign Affairs*, May-June 2001.

Swaine, Michael D. and Ashley J. Tellis. *Interpreting China’s Grand Strategy*. RAND, 2000.

Co-Chairman MULLOY. Thank you, Mr. Kapp.

Commissioner Wessel has indicated that he has some questions for the witness, so let me turn to him.

## PANEL I DISCUSSION AND QUESTIONS AND ANSWERS

Commissioner WESSEL. Thank you, Mr. Chairman, and thank you for all the witnesses coming today, spending your time. I know how busy you all are and we appreciate your appearance here.

First, I appreciate, Mr. Kapp, your testimony and also the suggested reading list, and would like to ask that the Commission make available to whichever Commissioners so desire copies of the readings that you’ve offered to us so that we can ensure that we get a full array of information as we move forward on our charge that Congress has put before us.

Your testimony also, Mr. Kapp, addresses as you call it, I think, the givens and you mentioned that at the beginning of your oral presentation today, that Congress has given us a fairly broad charge, and the title of the Commission, which includes the term security, is a somewhat undefined term because of the breadth of

the charge and how we move forward in the putting together our first report, the context through which we view all these issues is very important.

Mr. Benanav, you talked about the question of how this is a win-win situation and our job should be to convince the American public of that. I don't know that Congress' job is to convince the American public, but rather it is to listen to them and to listen to their concerns. When a number of members opposed PNTR last year they did so because their definition of national security is viewed through the prism of their public meetings, town hall discussions, et cetera, where the public views national security at their kitchen table. What's happening to their economic security, is their retirement security enhanced? If they're in the manufacturing field is their job security enhanced or undermined?

And as we address the givens, if you will, the questions that Mr. Kapp posed to us, I'd like the other witnesses or all three witnesses to talk about how we should integrate the way that the public views security, again often through the economic frame, with the traditional security issue which is national security in the military sense.

Mr. BENANAV. If I could answer that, it's clear that in my view the national security starts with physical security. The first duty of government is to protect its citizens from physical harm, but I think in a complex world like today it goes well beyond that. We're no longer 3 million farmers and as long as land is left alone we're okay.

We're the world's major economic power, and in addition to the physical security aspect, our ability to remain a strong, growing, solid economic power with a rising standard of living, I believe, is part of the national security interest. To be physically safe and impoverished is not what I would consider a successful national security policy. To be both safe and economically well off, with a rising standard of living, is a goal that Congress, the Administration and all of us have in common.

So I think you have to integrate economics and physical security in reaching a conclusion of how to deal with China. It would be much simpler if we cared only about physical security.

Commissioner WESSEL. Mr. Kapp?

Mr. KAPP. Well, Commissioner Wessel, I think that the national security of our country, which I appreciate your even asking us about—sometimes it is not appropriate to ask people associated with it as a community about what the definition of national security is, and I understand the impulse, but I thank you for at least inquiring.

I think it is a complex amalgam. The rising of the oceans is bad for national security too, you know. I mean, a lot of things environmentally, to take another example, affect our national security.

I wouldn't disagree for a minute with Gary Benanav that the defense of the United States against military threats is core, core elements of our definitions, but I also think that the approach to defining our national security has to—and I think most people who specialize in national securities issues accept this—has to take account of the fact that the world is not static. And to take it down to the China case, it has to take account of the fact that the China,

as I said on my testimony, the China that used to pour the tea when the great powers got together is, unless there's some sort of internal implosion, a China that we will not see again in our national lifetime, at least in our personal lifetimes.

Therefore, the national—the concept of what our national security is with regard to China has got to be one which takes into account not only a threat, of whatever definition the Commission or any individuals choose to adopt, but also the need to maximize the benefits and the advantages of a different reality, a reality in which the Chinese people in fact have disposable income in which they're becoming, although they're not quite there yet, a middle income country in which they in fact do have tremendous potential and increasingly actualized productive capacity which may change the equation of global resource uses and global economic distribution.

Somehow the definition of national security has got to grapple not just with the concept that this China which seems, at least for the most moment, more or less staggeringly to have gotten its act together after 150 years of dissolution, is partly a challenge and partly an opportunity for us.

Commissioner WESSEL. Mr. Trumka?

Mr. TRUMKA. Thank you, Commissioner.

First of all, when you consider national security I would urge this Commission to look beyond just a relationship between the U.S. and China, and I would urge you to consider this. Consider what affect China's unfair trade advantage, gained through violation of worker rights and human rights and forced labor and child labor, threatens to destabilize other countries in the region. Countries like Korea, who immediately after PNTR was voted on voiced the following concern: How do multinational corporations are only turning China into a low wage production base. How can Korea, with its high wage structure, compete with China?

So consider that advantage and how the affect it has on other countries, countries like Cambodia and even Mexico, who are now losing manufacturing facilities in the Mequilladera area to China because of this unfair advantage.

I would agree that you should look at the physical security when talking about security, as well as the economic security. Physically if you look at our trade picture with China that's the trade deficit that we run. I wish it were this way, but it's this way, and the question is each year with this deficit you continue to put billions of dollars into the hands of this government and what do they do with it. I mean, that's a decision that we have to make.

Now, do we suggest for those who would misconstrue what I'm saying that we don't have trade? No. Again, it's how do we do it and how do we manage it better so that we can protect ourselves both physically and economically.

Now, economically my testimony goes through a number of things. We assume frequently that just having businesses there, American businesses will raise the wages and have this wonderful treatment. There are three or four examples in my testimony about workers making Kathy Lee handbags for Wal-Mart or people work 12 to 14 hours a day, seven days a week, one day off a month. Yet after months of work 46 percent of the workers actually owed the

company money, and then whenever the workers protested those conditions about 800 were fired.

Nike workers who done the same thing, make 8 cents an hour—the New Balance sneakers, they were fired. And I think the thing that bothers me the most about the economic security is the American Chamber of Commerce in China actually advised the Chinese government to cut labor costs because the high labor cost has already discouraged some potential investors.

So the notion of trade with China can be a good thing, but not if it's unfettered laissez faire, and American corporations, if not pressed, if not bridled, and if not made to live by a code of conduct, won't and this is classic examples of how they sink to the lowest common denominator and the Chinese government actually helps them.

So when you think of security think about the destabilizing affect of all the countries and the advantage they get from these type of conduct whenever you come up with recommendations.

Co-Chairman MULLOY. Now, we're going to turn to Ambassador Lilley.

Co-Chairman LILLEY. I have one question for each of our speakers. I think you contributed a great deal to our knowledge.

Mr. Trumka, you imply that you would like to see a linkage between trade and human rights in China. You are, of course, aware we tried this in 1992 and '93, '94 and it was a disaster. We had to back off, put seven conditions on China, public conditions, and it didn't work. They say once bitten twice shy.

And I would say the other thing that we did, we were absolutely isolated in the world. Nobody supported us. They felt we were out of our minds.

I lay that before you because I think if we don't understand history we're going to make the same mistakes again. I think this was a mistake.

Mr. TRUMKA. First of all, it is good to know history, but frequently whenever something happens you don't have to vacillate 180 degrees in the opposite direction and pretend like because something wasn't perfect that you totally abandon it and never go back to revisiting it.

If you look at the European Union they are putting conditions on trade that they're doing with China. They're managing their trade with China a whole lot better than we are. They don't have deficits, they have surpluses. They don't assume that things are going to happen, and they would join us, I believe, in pressing for human rights and pressing for worker rights protections, and actually pressing their corporations. I advocate pressing U.S. corporations that go there to help us change these conditions as well and to link them together. Yes.

Co-Chairman LILLEY. My question for Mr. Benanav. You are quoted as saying in November 1999 to WTO, that 1 percent of China's insurance market would double New York Life volume.

Mr. BENANAV. Correct.

Co-Chairman LILLEY. This sounds a little bit like an old statement about Manchester Mills running forever by adding two inches on each Chinese pair of pants.



This is not reflected in Charlene Barshefsky's testimony on the insurance business. Would you indicate why you think this is going to be such a boom? I'm not sure AIG has achieved that level of doubling their volume on the basis of their sales in China.

Mr. BENANAV. Well, they certainly haven't in the short time they've been there. If you look at the proclivity of the Chinese population to save, the average Chinese family saves about  $\frac{1}{3}$  of its income. The average American family, if we're lucky, saves 5 percent of their income. Many of them actually don't save anything; they have negative savings.

So the Chinese population, while much, much less wealthy than the American population, tucks away a lot of money in banks and literally in mattresses. If the middle class in China grows, as we believe it will grow, there's a huge pool of savings. It's not going to happen in five years. It's going to happen over a period of 20 years, but the accumulated capital, accumulated personal savings of the Chinese population can become quite enormous and life insurance, as we see through our sales in the U.S. to Chinese families, life insurance is a very, very useful tool for them to save.

I'd like to also just give you a little answer to your first question. We agree that the United States should continue to press China—Chinese entities to move ahead with human rights and to move ahead with worker rights. So there is no disagreement, I believe, at this end of the table. The only question is how. The Chinese are very proud people and you can get a lot more done sometimes on sensitive issues by pressing in the back room than having them lose face in the front room.

Time and time we've learned that you will get a lot more accomplished by pressing—and the Administration needs to do it, many organizations of government and business should do that. The pressure has to be brought in the right way.

I don't think American businesses need to be pressed. I think American—95 percent of businesses operating in China have the kind of values that you'd like to see us have. Sometimes subcontractors and organizations that are not under the direct control of U.S. businesses do engage in activities that none of us like, but I think 99 percent of American businesses behave the way you'd like to see them behave, and Chinese workers are aware of the behavior standards of American firms, and they flock to work for American organizations for that reason. Their friends find out what's going on with American standards, and it will take time, but they too will require those kinds of conditions.

Co-Chairman LILLEY. Well, you're preaching to the choir on why diplomacy is a more effective way of getting things done.

My old friend, Dr. Bob Kapp, is always stretching our minds with these intellectual challenges, but don't you think that in your reading list that you could probably benefit by the works of Michael Pillsbury on Chinese views of warfare or Mark Stokes on Chinese technical acquisitions rather than relying on Owen Harries and Bob Ross and Andy Nathan? I think you need some balance in there.

Mr. KAPP. Well, Ambassador, as I said, one of the reasons that I put in the ones I did was that I felt they represented that very balance, and I have not a doubt in the world that this Commission

will be made well aware of the writings of a great many people that I didn't put on this list, including those you mention.

I don't myself have a complete take on the way in which you interpret everything that needs to be properly interpreted. The question of how one interprets what one reads is very much a part of this whole issue. Certainly, if the Commission wants to read the works that Mr. Pillsbury has published in the sense that he's translating writings of Chinese military figures as to their calculi of the future possibilities of conflict with the United States and other military conflicts in the world, it's out there for all of us to see.

Commissioner Mulloy, just let me say on the matter of the Europeans, I'm not a European trade specialist. I simply tried to call up a few items online. My understanding is that the Europeans are running a significant and growing trade deficit with China. Senator Sarbanes, I believe it was, said earlier that they're not running a surplus.

At the same time, if you read the rhetoric from the EU at least, the rhetoric is all the rhetoric of engagement, assistance in training, and investment in bringing China more and more rapidly into the full mainstream of economy, accepted commercial, and other practices.

Co-Chairman MULLOY. Thank you, Dr. Kapp.

I remember Senator Sarbanes' testimony was in the context of overall trade between Europe and the Chinese, that they were—Europe was running a deficit. It wasn't nearly as large as the deficit of America and they actually have more exports to China than we do, in the total context.

If I could call on Chairman D'Amato.

Chairman D'AMATO. Thank you, Chairman Mulloy.

First of all I want to commend the witnesses for their testimony. I had the opportunity to read the testimony carefully. I was impressed with the thought, the effort that went into all the testimony.

Mr. Trumka, I thought you T'd up a lot of issues that are really critical to this Commission's mandate. It provides kind of a menu of things that we need to be looking into.

And, Mr. Kapp, I thought your testimony was very thoughtful. You're obviously a real student of this relationship, and you talk about the need to maintain a dialogue with us. We'd like to do that with your group. We think that what you do is important. I was afraid that by the time I got to the end of your readings that we would end up with a very long pop quiz, and then we'd have to put off this hearing until we got the answers to you. But in any case, we want to thank you for that.

You know, we talked about history here. I can remember, Mr. Trumka, that many years ago when I was working for a senator who has since died, retired and died—Senator Abe Ribicoff. And we worked together, closely together with other senators like Scoop Jackson and the Administration in those days, and we put terrific pressure regularly on the Soviet regime on human rights, and we used our economic influence on that government all the time to try and bring about the kinds of things that you mention, to bring leverage to try and change their behavior.

We didn't change the Russian regime, but I can remember going to the Airport and picking up Mr. Sharanski and that guy came out of there as a result of the pressure of this body, this government on the Russian government, and he would have remained in prison and died in prison had we not exercised that leverage.

So I read history a little bit differently. I think that we made some differences. Maybe you call it out on the margin, but they were important differences for the world. We held ourselves out to use that leverage and we were successful in many respects. I can remember when Solzhenitsyn came out. I was involved with helping him relocate in Vermont. We worked with his wife to bring Sharanski out and others, and this man had been in prison in Russia more than 40 times. We escorted him to Senator Ribicoff's office and we put him in a chair so that he could see all the doors from that chair. Here's a guy who had been beaten up, and the kind of experiences he had was a reminder to us of what we stood for.

So I have a question in this respect, and that is who in the world has been using any kind of leverage on the Chinese regime in this area of human rights, which is every bit as egregious as what the Russians did to their people? And if it's not going to be us is it going to be anybody else, and are we abandoning that? Do we want to abandon that kind of pressure, to use economic pressure, as you point out in your testimony, to try to build a model or move the Chinese a little bit in the direction of the values that we care about, at least make it clear to them that we really care about those values?

I think that's—it's not meant as a criticism of anybody. It's a question I have. I'd actually like to ask Mr. Kapp, how do you feel about that? You're a student of this stuff. Is it we can only bring about limited change, but is it worth trying and is there a message out there when we don't try?

Mr. KAPP. Well, your last subclause is a very important one about life in general. Sometimes the things you don't talk about turn out to be more important because you didn't talk about them, and we in the business community have been trying to say that to our friends in the business community as they meet with people in public service these days. This is a time when the U.S.-China relationship is in a very parlous condition; it's gone through another series of jolts. We've been saying it's important that we remind our public service friends that the stability of this relationship is important, because if we don't say it out loud it's possible that people will say we don't care. So I think on the matter of human rights you've raised an important question at the very end there.

You know, one of the dangers in all of these superheated discussions on China is that if one says something that coincides with something the Chinese; one is labeled as their spokesperson and in fact as their lackey. That leaves one with a certain degree of diffidence. But let me just say that the economic and material well being of the populace is not a small matter when it comes to definitions of human rights for the Chinese people, and I don't think you have to be a spokesman for Beijing or a lackey of Beijing to point out that these have improved significantly; few people would doubt it. Admittedly, here are growing disparities of wealth and income become the coastal areas and the poorer interior and so forth.

Second of all, I go back to testimony I offered to the House as the Ways and Means Subcommittee years ago. I'm not a fan on "sending messages". I even put that in my testimony here. I hope that didn't seem impolite or disrespectful to the Commission. I think "sending messages", to the extent that it proves that you've sent a message, is not particularly productive and that, in fact, with China, as perhaps with other countries, it is sometimes unproductive. Just to say, "We told them how the cow ate the cabbage," and report back to your colleagues that you've done your work, I think, does not serve.

So then the question is what really makes a difference? I tried to say years ago in testimony it is not a moral achievement to take an action in the name of morality if you don't take into account the consequences of the action. The case in point was cutting off MFN in the name of human rights, back in the days when NPR was called MFN. If you cut off MFN in the name of human rights or in the name of religion, which was the issue in 1997, and you then discover that in fact the practitioners of their faith are labeled as pawns of a hostile United States, because the United States cut off China's ability to reach U.S. markets in their name and suffer the consequences, to me you have not taken a moral action.

I don't mean to sound like I'm simply equivocating here, but I do think you have to be sure that the actions you are going to take really are going to make a difference.

Now, there are moments—there is room for symbolism sometimes. But I come back to comments that a Chinese dissident made on the Web last year in the weeks before the May 2000 House vote on PNTR. He pointed out there's a sort of game that the Americans and the Chinese play. He put his view very crudely. He argued that the PRC regime is like a robber in the night. It seizes people and throws them in jail. The Americans get all upset. There's a big negotiation, the public is furious. They let a few people out. The Americans claim victory. And the system doesn't change.

These were the views of a man who spent years and years in China's "Laogai", or labor camps. He's testified before Congress about his experiences.

His point was that the real answer to these egregious human rights conditions that I think few of us would for a minute deny, lies in long-term systemic change, which is in fact best served by the raising of economic standards and the full integration of China into systems designed by the world to which China must submit.

Now, he was talking in the context of PNTR. But what I'm trying to say is that I'm not sure that punitive actions by the United States, especially if they're unilateral and the Europeans and the Japanese and others do not join in the punitive sanctions are the most effective way of trying to achieve these goals that I suspect everybody in this room would share.

Co-Chairman MULLOY. Now we turn to Commissioner Robinson.

Commissioner ROBINSON. Yes. Thank you, Mr. Chairman. I have just a couple of quick questions for Mr. Trumka.

First, Mr. Trumka, the AFL-CIO and I think you personally, were actively involved in opposing the initial public offering of stock of Petrochina last year, which as you know was ultimately downsized from an originally targeted amount of some \$10 billion

to \$2.89 billion. I was wondering if you could share the view and position of the AFL-CIO to the likely prospect that in the next few years scores, if not hundreds, of Chinese state-owned enterprises will be seeking to come to the U.S. stock and bond markets to raise billions of dollars. Do you have a view on that likelihood?

Mr. TRUMKA. Yes, I do. First of all, I'd also like to note for the record the assistance and the working relationship that we had, yourself included, in the IPO.

I would start off by saying that the IPO in the United States was represented by Goldman Sachs, and Goldman Sachs' initial advice to the Chinese government was that people will invest in your oil not in your people. So they separated into two corporations, their assets and their people. Had that IPO been totally successful it would have resulted in the layoff of approximately 1 million Chinese workers. We obviously thought that was wrong from many, many different levels.

Then we did a straight economic analysis of the deal itself, and when you read the very, very fine print in the back of it you were—investors were being asked to buy a 5 percent share in the government owned oil company, and you had virtually no rights because shareholders' rights in China are nonexistent. And in fact, there was a little paragraph that was tucked in page whatever, whatever that said we will probably never achieve our business plan because political politics in this country will forbid us from letting that happen.

We thought it was a bad deal for investors. We thought it was a very bad deal for people, and we organized roughly a little over 2 trillion dollars in money to say no to that IPO. They had planned 124 other IPOs, I believe it was, at that time that were scheduled to come down the pike. Their lack of success or overall lack of success with the Petrochina deal dissuaded them. I don't think it eliminated the threat, it just slowed it down. I think they're regrouping and I think you'll see them come back in a year or so with another IPO and try to come at it with a different point of view.

Commissioner ROBINSON. Was it the first time that the AFL-CIO had ever sought to leverage the U.S. capital markets to advance your organization's objectives? I mean, it's my recollection that that was the first time that AFL-CIO had ever engaged in that area.

Mr. TRUMKA. The only thing that I would correct is that it wasn't the AFL-CIO's objectives; it was shareholder objectives. It was the first time that we took the lead in speaking out on behalf of shareholders saying this is a bad deal from any point of view.

This company invests in Tibet. There were Tibetan monks that came and talked about how they were tortured with electrical devices. This monk pulled out an electric shocking device that he was tortured with. The money would have been used for that, and so it was our thought that we should not be using workers pension money in that type of an investment, an investment that ultimately, as I said earlier, would have resulted in the layoff of 1 million Chinese workers.

Commissioner ROBINSON. And one final question.

Are you familiar with the new SEC disclosure requirements that were made public in a correspondence of May 8th of this year from Acting SEC Chairman Laura Unger to Representative Frank Wolf?

Mr. TRUMKA. Yes.

Commissioner ROBINSON. Does AFL-CIO support those new disclosure requirements that pertain to foreign registrants in our markets doing business with U.S. sanctioned countries?

Mr. TRUMKA. Yes. We think it's a step in the right direction, although I point out one thing that's just come to surface, one way those rules can be circumvented. One of the public funds, trust funds wrote to a company by the name of Armana-Hess, who has a subsidiary—well, I should say they're a 25 percent owner in an oil company called Premier. Premier does significant business in Burma. They were pressed on the issue and Armana-Hess' response was, one, we have instructed Premier that none of our money that we invest in them can be used in Burma; and two, the two directors that we have are instructed never to speak of or participate in any issues of the company dealing with Burma.

Now, that will be their response to avoid the disclosure because the rules, I don't think, address that, and if anybody believes those are true I have ocean front property in southwestern Pennsylvania I'll sell you at an easy price.

Commissioner ROBINSON. Thank you, sir.

Co-Chairman MULLOY. Thank you. Commissioner Becker.

Commissioner BECKER. Thank you, Mr. Chairman.

I have a couple of questions that would perhaps follow-up questions on what's already been covered to Mr. Trumka, although I would certainly welcome comments from Mr. Kapp and from Mr. Benanav on the same subject.

In your written testimony you make reference to the fact of the almost inevitability of China's accession to the WTO and PNTR and comment about how our options here in the United States deal with some of the problems that you've raised, some of the questions that we've talked about here concerning human rights and repressed labor rights, to deal with those subjects.

Would you have any suggestions that you could offer yourself as to how we could strengthen things in the United States in order to deal with issues like human rights and the repressed labor as a comparative advantage against workers here in the United States? And I have a follow-up question if time permits.

Mr. TRUMKA. Many of the rules that the Chairman talked about or many of the tools that we had back then have been eliminated. WTO prevents—doesn't cover forced labor. WTO doesn't go after child labor, but what we can do, I think, and what we should be doing as I said earlier, is one, pressing the Chinese government; and two, pressing American corporations.

Now, we don't know exactly what percentage of their world market we are. It's between 25 and 50 percent. I refuse to believe that with that kind of economic power that there aren't leverage points that we can't find that force them to move. And forcing corporations, pressing corporations because as I told you, the American Chamber of Commerce in China asked the Chinese government, told them to lower wages because it's dissuading investment there. That's not the direction to go.

Now, in addition to those things we can pressure both of them through public hearings like this one, like consumer educational campaigns, and even some trade actions. And things that I think

we should consider is we can bring a Section 301 Trade Act of '74, 301, a case against China for their unfair trade practices, including the egregious violation of workers' rights.

Now, I don't know whether this will withstand a WTO challenge or not, but it's worth trying because it at least brings attention to the area that we're in. And even under WTO rules we have the right to restrict the import of goods produced by prison labor. Now, they're refusing to let us monitor those goods. We should be pushing them to absolutely open up and say we have a right under these rules that we've already negotiated to monitor them. Let us monitor them. Let us find out.

Just last year it was found out that a U.S. company was importing—you know those little black paper clips with the silver thing that they get wider and everything? Well, those were being contracted out to a prison facility.

We have to aggressively monitor the situation and then use all the trade remedies at our disposal to address it effectively.

And, Mr. Chairman, in response to both your questions, a point that you raised. If not the U.S. government who? If not the U.S. government nobody, because there's an inherent contradiction with American corporations. When they're on the ground in China and they have a chance to lower wages what will they do? They'll ask people to raise wages? They've never done that in the United States. I mean, there is an inherent contradiction and we confuse the difference between the freedom of multinationals to do business with the freedom of people in China to get democracy and do business. And we have to press them and press the Chinese government to continue to make those changes. Unions are still illegal in China.

Mr. BENANAV. Can I give you a reply? I think the question was if not the U.S. government who. I think there's a very good answer for that. If not the U.S. government, the Chinese people. I do believe that the government has a role to play here, as I said before, in quiet diplomacy, but I think that broad-based human right advancement, labor right advancement will come because the Chinese people ultimately demand it.

I've been going to China since 1983, and I'm not sitting here telling you things are wonderful in every respect. But if you look at China in a historical context, the progress that has been made from the time that I've been going there to today is really quite dramatic. Is it where we'd like it to be? No. Will it go further? I think it will. And as the Chinese people, as the middle class rises, as the education level rises, as they're exposed to American values and Western values the Chinese people will start to demand the kind of rights that we want.

If we look at our own history in the United States we didn't achieve this level of human rights and labor rights in a five-year or a ten-year period. It took us 200 years to get to this point, and for us to expect the Chinese to reach the same level when we snap our fingers is unrealistic. Greater pressure will come from the Chinese people. Not to say that we don't have a role to play in it, but our biggest contribution can be the assistance to the Chinese people to raise their middle class and their education levels.

Commissioner BECKER. It would appear, that the only defense that we would have in the United States then, would be our trade laws, and either enforcement of trade laws or improving the trade laws in order to deal with what is obviously a comparative advantage waiting for this 20 or 30 years for the Chinese to evolve up to a level. Is that not correct?

Mr. BENANAV. We, the business industry, will be very aggressive in making sure that whatever laws and commitments are made are followed by the Chinese, that they live up to their commitments and we will want to see that. But our greatest weapon—and I think this was true in the Soviet Union and Eastern Europe. Our greatest weapon is education. When a population becomes educated and understands our values that's a much more effective weapon than an occasional action in front of the WTO.

If you really want broad gauged advancement in human rights and labor rights, we have to capture their hearts, the hearts and minds of the middle class. We did that very successfully, I think, in Eastern Europe and even the Soviet Union, and the walls came down not because we forced them down, because the people did, and that's what we need to do here.

Co-Chairman MULLOY. Commissioner Becker, if we can move to the next questioner. Let me point out that if any witness feels that there are additional points that he wishes to make and you don't have time to do it now, please at the end of the panel, if we have additional time to do that, or you can send them in writing. But we've got to give each Commissioner his opportunity.

Commissioner Bryen.

Commissioner BRYEN. Thank you, Mr. Chairman.

My questions are for Mr. Benanav and Mr. Kapp. They're easy questions, I think.

In your presentation this morning, which was very interesting, neither of you talked about the trade deficit. This morning when we had the senators present, they talked a lot about the trade deficit, and it seems there's growing concern about it, that it's getting worse and worse.

My first question is about the trade deficit. If this relationship with China is such a great thing how come we're taking it on the chin in terms of the overall trade relationship?

Mr. BENANAV. Well, one of the reasons why I think PNTR makes great sense and having China come into the WTO makes great sense is that the other half of the trade deficit, our ability to export is significantly enhanced. China's had NTR status for over 20 years. We have been foreclosed from many of the Chinese markets while NTR was available for them to import. By getting them into the WTO and by getting them to sign the agreement the ability of American firms to export to China will be significantly enhanced. Agriculture, financial services, even many manufactured goods that could not be imported into China will now be available for imports into China.

So I see PNTR and WTO accession as a help to the trade deficit. Certainly not a harm because the Chinese a year ago had the same rights to import that they will have a year from now. They don't get any additional rights to bring their goods into the U.S. after WTO than they had before WTO.



The only tool we really had, if you wanted to fix the trade deficit with China quickly, was to not renew their trade status, their NTR status. That is such an—that's like dropping an atomic bomb in economic terms, and we didn't do that even in the year of Tiananmen Square. So I consider that a totally unrealistic weapon to use against the trade deficit.

Commissioner BRYEN. Mr. Kapp?

Mr. KAPP. Well, in my written testimony I spoke to it and I included some materials both by me and by our counsel and also by a gentleman who wrote an article in the Foreign Affairs on the subject.

Commissioner BRYEN. In your spoken testimony you didn't.

Mr. KAPP. We have a big merchandise trade deficit with China. It's growing. It's not as big as it's said to be for important reasons that are not trivial with regard to how you count the deficit.

There are issues of substitution of production. Taiwanese investment—Taiwanese exports to the mainland since 1992 have risen 401,000 percent, according to Taiwan statistics. It is, I think, a small reflection of the fact that Taiwan, Korea, Hong Kong, and other nations that used to send experts straight to the United States are investing in production on the mainland for that purpose.

Commissioner BRYEN. Oh, I understand that. I'm trying to get to a different bullet.

Mr. KAPP. I'm sorry.

Commissioner BRYEN. Which is—

Mr. KAPP. And you know that China's merchandise trade worldwide is nearly balanced. You know that the United States has a \$5 billion surplus on the services account. None of these eliminates the fact that there's a big deficit, and we also know that even with the market break throughs that we've worked so hard to achieve through negotiation and look forward to realizing, U.S. exports to China would have to grow five times as fast as U.S. imports from China in order to even start reducing the trade deficit. So there's a structural issue there which is very serious.

Commissioner BRYEN. That works against us.

Mr. KAPP. Well, it certainly means that the trade deficit is—the merchandise trade deficit is not going to come down overnight.

But on the question of why we are “taking it on the chin”, to use your words, some people would argue that taking it on the chin is not a complete description of the reality here. This will not be accepted by everybody on the panel, but some people would argue that the presence of low-cost Chinese manufacturing and the exporting of low-cost goods to American markets helps keep consumer prices and cost of living increases down in the U.S.

Commissioner BRYEN. Some people would argue that if we don't export, our economy suffers a great deal.

Mr. KAPP. Absolutely right. That's why we fought so hard in the WTO.

Commissioner BRYEN. Exactly. Countries like Japan—and that was my second question—do considerably better than we do with a profile that's not terribly different than ours. They do considerably better than we do in terms of exports to China. Why?

Mr. KAPP. I'm surprised it's taken us so long in this hearing to get me to the point of saying I'm not sure, because I certainly have felt that from the minute I walked in the door. I really don't have a full answer to whether or not it is a function of government dominated decisions, which are getting fewer and fewer by the day I might say, to prefer imports from one country over those from another; whether it's a function of particular kinds of Japanese products that compete successfully against American products; or whether the Japanese are in some cases selling into China products, for example, for TB tube manufacture or other things that they've invested in which we no longer sell at all.

I can certainly do my best to come up with a better answer than that.

Commissioner BRYEN. I would like you to do that, because it seems to me that there's such a big disparity, so significant, and we seem to be getting a greater trade deficit. We're not making any improvement. So I'd like to see what you come up with.

Mr. KAPP. Mr. Chairman, if I can take just one more second with Commissioner Bryen.

Many people would argue instantly on the question of the disparity between Japanese imports and exports; imports from, exports to China. Many people just snap their fingers and say oh of course, the reason is that the Japanese let fewer Chinese goods into Japan. It's not necessarily a question only of the Japanese having greater success in Chinese markets than Americans, but also that they may be having a better success in keeping Chinese products out.

Mr. BENANAV. I think part of the answer is the Japanese firms have been at this a lot longer. They work much harder at export businesses than American firms. American firms have the luxury of having a huge domestic market and many of them just don't—have not seen China as a place where they can make a lot of money, and I think as American firms become better at exporting and learning how to do business in a very difficult place you'll see our exports rise. The Japanese have invested 50 years in this.

Commissioner BRYEN. But right now we're not. I mean, right now we're seeing the reverse so that where we're at now the trend is negative. Japan has \$34 billion worth of exports to China compared to our, 16.1. That's a big difference and the base here is quite different, so it's very worrisome that all the celebration of the trade relationship that we hear, on the other hand the performance isn't there, and that's the point I wanted to get at.

Co-Chairman MULLOY. Mr. Trumka, you wanted to add something?

Mr. TRUMKA. I really do, because I think some of the answer to your question, Commissioner, was contained in the Wall Street Journal the day after the PNTR vote, and some of what I believe is a difference in philosophy and approach. The Wall Street Journal said the day after PNTR this deal is about investment, not exports.

U.S. foreign investment is about to overtake U.S. exports as the primary means by which U.S. companies deliver goods to China, and here's a list of companies that have closed down production facilities and have gone to China. Zebco, Innovative Home Products, New Coat, LaCrosse Footwear, it goes on.

The difference is China is that they're going to produce at home and send a product. Our philosophy is to shut down at home and send a factory, and the more factories we send the worse the deficit is going to get.

Two experts haven't told you, haven't given you a glimmer of hope about that deficit reducing in the foreseeable future, and it's going to grow. It's a difference in philosophy; move a factory, not a product.

Co-Chairman MULLOY. Okay. Let me just—Mr. Kapp, you offered to help us in terms of analyzing that. And part of our statute is to analyze that point, so if you could help us with relation to China's trade surplus with Europe and Japan that would be enormously useful to us.

Commissioner REINSCH.

Commissioner REINSCH. Thank you very much.

This is an interesting panel. You've just laid out the dilemma that the policy makers have. Everybody wants to get to the same place but you have very different ways to get there. I think it's helpful for you to lay that out.

I just have a couple questions that I think will help me just aggregate some things and understand some of the points you're making better, and my first question is for Mr. Trumka.

If the Chinese did all the things we want them to do in the human rights, worker rights area, the various things you identified—and I think it was clear on the panel that everybody is in favor of correcting those things—how much difference would it make in the bilateral trade deficit?

Mr. TRUMKA. A significant difference because while there would be less of an incentive you wouldn't be able to pay 8 cents an hour to produce Nike bags and backpacks. You'd produce them at a higher rate, there would be less incentive to go there. We'd send the product over there rather than the factory.

Commissioner REINSCH. Can you—not necessarily now, but can you later on quantify for us what you think the net effect on the deficit would be and submit some data?

Mr. TRUMKA. With assumptions, sure.

Commissioner REINSCH. Yes.

Mr. TRUMKA. Absolutely.

Commissioner REINSCH. Mr. Kapp, do you agree with Mr. Trumka's position?

Mr. KAPP. Well, I would say first of all that I tried to suggest in my testimony that American companies invest in China for many reasons; one of which is the emergence of a very large and rapidly growing Chinese market. In many, many other countries around the world, American and Japanese and European firms invest in the country where the market is for reasons of better effectiveness in addressing that market.

So I think it is important for the panel to keep in mind the fact that corporate decisions on where to invest and what to make when you do invest, and whether to do a joint venture or a wholly owned and so forth are not unidimensional decisions.

On the matter of the 8 cent labor, I understand that the minimum wage in China is now 200 RNB a month by national law, and if you calculate that out at some reasonable level or hours or

even more if it's an unreasonable level of hours, the number gets down to a very low per hour unit of compensation.

It would be worth the panel's asking, however as it looks at the endeavors in which U.S. companies do commit investment in China, whether those endeavors are the 8 cent an hour endeavors. The nearest you will come, I believe, is probably going to be textiles and apparel or possibly textiles, apparel and shoes.

But American companies are not investing, in shoe factories and textile plants. Some U.S. firms arrange for such production through, as you know, doing it through sub-contractors and so on. But if you look at where American companies are themselves investing in China I think you're going to discover that they're not investing in the kinds of production that utilizes that lowest of the low end of Chinese labor.

Are they going to China only for the labor costs? Some may, but a lot do not. I think everybody understands, again, that there is a mix of reasons that international investors and put money into other countries, whether it be China or India.

That leads me to the last point on this, and that is I do think it's important for this panel, as it asks itself these China questions, to ask whether they are China-focused questions or generic questions. If you're talking here about broad issues of capital flows in the world, or broad issues that involve developing countries, or broad issues of countries that pay workers less than they might receive in the developed industrial states of Western Europe and the United States, then it's important not to come up with conclusions speaking only of China that are misdirected simply because China is the mandate of the Commission even though the real issue is actually a much broader subject.

Commissioner REINSCH. Actually I'm glad you made that point, because it seems to me that the Chinese are pursuing a set of economic strategies that are not unique to them, either historically or right now, and which in some respects are wise for them. They are not necessarily wise for us, which I think a lot of you have made clear. But it would be nice to sort out what is unique about China as opposed to what is the same about China and what a lot of other countries are doing. As someone who was a veteran, as were Mr. Trumka's predecessors and Mr. Becker's predecessors of the trade wars with Japan in the '80s when an awful lot of things were said, some of them the same that are being said today, although that's not a problem that we seem to be worried about as much today as we were then despite the size of the deficit. It seems to me the Chinese are doing a number of things. As far as their economic development is concerned it's pretty much the same as what the Japanese did, albeit not with respect to the points that Mr. Trumka made.

And that's why I asked my first question, to try to sort out the differences here and figure out what we need to do to attack the question that the senators raised, which was the deficit. Mr. Trumka feels if we attack some of these moral issues, for lack of a better term, that that will get us there, and I was trying to get a sense of what you feel.

Not unrelated to that, Mr. Benanav, you made a comment, which I agree with about the extent to which Americans present in China

uphold higher standards of behavior, if you will, and I accept that comment. I haven't heard other people refute it, although I think Mr. Kapp's comments about the contractors are well taken and bear separate investigation. But in that case, with respect to direct involvement, would you object to a code of conduct, the Sullivan Principles, if you will, for corporations operating in China?

Mr. BENANAV. For American firms doing business there?

Commissioner REINSCH. American firms with respect to their behavior.

Mr. BENANAV. I honestly don't feel one is necessary, because I think that American firms by and large—as I said, 99 percent of them adhere to those principles anyway. I think the more we add bureaucratic requirements, reporting requirements for a purpose that's not really going to be very valuable because it's already being done, it's not a very good idea. I just don't see that American businesses go into China the way Mr. Trumka sees just to take advantage of the 8-cent an hour labor. I think they treat their workers pretty well, and I don't think the Sullivan Principle will add anything.

Commissioner REINSCH. I assume, Mr. Trumka, that while you would say that such a code would probably be a good thing, you would also say it's not enough; is that right?

Mr. TRUMKA. I would say that because it would have no teeth, although the reporting—if there were significant reporting requirements that could be an interesting thing to allow us to know. And I point out to my colleague to my right that if he thinks everything is hunky-dory with American corporations going over there I'll give him the White Paper that the American Chamber of Commerce gave to China and they advised the Chinese government to cut labor costs because high labor costs had already discouraged some potential investors.

Now, that wasn't some Mickey Mouse contractor. That was the American Chamber of Commerce advocating cutting a woefully inadequate pay grade in that country, and if that's the American value that the Chinese worker's going to learn, I submit to you that it will have an adverse affect on the best interest of this country.

Commissioner REINSCH. Mr. Trumka, one more thing quickly.

You said in your testimony that the United States has lost 675,000 manufacturing jobs since last July, I believe it was. I assume you're not blaming all that on China?

Mr. TRUMKA. No, I'm not, although the significant number of jobs were in electronics and one other market, and those are both areas that Chinese investment in China has been the highest in. We're doing circuit boards over there. We're doing computers over there. We're doing refrigerators, things of that sort from the big corporations. No, I don't suggest that all 675,000 manufacturing jobs were lost there. I suggest a number and a growing number has been lost there.

Commissioner REINSCH. Thank you. My time is up. I invite the panel to submit for the record any comments you might want to make on one other subject, who is the extent exchange rates, affect the bilateral deficit.

Co-Chairman MULLOY. Mr. Trumka, there is one additional thing before we turn to Commissioner Dreyer.

That list that you gave of companies that moved?

Mr. TRUMKA. Yes.

Co-Chairman MULLOY. It would be very helpful to have that submitted to the Commission for the record just in case there was a desire to follow-up and get the thinking of what went on there.

Mr. TRUMKA. Very good.

Co-Chairman MULLOY. Thank you. Commissioner Dreyer?

Mr. TRUMKA. Mr. Chairman, excuse me. Would you like a more expansive list?

Co-Chairman MULLOY. Yes. That would be great. Thank you, Mr. Trumka.

Commissioner DREYER. I have a question for each of the panelists. For Mr. Benanav, to lead off, you mentioned that China has not yet developed the range of institutions that will enable it to meet its WTO obligations, and I wonder if you are not concerned that allowing China into WTO before it has developed these institutions is going to remove a key incentive for China to actually develop these institutions. You quote Commissioner Waldron as saying that these institutions are getting more shaky rather than more stable, and that's certainly a concern I have, that if you let the Chinese into the WTO too soon they feel they're home free and they don't need to conform to certain things because they've already got the membership.

And finally, as a follow-on for that, are you not concerned that if your insurance company goes in there, and you mentioned the demonstration effect that you hope will take place, that the demonstration effect in fact is that you are training your Chinese competition and you're going to lose out on market share?

Mr. BENANAV. The first question, yes, we are concerned that the institutions are not as solid as they ought to be. We have a classic chicken and egg problem here. The advantage of getting them into the WTO is once they're in there is an enforcement mechanism. Today there is no enforcement mechanism. If they arbitrarily apply some kind of rule and do things in a non-transparent way all you can do is ask the Ambassador to intercede on your behalf. There is no way to enforce a set of rules.

Once they're in the WTO, as imperfect as it will be, as painful as it will be, as long as it will be, there is an enforcement mechanism and when that enforcement mechanism starts to take affect, as the learning starts to take affect, we believe that the institutions will be built up.

I've personally offered to send 250,000 American lawyers if they'll take them to help them with the institutions.

Commissioner DREYER. We can spare them.

Mr. BENANAV. That was my point. But it is not going to be easy. We're not kidding ourselves, but we believe this is the best way to get those institutions up and running.

In terms of your second question, are we training our competition, the answer is absolutely, definitely yes, we are. We believe that the Chinese local institutions will learn, and they already have learned an awful lot about how to compete in our businesses. We would certainly love to dominate the market but we know we can't. The reality is the more the competition exists and the more

that competition succeeds the more we're going to see the insurance market opened up.

As I said earlier, the potential for the market is huge, but it's going to take competition to open that market up. The state-owned monopoly that had that ability for years and years and couldn't really take advantage of it was because they didn't know how to compete. Today that state-owned monopoly has got a lot of competition, it's learning new tricks, the whole industry is going to open up.

This is not a question of a limited pie where we're fighting for a piece of that sized pie. That pie has great potential to grow and competition is what's going to make that pie grow.

Commissioner DREYER. So you feel that a sufficient number of Chinese are going to decide that New York Life is the company they keep?

Mr. BENANAV. That's right. Thank you for the advertisement.

Commissioner DREYER. I watch TV.

Question for Mr. Trumka, and actually this is in two parts too. I ask this as the daughter of two blue collar workers. Are you not concerned that there is no real growth potential for the American working class? In other words, the inexorability of jobs being exported means that we are going to find that U.S. workers have to be retrained to do something else, which may not be what they wanted to do, and that this is kind of King Canute trying to hold back the tide to try to institute measures to prevent this.

And second, you mention the need to press China on certain issues, and I wonder listening to that how you would respond to Dr. Kapp's observation that in pressing China we are often just making a statement to make a statement and it ends up being counterproductive. In other words, let us say that a Lech Walesa arises in China, and of course what the Chinese government's first reaction is going to be is to put him in jail for something or other.

Mr. TRUMKA. They already have.

Commissioner DREYER. They already have, yes. Good point. And although nobody quite as famous as Lech Walesa—

Mr. TRUMKA. Because they gave him—

Commissioner DREYER. They nip it in the bud.

Mr. TRUMKA. It's tough to get famous overnight.

Commissioner DREYER. Yes. And it kind of limits one's ability to get famous. We protest and then the Chinese government says this is interference in their sovereign affairs, and then what have we really gained?

Mr. TRUMKA. Well, he may be right. If we continue to give away, continue to give away every single tool other than lip service to that, and the more we give away through trade agreements the less power you have, the less tools you have available to you.

Now, look, they can't have it both ways. You heard my colleague to my right say that we really favor quiet diplomacy when it comes to workers' rights and human rights, but boy, we want them in the WTO so we can pillar and post them publicly through the WTO mechanisms whenever it deals with investor rights or intellectual property rights. Those two things are sort of inconsistent. If it's quiet diplomacy for workers' rights and human rights why not quiet diplomacy for business rights?

If it's public adversarial proceeding for business and intellectual property rights, why not for worker and human rights? That inconsistency needs to be pointed out.

Your second thing—your first question, actually. I answered them in reverse order. Does it concern me that all of our manufacturing jobs, that many of them are getting sent overseas or away from us? Yes, it does. It concerns me dramatically because those jobs have really built the middle class. Those jobs have really been good in supporting families. Those manufacturing jobs have made America great, and the loss of those jobs has had a devastating affect on places where I came from, places in Appalachia, places throughout the United States where manufacturing was a tremendous opportunity, and it need not be that way. There isn't an either or.

Commissioner DREYER. So it's not an inevitability?

Mr. TRUMKA. No, it isn't. I mean, if you look at—look at Japan. Look at the European nation, what they've been doing. They have not said in order to compete in the world we have to jettison manufacturing. They figure out a way to either specialize that manufacturing, modernize that manufacturing, make it more efficient or provide workers facilities with greater training and uplifting. That's what we should be doing. That's our strength.

Now, if we continue to give away tool after tool after tool, all you will have left is cajoling. I understand one thing, and I don't claim to be an expert about China, but I understand one thing. They understand strength and they understand weakness, and their culture causes them to interpret things as weakness and interpret things as strengths. We are better off dealing with them through strength than through weakness.

Co-Chairman MULLOY. We have to move on. Commissioner Lewis, please.

Commissioner LEWIS. Thank you very much for the three of your presentations. They were really very instructive and informative.

I'd like to ask each of you, particularly Mr. Kapp and Mr. Benanav, would you be willing to make a critique of Mr. Trumka's presentation today. He gave us a five-page presentation in which he said things in his presentation like—and I guess these facts are not disputable, but maybe you would dispute them.

Our own State Department reports that human rights have deteriorated. He said that independent trade unions are illegal. He said that export jobs generate—exports generate new jobs, imports often displace jobs. He said that the deal is about investment, not exports. He said that the investment overseas is a race to the bottom, and he said that the denial of workers' rights in China is a standard that is deteriorating in the working conditions, and he quotes the Korean Times article.

Would you be willing to critique what he wrote to us?

Mr. KAPP. I would.

Commissioner LEWIS. I would appreciate it if you would do that.

I would also appreciate it if you would give us a critique of their presentations.

Mr. BENANAV. You're not talking about right now, though. You're talking about submitting.

Commissioner LEWIS. Oh, no. Yes.



Mr. BENANAV. Sure.

Commissioner LEWIS. I'm going to ask each of you some questions, and I want some really short answers because I have a bunch of questions and I only have seven minutes.

Mr. Trumka, you quoted the Chamber of Commerce. Could you give us a copy of that, the source of that?

Mr. TRUMKA. Yes.

Commissioner LEWIS. Okay. Number two, I don't know that this is a fact, but if in fact we knew that there's a struggle going on in the Chinese leadership and that the moderates in China want us to joint—want China to join the WTO for the purposes of leading China into the world and the hard liners there don't want them to join the WTO and the moderates seem to be winning out, and if in fact we reject their joining the WTO it would really give much more credence to the hardliners and to the military, would that change your view about China joining the WTO?

Mr. TRUMKA. I think that's an inevitability. They're going to joint the WTO.

Commissioner LEWIS. But would that change your view about whether they should be allowed in?

Mr. TRUMKA. It would depend on the cost for us, I guess. The short-term and the long-term cost for us. If we are to give the moderates—

Commissioner LEWIS. If we knew that the joining—

Mr. TRUMKA. —short term but put us at a long-term disadvantage I would say look long term rather than short term.

Commissioner LEWIS. But if we knew. Talking about Mr. Kapp's definition of national interest. If we knew that their joining the WTO would strengthen the moderates, would that change your view?

Mr. TRUMKA. It may.

Commissioner LEWIS. Okay. Thank you.

I'd like to ask Mr. Kapp a question. You've mentioned national security, and I think it was really very instructive how do you define national security, and the question became—the facts came out that our manufacturing base is deteriorating. Many thousands of companies are moving, and that wages in America, until the last two or three years of the Clinton Administration, actually deteriorated for 80 percent of Americans. Is that in the national security—does that help our national security?

Mr. KAPP. I would say that the long-term deterioration of real wages does not help the national security.

Commissioner LEWIS. Okay. Thank you.

Mr. Benanav, you mentioned in page 4 an open economic system—and I think your presentations were really excellent, all three presentations.

“Open economic systems do not in and of themselves overtly lead to open political systems, but I do believe that without an open economic system there can be no hope of developing an open political system.”

Mr. BENANAV. That's right.

Commissioner LEWIS. That may very well be. I wonder, switch and say do you believe that a non-democratic regime can have a labor union movement? In other words, isn't that equally true of

labor union movements, that there can't be a labor union movement in an autocratic regime, that you need a democracy to have it?

Mr. BENANAV. No. I don't agree with that.

Commissioner LEWIS. Can you give me an example of where there's been a free labor movement in a non-democratic system?

Mr. BENANAV. I guess I have to do a little research on that.

Commissioner LEWIS. Would you please?

Mr. BENANAV. Yes.

Commissioner LEWIS. Because I think the labor movements are like the canary in the mine shaft, and where you have a free labor movement I think you have a democratic system.

Mr. BENANAV. I'm not an expert in European history, but my recollection is that under the regime that prevailed in the 1930s in Germany there were labor unions.

Commissioner LEWIS. Was it a free labor movement? You see, what I'm getting at is Korea as an example. I was first in Korea in 1963. I was first in China in 1979. The Korean labor movement is a strong labor movement, and therefore there's a strong middle class in Korea, so they're buying our goods. If you don't have a strong middle class the country can't buy our goods.

Mr. BENANAV. I agree with that.

Commissioner LEWIS. Okay. So that's why I think labor movements help build middle classes, but I'd like an example from you if you can give me one.

Yes, Mr. Kapp?

Mr. KAPP. Commissioner Lewis, on the matter of whether declining real wages are in the interest of national security, the only thing to add to that this is connected to productivity too. Real wages are not just a function of how much the person takes home and puts in the bank every week.

Commissioner LEWIS. I understand that. It has to do with the standard of living. I understand that, yes.

I want to ask one last question. On the military build up that the Chinese are now undergoing, with the \$85 billion surplus that they're running with us and tapping into our capital markets, do you believe, as has come out in some of the prior facts, that we are helping with their military build up with this great surplus they're running with us?

Mr. BENANAV. I think the Chinese military build up is completely independent. If they want to build up their military they can do so whether or not we have this huge deficit with them. I think it's more a matter of their national interest rather than how much money they have. They have the complete ability to channel money into private sector, military sector, and they will do as they please regardless of the size of the deficit.

Mr. TRUMKA. I think that the money that we give them absolutely gives them the opportunity to do more in that build up than they would without it. If they were running a deficit to us that would be \$85 billion that wasn't available for military build up that was coming to us.

The other thing that I might ask the Commission to look at is the Chinese government—the Chinese military has its own companies that do business right here in the United States under the

name of Narencio. They make a profit everyday off of Americans and they send that directly back to the military.

Mr. KAPP. Let me just urge the Commission to not to enter into this subject without some very well-informed thinking. The assumption that every dollar in hard currency that is earned by Chinese companies goes into some sort of a pot which is managed by the seven men on the Standing Committee of the Politbureau and thenceforth doled, out to the PLA or the Ministry of National Defense of the Central Military Commission, is misguided and hopelessly polemical; simply won't stand up.

Do not, without doing your own serious research yourselves, accept the casual claim that if there's a \$50 billion deficit, or whatever the number is, between the United States and China, that's 50 billion that goes right up to Jiang Zemin and his six colleagues, and straight over to the Central Military Commission. And that once it gets over to the Central Military Commission, it's all used for things other than barracks and food and uniforms and so forth and so on.

There are many, many, many nuances in here, about which a Commission like this has got to inform itself albeit not in this session, if it is to speak with authority. Once again: the research is available; I urge you to read it.

Commissioner LEWIS. I want to thank the three of you again for your very thoughtful presentations and if, in critiquing Mr. Trumka's presentation, if you want to also take a look at Kevin Kearns and critique that also, I welcome that also.

Co-Chairman MULLOY. Well, thank you, Fellow Commissioners, for being so cooperative in the time frame we've stayed within and I want to thank this panel very much. I'm going to refrain—you know, I'm the only one who didn't ask questions. I'll refrain from doing that because both of our next witnesses are here and we don't want to delay them. If it would be feasible, I would submit those questions to you for the record, and if you could give us responses.

And finally, I want to offer again the opportunity, if there are additional things that you want to do to add to the comments you've made, please feel free to do so and they will be included in the record of the Commission. But thank each of you for being here today and for your help.

We have on our second panel the Honorable Charlene Barshefsky, the former U.S. Trade Representative who negotiated the November 1999 Bilateral Market Access Agreement with China that prepared the way for China's entry into the World Trade Organization which my understanding this could happen as late as later this year. I'm going to assume it's later this year. I think that would be the hope of the Chinese to get in before the next WTO meeting, general meeting, which could be in November.

In addition to Ambassador Barshefsky, we are very fortunate to have with us Admiral Joseph W. Prueher, who was our Ambassador to China from December 1999 to May of this year and he did a great job during that difficult period with the plane. Previously, the Admiral served as Commander and Chief of the U.S. Pacific Command, so he brings in expertise on China and on national secu-

rity matters that we very much welcome. If I could first call on Ambassador Barshefsky.

PANEL II: CHINA PNTR AND WTO ISSUES

**STATEMENT OF AMBASSADOR CHARLENE BARSHEFSKY, VISITING  
PUBLIC POLICY SCHOLAR, THE WOODROW WILSON CENTER,  
AND FORMER U.S. TRADE REPRESENTATIVE**

Ambassador BARSHEFSKY. Thank you very much. It's a great pleasure to be here and it's particularly a pleasure to be here with Joe Prueher, who did a brilliant job as our Ambassador, not only with respect to national security issues, but with respect to the issues with which I was most familiar and that is trade.

Let me begin by saying that as you know, in November of 1999 after years of negotiation, the U.S. and China reached a bilateral agreement on China's WTO accession. The agreement secures broad range and comprehensive one-way trade concessions on China's part, granting the U.S. substantially greater market access across the spectrum of industrial goods, services and agriculture. This agreement strengthens our guarantees of fair trade and it gives the U.S. far greater ability to enforce China's trade commitments.

By contrast, the U.S. agreed only to maintain the market access policies we already apply to China and have for over 20 years, by making China's normal trade relations status permanent. China's WTO accession is a clear economic win for the United States. Together with permanent NTR, it will help to open the world's largest market to our goods, farm products and services in a way we have not seen in the modern era. But China's accession also has deeper implications. Our relationship with China, given her size and economic weight, affects all of America's foreign policy and security goals in Asia from broad strategic interests to regional issues in Korea, Southeast Asia and elsewhere; human rights and religious freedom; weapons proliferation, environmental issues; labor rights; crime; narcotics trafficking and many others.

We have serious differences with China on a number of these issues and we have found areas of common ground as well. We have a fundamental responsibility, I believe, to help develop a stable, mutually beneficial relationship in which we act upon areas of shared benefit and mutual interest while we also make clear our areas of disagreement and aggressively assert our rights and positions.

WTO accession will form a key foundation of our relationship with China and will help promote longstanding American goals in China. First, by helping to open and liberalize China's economy, accession will, over time, help to create new economic freedoms for Chinese citizens and promote the rule of law in many fields now dominated by state power and control. A number of leading Chinese and Hong Kong advocates of democracy have endorsed WTO membership not only for its economic value but as a foundation for broader future reform. And second, by integrating China more firmly into the Pacific and world economies, WTO accession will give China a greater stake in regional stability and prosperity. It will, thus, together with our military presence in the Asia Pacific

and our regional alliances, be a factor in favor of long term regional peace.

Let me take a moment, if I could, and put China's accession in its historic context. The WTO that China now seeks to join had its roots in the GATT, the General Agreement on Tariffs and Trade. Its creation in 1948 reflected the personal experience of President Truman and his European counterparts in economic depression and war. They had seen the Smoot-Haley Act in America and similar protectionist policies overseas, deeper in the depression and contribute to the political upheavals of the 1930's.

Post-war, they believed that by reopening world markets, they could promote growth and raise living standards and that, in tandem with a strong and confident security policy as open markets gave nations greater stakes in peace and stability and prosperity beyond their borders, a fragile peace would strengthen. The work they began has continued for over 50 years and the faith they've placed in open markets and the rule of law has been abundantly vindicated.

Through eight rounds of global negotiations and as 112 new members joined the 23 founders of the GATT, we abandoned the closed markets of the depression era and helped to foster a 50-year economic boom. China was a founding member of the GATT, one of the original 23 countries, but with the Communist revolution in 1949, China embarked on a different course. Among its new leader's first steps were to expel foreign businesses from China and bar direct economic contact between Chinese citizens and the outside world.

Inside China were similar policies, including the destruction of private internal trading networks, abolition of private property, abolition of land ownership and of course, the suppression of the right to object to any of these policy changes. One cannot separate post-war China's deepening isolation from the outside world from its steadily increasing internal repression and diminishing space for individual life and freedom.

Likewise, China's economic isolation had severe consequences for regional peace and stability. Asia's largest nation had little stake and prosperity and stability—indeed, saw advantage in warfare and revolution—beyond its borders. Every Pacific nation felt the consequences not only in economics and trade but in peace and security. China's domestic reforms since 1978 have helped to undo this isolation integrating China into the Pacific regional economy as they opened opportunities for Chinese at home. The results have been profoundly positive.

As China's people regained the right to farm their own land, open businesses, choose their own places of employment, they have found new opportunities, both to raise living standards and determine their own futures. At the same time, China has moved gradually from a revolutionary role in the Asia Pacific region to a willingness to play a positive and stabilizing role on issues as varied as maintaining the peace on the Korean peninsula and the Asian financial crisis.

A bipartisan American trade policy over the past 30 years has contributed to these positive trends. Broadly speaking, U.S. goals have been to support Chinese domestic economic reform and inte-

grate China into the Pacific regional economy through a variety of means including commercial trade agreements. This has extended from a lifting of the trade embargo in 1972 by President Nixon to our Bilateral Commercial Agreement in 1980 under President Jimmy Carter, to agreements in the 80's and to a series of agreements in the Clinton years on intellectual property rights protection, textiles and agriculture.

Taken as a whole, this work has helped to open the Chinese economy, created a new series of opportunities for Americans, and given the Chinese public a broader array of contacts with the outside world than at any time since the late 1940's. But this work is only partly done. China's trade barriers remain very high. A number of policies dating from the 1950's are still unchanged and China's integration with the world economy remains insecure. Like Japan, China's neighbors remain blocked from an economy which could be an engine of growth for the region.

WTO accession represents a potentially profound and historic opportunity building upon but going much farther than China's domestic reforms to date. As it joins the WTO, China will do much more than simply reduce trade barriers at the border. In much broader terms, for the first time since the 1940's China will permit foreigners and Chinese businesses to import and export freely into and out of China. China will reduce and in some cases remove entirely state control over internal distribution of goods and the provision of services. For the first time since the 1940s, China will enable foreign businesses to participate in information industries such as telecom, including the Internet. And China will subject its decisions in all areas covered by the WTO to enforcement, including informal dispute settlement and trade sanctions, if necessary.

These commitments are a remarkable victory for economic reformers in China: moving China away from a number of policies dating from the Cultural Revolution and Great Leap Forward. Its WTO accession will go further, helping to reform policies dating to the earliest years of the Communist era, including absolute government control over economic contacts with foreigners, nationalization of major industries and destruction of private local commerce within China.

All together this will, over time, give China's people more access to information. It will help to weaken the ability of hardliners in China to isolate China's public from outside influences and ideas. More deeply, WTO accession reflects a judgment, though one not universally shared among China's leadership, that prosperity, security and international respect will not come from the static nationalism, state power and state control over the economy that China adopted after the war. Rather, China is more likely to gain these from greater integration with the world, rising economic freedom at home and ultimately, development of a rule of law. These are concepts inherent in the initiative President Truman began in 1948 with the founding of the GATT.

Accession, because it has a potential beyond economics toward the development of the rule of law, is supported by many Hong Kong and Chinese activists for democracy and human rights. Whether Martin Lee, the leader of Hong Kong's democratic party, or Ren Wandong, the founder of China's modern human rights

movement—all have viewed WTO accession as China's most important step toward internal reform in 20 years. It is why the Clinton Administration's support for China, and why I believe the Bush Administration's support for China's WTO accession, rests on a broader, long-term commitment to human rights and freedoms as well as new opportunities and strengthened guarantees of fairness for Americans.

And with that, I'll be pleased to stop.  
[The statement follows:]

PREPARED STATEMENT OF AMBASSADOR CHARLENE BARSHEFSKY

Thank you for this opportunity to testify on one of the most important American trade and foreign policy goals in many years, and that is China's integration into the global rules-based trading system.

*China's Trade Concessions and Broader Strategic Goals*

In November of 1999, after years of negotiation, the U.S. and China reached a bilateral agreement in China's WTO accession. It secures broad-ranging, comprehensive, one-way trade concessions on China's part, granting the United States substantially greater market access across the spectrum of industrial goods, services, and agriculture. This agreement strengthens our guarantees of fair trade, and it gives the U.S. far greater ability to enforce Chinese trade commitments. By contrast, the U.S. agreed only to maintain the market access policies we already apply to China, and have for over twenty years, by making China's Normal Trade Relations status permanent.

China's WTO accession is a clear economic win for the United States. Together with permanent NTR, it will open the world's largest nation to our goods, farm products and services in a way we have not seen in the modern era.

But China's WTO accession also has deeper implications. Our relationship with China, given China's size and economic weight, affects all of America's foreign policy and security goals in Asia: from broad strategic interests to regional issues in Korea, Southeast Asia and elsewhere; human rights and religious freedom; weapons proliferation; environmental issues; labor rights; crime and narcotics trafficking; and many others. We have serious differences with China in a number of these issues, and have found areas of common ground as well. And we have a fundamental responsibility to develop a stable, mutually beneficial relationship in which we act upon areas of shared benefit and mutual interest. WTO accession will allow us to do so, as it complements and supports long-standing American goals in China policy:

—By helping to open and liberalize China's economy, WTO accession will help to create new economic freedoms for Chinese citizens and promote the rule of law in many fields now dominated by state power and control. A number of leading Chinese and Hong Kong advocates of democracy endorse WTO membership not only for its economic value, but as a foundation for broader future reforms.

—By integrating China more firmly into the Pacific and world economies, WTO accession will give China a greater stake in regional stability and prosperity. It will thus, together with our military presence in the Asia-Pacific and out regional alliances, be a factor in favor of long-term regional peace.

*America and the Trading System*

Let me begin my detailed review by putting the WTO accession in its historic context.

The World Trade Organization China now seeks to join has its roots in the General Agreement on Trade and Tariffs, or GATT. Its creation in 1948 reflected the personal experience of President Truman and his European counterparts in Depression and War. They had seen the Smoot-Hawley Act in America and similar protectionist policies overseas deepen the Depression and contribute to the political upheavals of the 1930s. Fifteen years later, they believed that by reopening world markets they could promote growth and raise living standards; and that, in tandem with a strong and confident security policy, as open markets gave nations greater stakes in stability and prosperity beyond their borders, a fragile peace would strengthen.

The work they began has now continued for over fifty years, and the faith they placed in open markets and the rule of law has been abundantly vindicated. Through eight Rounds of negotiations, and as 112 new members joined the 23 founders of the GATT, we abandoned the closed markets of the Depression era and

helped to foster a fifty-year economic boom. America, as the world's largest exporter, benefits perhaps most of all: the efficiency of our industries and the high living standards of our families reflect both the gains we receive from open markets abroad, and the benefits of our own open-market policies at home.

But the development of the trading system has had equally important effects worldwide. As it has developed over the past fifty years, the world economy has grown six-fold; per capita income nearly tripled; and hundreds of millions of families escaped from poverty. And perhaps the best testimony to this success is that many of the new applicants to join the WTO are nations which are abandoning the postwar experiment in communist central planning.

*China's Road: From Revolution to Reform*

And that brings me to China.

With the Communist revolution, China set out upon a very different road than the one President Truman and his colleagues had charted. After 1949, it shut doors it had once opened to the world. Among its new leaders' first steps were to expel foreign businesses from China and bar direct economic contact between Chinese citizens and the outside world. Inside China were similar policies: destruction of private internal trading networks linking Chinese cities and villages, abolition of private property and land ownership, and of course suppression of the right to object to these policies.

In essence, one cannot separate postwar China's deepening isolation from the outside world from its steadily increasing internal repression and diminishing space for individual life and freedom. Likewise, China's economic isolation had severe consequences for regional peace and stability: Asia's largest nation had little stake in prosperity and stability—in fact, saw advantage in warfare and revolution—beyond its borders. Every Pacific nation felt the consequences not only in economics and trade but in peace and security.

China's domestic reforms since 1978 have helped to undo this isolation, integrating China into the Pacific regional economy as they opened opportunities for Chinese at home. The results have been profoundly positive: as China's people regained the right to farm their own land, open businesses and choose their own places of employment, they have found new opportunities both to raise their living standards and determine their own futures. At the same time, China has moved gradually from a revolutionary role in the region to a willingness to play a positive and stabilizing role on issues as various as the maintenance of peace on the Korean peninsula and the Asian financial crisis.

A bipartisan American trade policy over the past thirty years has contributed to these positive trends. Broadly speaking, U.S. goals have been to support Chinese domestic economic reform, integrate China into the Pacific regional economy, through a variety of means including commercially meaningful agreements that open opportunities for Americans. This has extended from the lifting of the trade embargo in 1972, to our Bilateral Commercial Agreement in 1980, trade agreements in the 1980s; and to a series of more recent agreements including:

—*Intellectual Property.*—In the early 1990's, China's failure to protect intellectual property rights was one of the most problematic aspects in the trading relationship. Piracy of films, software, CDs, and other intellectual property works cost U.S. industry hundreds of millions of dollars and led to trade confrontations with China, including invocation of sanctions on two occasions. The United States ultimately negotiated agreements in 1992 and 1995, and then won further commitments in 1996 that led China to pass world-class copyright, patent and trademark laws; close the vast majority of pirate production facilities, cease the export of pirated products and significantly improve enforcement—the principal focus of the agreements.

—*Textiles.*—Likewise, textile transshipment and market access barriers have historically been a problem in our textile trade relationship with China. While problems remain, two separate agreements, in 1994 and 1997, combined with sustained enforcement efforts by the U.S. Customs Service and the Administration, as well as imposition of triple charge penalties, have helped to mitigate these problems. The 1997 agreement, in fact, committed China for the first time to significantly reduce its textile restrictions.

—*Agriculture.*—Most recently, the Agreement on Agricultural Cooperation in April of 1999 lifted long-standing bans on exports of American citrus, meats and Pacific Northwest wheat, imposed due to unscientific sanitary and phytosanitary measures. As in the cases of intellectual property and textiles, frequent consultations with implementing the agreement is key.

Taken as a whole, this work has helped to open Chinese economy; created a series of new opportunities for Americans; and given the Chinese public a much broader



array of contact with the outside world than at any time since the late 1940s. But the work is only partly done. China's trade barriers remain very high; a number of policies dating from the 1950s are still unchanged; and China's integration with the world economy remains insecure. Likewise, China's neighbors remain blocked from an economy which—like Japan's—could be an engine of growth. One index of this is our substantial trade deficit with China. Another is that since we extended Normal Trade Relations (formerly MFN status) to China in 1980, our exports to China have grown by only \$10 billion, a figure significantly less than our total growth to most other major trading partners in Europe, North American and East Asia.

WTO accession thus represents a potentially profound and historic shift, building upon but going much further than China's domestic reforms to date. As it joins the WTO, China will do much more than reduce trade barriers at the border. For the first time since the 1940s it will:

- Permit foreigners and Chinese businesses to import and freely into China;
- Reduce, and in some cases remove entirely, state control over internal distribution of goods and the provision of services
- able foreign businesses to participate in information industries such as telecommunications including the Internet; and
- Subject its decisions in all areas covered by the WTO to enforcement, including through formal dispute settlement when necessary.

These commitments are a remarkable victory for economic reformers in China. China's domestic reforms have moved away from a number of policies from the era of the Cultural Revolution and Great Leap Forward. Its WTO accession will go further, helping to reform policies dating to the earliest years of the communist era: absolute government control over economic contact with foreigners, nationalization of major industries, and destruction of private local commerce with China.

Altogether, this will give China's people more access to information and weaken the ability of hardliners in government to isolate China's public from outside influences and ideas. More deeply, it reflects a judgment—although one still not universally shared within China or its leadership—that prosperity, security, and international respect will not come from the static nationalism state power and state control over the economy China adopted after the war. Rather, China is more likely to gain these from the greater integration with the world, rising economic freedom at home, and ultimately development of the rule of law inherent in the initiative President Truman began in 1948 with the founding of the GATT.

WTO accession, therefore, has potential beyond economics and trade: as a means to advance the rule of law in China, and a precedent for willingness to accept international standards of behavior in other fields. That is why many Hong Kong and Chinese activists for democracy and human rights—Martin Lee, the leader of Hong Kong's Democracy Party; Ren Wanding, a dissident who spent years of his life in prison—have viewed WTO accession as China's most important step toward reform in twenty years. And it is why U.S. support for WTO accession rests on a broader long-term commitment to human rights and freedoms, as well as new opportunities and strengthened guarantees of fairness for Americans.

#### *WTO Accession and American Trade Interests*

It also, of course, represents the achievement of specific American economic interests. While China's principle concern is the potential of WTO accession to create jobs and foster sustainable growth through economic reform, the Clinton Administration sought commercially meaningful and enforceable commitments that help Americans on the farm and on the job export to China, by addressing the many layers of trade barriers and policies which limit access.

The bilateral WTO agreement builds upon and consolidates reforms obtained in all our previous negotiations, and reflects our experience with the enforcement of those agreements. Clearly, to win its full benefits, the U.S. must be vigilant in monitoring and enforcing compliance. And the bilateral agreement gives the U.S. all the tools necessary to do so. Thus, in all respects, this bilateral agreement meets the high standards that President Clinton set.

##### *1. Overview*

First, the bilateral agreement is *comprehensive*. It will reduce Chinese trade barriers across the range of goods, services and agricultural products; eliminate or sharply reduce restrictions on freedom to import and distribute goods within China; address industrial policies intended to draw jobs and technology to China; and strengthen our guarantees of fair trade practices.

Second, it is fully *enforceable*. China's commitments in all areas are specific and include timetables and final dates for full implementation. These commitments are

enforceable through our trade laws, WTO dispute settlement and other special mechanisms including periodic multilateral review of China—implementation and compliance. These will, of course, require vigilance and constant commitment to enforcement by the United States as well as by China's other trading partners in the WTO. The U.S. must be committed to vigorous monitoring and enforcement.

And third, its results will be *rapid*. On accession to the WTO, China will begin opening its market from day one in virtually every sector. The phase-in of further concessions is limited to five years in almost all cases, and in many cases one to three years.

Let me now offer some of the details in each major sector.

## 2. Industry

In industrial goods, China will cut tariffs from an average of 24.6% in 1997 to 9.4% by 2005 and bind them at these new, lower levels. It will eliminate quotas and other numerical restrictions. And it will allow American firms to import and distribute their products freely in China. This is essential, as American companies, farmers and workers need the ability to import, export and distribute goods in China to compete effectively—rights currently denied but which will be permitted under the agreement, allowing our businesses to export to China from here at home, and to have their own distribution networks in China, rather than being forced to set up factories there to sell products through Chinese partners. Some highlights include:

*Trading Rights.*—China will grant American companies, over a three-year phase-in period, rights to import and export most products without Chinese middlemen. Currently, the right to engage in trade (importing and exporting) is strictly limited; only companies that receive specific authorization or who import goods to be used in production have such rights. This limits not only the ability of U.S. companies to do business in China, but in particular has limited U.S. exports.

*Distribution.*—As in the case of trading rights, the right to distribute products is critical to our ability to export successfully to China. After accession, China will allow American firms to market, wholesale, retail, repair and transport their products—whether produced in China or imported. At present, China generally prohibits companies from distributing imported products or providing related distribution services such as repair and maintenance services. China will permit enterprises to engage in the full range of distribution services over a three-year period for almost all products.

*Tariffs.*—China will make substantial tariff cuts on accession with further cuts phased in, two thirds of which will be completed in three years and almost all of which will be completed within five years. On U.S. priority industrial items, tariffs will drop on average to 7.1%—a figure comparable to those of most major U.S. trading partners. As in agriculture, China will bind tariffs at these low levels. Some specific examples include:

*Information Technology Agreement.*—China will participate in the Information Technology Agreement (ITA), eliminating all tariffs on such information products as semiconductors, telecommunications equipment, computer and computer equipment and other items by 2003 in most cases and 2005 in a few others.

*Autos.*—China will reduce tariffs on autos from rates of 80%–100% today to 25% in 2006, and on auto parts to an average of 10% from an average of over 23%.

*Wood and Paper Products.*—China will reduce high tariffs on wood and paper to levels generally between 5% and 7.5%. As noted below, China will also implement any sectoral APEC Accelerated Tariff Liberalization initiative adopted by the WTO in this sector.

*Chemicals.*—China will commit to the cast bulk of chemical harmonizations, reducing tariffs from present rates between 10%–35% to an average rate of 6.9%. These reductions include reductions on all priority U.S. Chemical exports.

*Furniture.*—China will reduce its current average tariff rate of 22% to 0% on all furniture items covered by the Uruguay Round sectoral initiative, by 2005.

*Accelerated Tariff Liberalization.*—China has agreed to implement the Accelerated Tariff Liberalization initiative of APEC when WTO consensus is achieved in the context of a new global Round of trade negotiations. This would eliminate tariffs on forest products, environmental goods and services, energy and energy equipment, fish, toys, gems and jewelry, medical equipment and scientific instruments, and also includes chemical harmonization.

*Non-Tariff Barriers.*—China will eliminate all quotas and other quantitative measures upon accession for top U.S. priorities including certain fertilizers and fiber-optic cable by 2002, and by 2005 in all cases.

### 3. Agriculture

In agriculture, China will make substantial reductions in tariffs both on accession to the WTO and over time. It will adopt tariff-rate quotas that provide significant market access for bulk commodities of special importance to American farmers. It will agree to apply science-based sanitary and phytosanitary standards including in grains, meats and fruits. And it will eliminate export subsidies. Notable achievements here include:

*Tariffs.*—China's agricultural tariffs will fall from 31% to 14% for our priority items. All cuts occur over a maximum of four years, and will be bound at the applied levels. To cite a few examples:

[In percent]

	Current Level	Under the Agreement
Beef .....	45	12
Citrus .....	40	12
Apples .....	30	10
Cheese .....	50	12
Wine .....	65	20
Beer .....	70	0

*TRQs.*—China will liberalize its purchase of bulk agriculture commodities like wheat, corn, rice, cotton, and so on, through tariff-rate quotas—that is, very low tariffs (1% for bulk commodities) on a set volume of commodities. This portion of the agreement includes provisions to maximize the likelihood that these TRQs are filled. In particular, a portion of each TRQ is reserved for importation through private traders, and TRQs which have not been filled will be redistributed to other end-users with an interest in importing on a first-come, first-served basis. Some salient examples include:

	1998 Total Imports	Initial	TRQ	2004 TRQ	Private Share
Cotton .....		200,000 mt	743,000 mt	894,000 mt	67%
Wheat .....		2,000,000 mt	7,300,000 mt	9,636,000 mt	10%
Corn .....		250,000 mt	4,500,000 mt	7,200,000 mt	25% grows to 40%
Rice .....		250,000 mt	2,660,000 mt	5,320,000 mt	.....
Short/med grain .....		1,330,000 mt	2,660,000 mt		50%
Long grain .....		1,330,000 mt	2,660,000 mt		10%

*Export Subsidies.*—China will eliminate agricultural export subsidies. This is an important achievement in its own right, and a step toward the U.S. goal of totally eliminating export subsidies worldwide.

*Domestic Support.*—China has committed to cap and reduce trade-distorting domestic subsidies. China also committed to provide greater transparency to make its domestic support measures more predictable.

*Sanitary and Phytosanitary Standards.*—China will agree to apply sanitary and phytosanitary standards based on science. Among other things, this will give the U.S. additional means of enforcing the Agreement on Agricultural Cooperation and its commitment to lift longstanding bans on American meats, citrus fruit and Pacific Northwest wheat.

### 4. Services

In services, China will open markets across the spectrum of distribution services, financial services, telecommunications, professional, business and computer services, motion pictures, environmental services, and other industries.

*Grandfathering.*—China will protect the existing activities and market access of all service providers operating in China at the time of accession.

*Distribution.*—As noted above, China now generally prohibits firms from distributing products other than those they make in China, or from controlling their own distribution networks. Under the Agreement, China will liberalize wholesaling and retailing services for most products, including imported goods, throughout China within three years. This will remove all restrictions on wholesaling, retailing, maintenance and repair, marketing, customer service and transportation, along with restrictions on auxiliary services including trucking and air express delivery, air courier, rental and leasing, storage and warehousing, advertising and others. This is

of immense importance in its own right and as a step that will enable U.S. exporters to do business more easily in China.

*Insurance.*—Currently only two U.S. insurers are operating in China's market. With WTO accession, China agrees to award licenses solely on the basis of prudential criteria, with no economic-needs test or quantitative limits on the number of licenses issued; progressively eliminate geographic limitations within three years, and permit internal branching consistent with the elimination of these restrictions; over five years expand the scope of activities for foreign insurers to include group, health and pension lines of insurance. For non-life insurance, branch and joint ventures at 51 percent equity share are permitted on accession, and wholly-owned subsidiary permitted within two years from date of accession. For life insurance, joint ventures are permitted with the partner of choice at 50 percent equity share upon accession.

*Banking.*—Currently foreign banks are not permitted to do local currency business with Chinese clients, and only a few can engage in local currency business with their foreign clients. China also imposes severe geographic restrictions on the establishment of foreign banks. With this agreement, China commits to full market access in five years for U.S. banks. China will allow internal branching and provide national treatment for all newly permitted activities. It will also allow auto financing on accession, and allow local currency business with Chinese enterprises starting two years after accession and allow local currency business with Chinese individuals from five years after accession. Both geographic and customer restrictions will be removed in five years.

*Securities.*—China will permit minority foreign owned joint ventures to engage in fund management on the same terms as Chinese firms. Minority joint ventures will be allowed to underwrite domestic equity issues and underwrite and trade other securities (debt and equity). As the scope of business expands for Chinese firms, foreign joint venture securities companies will enjoy the same expansion in scope of business. China has also agreed to hold regular consultations with the U.S. Treasury Department under the auspices of the Joint Economic Commission with China. The purpose of this is to exchange information and assist the development of China's financial and capital markets.

*Telecommunications.*—China now prohibits foreign investment in telecommunications. With WTO accession, it will join the Basic Telecommunications Agreement, implementing regulatory principles including interconnection rights and regulatory rules. It will end geographic restrictions for paging and value-added services within two years, mobile and cellular within five years, and domestic wireline and closed user groups in six. It will also end its ban on foreign direct investment in telecommunications services, allowing 49% foreign investment in all services and 50% foreign ownership for value added and paging services in two years.

*Audiovisual.*—China does not allow foreign participation in distribution of sound recordings. Under the agreement, China will allow 49% foreign equity for the distribution of video and sound recordings, majority ownership in three years for construction and ownership and operation of cinemas. China has also agreed to allow the importation of 20 films per year on a revenue-sharing basis.

*Other.*—Also covered is a broad range of other services—architecture, engineering, accounting, legal, travel and tourism, computer and business services, environmental services, franchising, express delivery and many more. In each, China has made specific, enforceable commitments that open markets and offer competitive American industries important new opportunities.

##### 5. Protocol Issues

Finally, the bilateral agreement deals, appropriately, with the special and unusual characteristics of the Chinese economy. These include the high degree of state participation in the Chinese economy; a series of industrial policy measures intended to draw jobs and technology from the U.S. and other trading partners to China, such as local content, offset and export performance requirement as well as forced technology transfer; and special measures to address import surges from China and unfair export practices like dumping.

Altogether, no agreement on WTO accession has ever contained stronger measures to strengthen guarantees of fair trade and to address practices that distort trade and investment. China's major commitments in this regard include:

*Import Surge Protection.*—China agreed to a twelve-year product-specific safeguard provision, which ensures that the U.S. can take effective action in case of increased imports from China which cause market disruption in the United States. This applies to all industries, permits the U.S. to act based on the lowest showing of injury, and act specifically against imports from China.

*Non-Market Economy Dumping Methodology.*—China's WTO entry will guarantee U.S. rights to continue using the current "non-market economy" methodology in anti-dumping cases for fifteen years after China's accession to the WTO.

*Subsidies.*—Likewise, when the U.S. applies its countervailing duty law to China, we will be able to take the special characteristics of China's economy into account. Specifically, where government benefits are provided to an industry sector and state-owned enterprises are the predominant recipients or receive a disproportionate share of those benefits, the United States can take action under our unfair trade laws. The agreement also establishes that the U.S. can determine whether government benefits, such as equity infusions or soft loans have been provided to an industry using market-based criteria rather than Chinese government benchmarks.

*Investment Reforms.*—China will reform a large number of policies intended to draw jobs and technology away from China's trading partners. It will for example, implement the WTO's Agreement on Trade-Related Investment Measures agreement on accession; eliminate mandated offsets, local content and export performance requirements and refuse to enforce contracts containing these requirements; and not condition investment licenses on performance requirements of any kind. All of this will make it significantly easier for Americans to export to China from home, rather than seeing companies forced to set up in China in order to sell products there.

*Technology Transfer.*—China will abolish requirements for technology transfer for U.S. companies to export or invest in China. This will better protect our competitiveness and the results of U.S. research and development.

*State-Owned and State-Invested Companies.*—China commits that state trading companies and state-invested enterprises will make purchases and sales solely on commercial terms, specify that purchases by these companies are not government procurements and thus are not subject to any special or different rules that could undercut the basic commitment, and provide U.S. firms the opportunity to compete for sales and purchases on non-discriminatory terms and conditions.

*Textiles.*—Under the agreement, quotas will remain in effect for Chinese textiles as for those of other WTO members until 2005. From then until January of 2009, the U.S. will have a special safeguard enabling us to address market-disrupting import surges from China in the textile sector. This is in addition to the broader product-specific safeguard noted above.

#### *Case Study: The Auto Industry*

To illustrate more clearly the cumulative effect of these commitments, let me offer a case study of the present situation and the changes WTO accession will make for the automobile industry.

At present, a combination of trade barriers and industrial policies adopted to draw auto investment to China makes it virtually impossible to export cars to China. Typically, the U.S. exports about 600 cars a year to China, many of them used; in recent years, the figure was likely below 400. The bilateral agreement addresses the policies which have limited U.S. export capability as follows:

- It reduces barriers at the border: cutting tariffs from 80–100% today to 25% in 2006; forbidding discriminatory value-added taxes; and raising the current virtually prohibitive quota to \$6 billion worth of autos and then eliminating it entirely within five years.
- China must commit to open its distribution markets and grant trading rights, ensuring that firms and dealerships in China can import autos directly from the United States, and that Americans can move their products freely within China to the areas of greatest demand.
- The agreement opens up services essential to auto sales: China will let auto firms provide financing, set up dealerships, advertise their products, provide repair and maintenance, and import parts.
- It abolishes certain industrial policies intended to draw auto jobs, investment and technology to China: China will abandon requirements that require firms to set up factories in China in order to sell in China, and abolish local purchase requirements and forced technology transfer.
- The U.S. strengthens guarantees that auto production and jobs in the United States will be secure. On the import side, the agreement includes a "product-specific safeguard" available to all industries for 12 years—in this case, a guarantee that if auto imports from China should rise so as to cause market disruption, the U.S. can impose emergency limits; and a guarantee we will be able to employ special "non-market economy" methods of calculating and counter-acting dumping for fifteen years.
- The agreement contains enforcement mechanism for all of these separate and overlapping commitments. This includes American trade laws and the WTO's dispute settlement mechanism.

The comprehensive nature of the provisions reached on automobile trade in the agreement is matched, although specific features differ, in every industry of significant concern to the U.S. economy.

#### *Enforcement*

Of course, trade commitments require full implementation and enforcement to be meaningful in practice. Previous successes in improving intellectual property rights and enforcing textile commitments demonstrate how crucial constant oversight, monitoring, and strict enforcement are in the case of China, and our trading partners in general. And with China's WTO membership, the U.S. will gain a number of advantages in enforcement we do not now enjoy.

First is the WTO dispute mechanism itself. In no previous agreement has China agreed to subject its decision to impartial review, judgment and ultimately imposition of sanctions if necessary.

Second, of course, is the continued right of the U.S. to use the full range of American trade laws, including Section 301, Special 301, and countervailing duty and anti-dumping laws.

Third, the U.S. gains substantial new leverage by creating the product-specific safeguard, as well as guaranteeing our right to use non-market economy anti-dumping methodologies. These features of the accession will significantly strengthen U.S. ability to ensure fair trading practices.

Fourth, and very significant, are strengthened enforcement capabilities through the multilateral nature of the WTO. The accession, to begin with, will create a multilateral review mechanism to monitor all of China's implementation closely. And as these commitments come into effect, China will be subject to enforcement by all 135 WTO members, significantly diminishing China's ability to play its trading partners off against one another. In all previous disputes over Chinese compliance with agreements, notably those over intellectual property, the United States had to act alone. With China in the WTO, the U.S. will be able to work with 134 other members, many of whom will be concerned about the same issues we raise and all of whom will have the legal right to enforce China's commitments.

Fifth, the specificity of China's commitments in the bilateral agreement will help ensure that China complies. Experience shows that agreements with China are enforced most satisfactorily when obligations are concrete, specific, and open to monitoring. The bilateral agreement therefore includes highly specific commitments in all areas, clear time-tables for implementation and firm end-dates for full compliance and present clear evidence of failure to comply.

Finally, however, enforcement as in any agreement depends on U.S. commitment. Last year, President Clinton secured new enforcement and compliance resources at the Office of the Trade Representative, the Commerce Department, USDA and other branches of government with enforcement responsibilities. These resources will help to build the largest monitoring and enforcement effort for any agreement, covering China's obligations in the WTO and also Import Administration issues such as dumping and countervailing duties.

#### *WTO Accession and American Strategic Interests*

From the perspective of trade policy, China's accession to the WTO is a clear win. China's trade concessions are of one-way and enforceable. In return, the U.S. made permanent the normal trade status we already grant to China. Permanent NTR will become effective once China formally accedes to the WTO.

From the perspective of reform and liberalization in China, the importance of this agreement is equally clear. As it implements these commitments, China will become a country which is more open to the world, whose people enjoy more choices in daily life and more contact with the outside world, and whose government in a number of important fields, will become, over time, more responsive to the rule of law than it is today.

But we must also look to a still deeper issue. China is the world's largest country, and over the past decade the world's fastest-growing major economy. The future course of our relationship will have great bearing on American security and strategy in the 21st century, and in this regard WTO accession offers us a great deal.

Our relationship with China today is free neither of deep-seated policy disagreements nor moments of tension. These are perhaps natural: we are great Pacific powers, and our governments reflect vastly different political systems and values. Such a relationship, however, poses profound questions for future peace and stability across much of the earth.

We should not, of course, imagine that a trade agreement will cure all our disagreements. Rather, when we disagree with China we must act with candor and a firm assertion of our interests and values. But as we do so, we must also recognize

how important a stable and peaceful relationship with China is—for the world, the Chinese, and ourselves. And thus we have a fundamental responsibility to find and act upon areas of shared interest and benefit.

We saw this responsibility clearly, and acted upon it, in the Asian financial crisis two years ago. We see it in the maintenance of peace on the Korean peninsula; the search for stability in the Taiwan Strait; the environmental problems of the Asia-Pacific. And we have seen it in trade for over a quarter century.

American trade initiatives in China stretch from the end of the trade embargo in 1972 through our Commercial Agreement; the renewal of NTR for the past 20 years; more specific trade agreements in the 1980s; our support for China's participation in APEC; and the market access, textile and intellectual property rights agreements of the 1990s. Each step had a foundation in concrete American interests; but each also helped to promote reform and the rule of law within China, integrate China in the Pacific economy, and strengthen China's stake in prosperity and stability throughout Asia.

As such, together with our network of alliances and military commitments, trade policy has helped to strengthen guarantees of peace and security for us and for the world. And China's WTO accession will be the most significant step in this process for many years.

Thank you, Mr. Chairman, and Member of the Commission.

Co-Chairman MULLOY. Thank you, Ambassador Barshefsky. Admiral Prueher?

**STATEMENT OF ADMIRAL JOSEPH W. PRUEHER, FORMER AMBASSADOR TO CHINA**

Admiral PRUEHER. Thanks a lot, Commissioner Mulloy. For the members of the Commission, it's a pleasure for me to be here today and to be with you. I beg your indulgence in that I have not submitted a written statement. My household goods are not yet unpacked and I don't have a typewriter, so I will buff up my transcript a little bit to give you a written statement.

Also, it's a pleasure for me to be here with Ambassador Barshefsky. We are accustomed to seeing each other when we are weary, so this is a treat. I also would like to give one demurrer. I am not an old China hand. There are some here whose works I read, who understand China better. Art Waldron is not here today, but he also does a great job with that, but I have been heavily immersed for the last five years in China issues with both some skinned knuckles to show for it, as well as a deep respect for a lot of the things the Chinese are doing.

One of the things that is evident from listening to the speakers today and also from listening to the questions is the difficulty of trying to get a balanced discussion about China. Ambassador Lilley cautions against anecdotes. One of the points that many make that know anything about China is that you can find numerous examples of things that are wonderful about China and you can find an equally number of outrageous things to typify the things that we don't like about China. It's important to get those in balance; the Commission has a big challenge to do just that.

Let me start by trying to get what I think is the right perspective about China. First—and these are points that I've heard made before—but I'd like to summarize them. The U.S./China relationship is very important to us. It's important to the East Asia Pacific Region and it's important to global security (I'll talk about the security issue a little bit more later). One of the most enlightening examples straying into the anecdotal realm, was shortly after I got to China a young doctoral candidate came up to me in the airport while we were waiting for the airplane and said, "I've been study-

ing Manifest Destiny in the United States I wondered if you'd like to discuss that with respect to our version of the Middle Kingdom". It's a very interesting discussion to have and you can go on and on with it, but what it means is the people of the United States feel correctly that our country is special in the world and we have a special influence in the world.

The Chinese feel the same way. It brings us into confrontation a lot of times because we both believe we have some things right. However, it shapes a little bit of our national outlook and it shapes our view toward each other and it shapes the competition that we have over many issues. Another thing that has occurred in the last few years of working with the Congress, working with groups in the United States, is that I think a lot of Americans, (not necessarily ones that are really into the topic, but many) tend to equate monolithic world Communism and the views represented by Khrushchev's "We will bury you", with Chinese Communism and think that they are somewhat one and the same.

My own opinion is that this view misses the mark. Chinese characteristics transcend the Communist characteristics. Many of the things we like about China are Chinese, not Communist; and many of the things we don't like are also Chinese, not Communist. So there's a hazard in getting too much of the Communist ideology in this discussion. Though it has some merit, I didn't meet very many Communist ideologues in China in the last few years. There are some, but there are not too many around. Let's be careful of not overdoing that bias.

Another point that has been made a couple of times is we need to think in two ways. We need to think in the long haul, strategically about our relationship with China. How do we want all this to turn out in the end game? We need to think in those terms. The other part—some people dwell on the economic and trade part—is the shorter haul, the tactical haul, how do we want to get there. And those are two sort of separate topics. But we need to not lose sight of what we want the picture to look like at the end of 25 or 30 years and then how do we get to that level.

Another point that I think is very important as we look at U.S. foreign policy, our U.S. foreign policy; toward China is driven by our domestic policy. Our articulations are done that way, our thoughts about it are done that way and our foreign policy and our economic policy toward China is sub-optimized to our domestic policy and our domestic audience. That's as it should be.

Likewise, when we look at what China says about the United States, the same thing is true there. They are speaking to domestic constituencies in China. Their articulations, some of the utterances that you see out of the leadership is meant not for us. It's meant for the Chinese domestic constituency as they try to maintain stability in China and trying to change. That's an important facet to understand and an important part to think about.

I mentioned the good and the bad. When one goes to China and spends some time, you're captured by the people, the ordinary Chinese. The point that was brought up earlier was the sense of entrepreneurship, certainly a prominent point. Also there's a sense of reverence for authority. There's a sense of humor amongst the Chinese, the ordinary Chinese. There's a sense of dignity. You also,



when you talk to some of the leadership, get a large sense of real purpose that they are trying to solve Chinese problems. They'll solve them at someone else's expense, if they can, but they're really trying to solve Chinese problems and not just trying to be counter anything that the United States might like.

You're also captured, of course, with the things you can admire, the work ethic, which goes into cheap labor, but also there's a tremendous work ethic, an intellectual capacity and the dignity that I mentioned as well as the sense of culture. I think it's important to be wary of being too cynical about the motives of the Chinese. However, a heavy dose of non-naivety and skepticism is very much warranted. In the negotiating piece of our interaction (or how they are dealing in the tactical part) it's hardball all the way, but when you look at their motives, you need to think a little bit and understand their point of view.

Now, on the other hand, there are things that are just anathema to us and they've been brought up today; human rights issues, religion freedom issues, lack of rule of law. I think if our Chinese compatriots could get along fine and organize and structure their modernization without rule of law, they'd probably be happy to do so. But I think they see they need this structure to move ahead and modernize and improve their economy. Let me shift now to what I think the U.S. interests are and what we are trying to do.

Many people say (I'm one of them) that the common interest that China has with the United States outweigh our differences. That's a nice statement to make. It's a good platitude. Okay, and then you've got to get into it, what are some of those things? The U.S. objectives in East Asia are a stable, not rigid status quo, but stable, a secure East Asia Pacific Region in which the people of the neighborhood, us included, can pursue prosperity in a peaceful way.

China has that same objective. Those are our long term objectives. Now, subsets of this are regional stability in the military sense that we talked about—traditional security thoughts. Jamu and Kashmir is an issue for us. The Korean Peninsula is an issue for us and it's looking better, not finished but better. And then the other one is, of course, the Taiwan Straits where there exists both a conflict for us and also a common interest. If a stable situation, suitable to both sides of the straits can be achieved, that would be in the U.S. interest as well.

We can talk more about Taiwan in the Q and A if you'd like to. I don't want to derail now because that's a separate subject. There are other issues we have in common which are transnational issues. Terrorism, China is not an exporter. Environmental issues, non-proliferation issues, water, AIDS, food, those things are things that our nations need to work well on together in order to have them come out right for the globe.

World organizational issues, the foremost one today, of course, is the WTO, but also UN, the World Health Organization, World Food Organization, all of those others and then finally we have a common interest in economics and trade. As was pointed out, I think, by all others, either pro or con on leverage for WTO, we're going to trade with China. It's going on now. It's going to go on in the future. One of the dilemmas on WTO entry is most nations that enter are just entering onto the world trade scene in a big way.

China's been on it for a long time. So they are both developed and undeveloped.

There is a particular dilemma, but it behooves both of our nations to get a standard set of ground rules with which we can work. WTO accession offers that. I, again, tip my hat to Charlene. She's a tough negotiator and she drove a very good bargain for the United States in getting a negotiation and in getting an agreement for WTO. It may be so good that the Chinese have a hard time complying with it. That's true.

I'd also like to tip my hat to Bob Zoellick on his recent trip to Shanghai. They worked some of the really tough issues from a little different perspective. Now, it looks like we have a situation where we can move forward. And this leads to implementation of PNTR and WTO and the question: Will it work? I think that's one of your fundamental issues. Will it work over time? The fact is, it will and soon China can comply with many parts of WTO—several issues and a lot of the stipulations of the WTO agreement. Other stipulations will need phase-in which come in various levels. My opinion is some compliance will take longer than are in the agreement. It's going to be very difficult.

And analogue for me (I'm a simpleminded sailor here). Say you've got a teenager that you want to teach to bench press or train to bench press 400 pounds. You can't just say, "Bench press 400 pounds, start doing it. I'm going to monitor you every day and beat you if you don't". You know, there has to be a balance of training. There has to be some time to comply and be able to do it and there has to be some help in coaching. So I think this is important to the Levin-Bereuter addition. I didn't hear Senator Thompson's testimony this morning but we've had quite a few discussions over the last couple years and I know and agree with his point of view on non-proliferation.

So another issue is let's not give up leverage on these important issues. That's a very good point, but we need to balance our monitoring and compliance efforts with coordinating with the EU and Japan with training and education efforts in order to hasten the compliance of China into WTO. This will be important: education, training combined with monitoring compliance thoroughly.

The objective is that U.S. firms don't necessarily get an advantage, but they get a fair chance to compete in China, a fair chance to compete not only with Chinese, but also with the EU and also with the Japanese there, who are tough competitors indeed.

Finally, I'd like to get at the issue of security that we talked about earlier because it's very important to me and important to all of us. Security is traditionally talked about in military terms, but that is not quite sufficient for what we're encountering in the world today. In my mind and with many others that ponder this subject, security really encompasses three elements; political, traditional military security, and economic (or economic and trade). I think of these as three overlapping Venn diagrams and at one point or another in various relationships one Venn diagram will be pre-eminent but you're working in the middle where those Venn diagrams overlap. You cannot ignore the economic or the political things when you're working the physical military security part nor

can you ignore the military part when you're trying to work politics or when you're trying to work the economics.

Now, if you think about security in that whole context, vis-a-vis our relationship with China, and we need to watch each aspect very carefully. PNTR or WTO accession is not an end in itself for China. It's part of a continuum of the security issue and it's something—but it's an essential part as we move forward in our relationship. And this relationship as we work with China, is something that is doable. But it is not easy and it's not something that the Commission is going to be able to solve by recommending a single bold stroke—the way we would like to do it.

If it grows, and it can, this relationship will be something that grow over time. Time and patience are not two of our foremost virtues. It's going to need comprehensive dialogue at the highest levels to work at this inner section of the Venn's. It needs to be worked again comprehensively in the military, political and economic piece. We cannot work them independently.

My real last point is that China is in a stage of immense transition right now. They are also faced with immense challenges. Now, you read some articles where authors talk about how strong China is getting: we must fear it. We are told to feel that China is on the ascendancy. There's no doubt about that. We cannot control, as someone pointed out before, how this occurs but we can really skew how this change occurs in China.

We must remember China has huge challenges as well; the non-performing loans in their banks and the conversion of their state owned enterprises are two tremendous challenges for them. The split between what we read about of the ascending China, which is only 300 million, and the other 900 or billion Chinese in the agriculture sector who are not enjoying all these advantages. We have this dichotomy where a discussion comes up regarding influence of the Internet and you go to Shanghai or Beijing and you go to Internet Cafe and you think the Internet will have a big influence. You can go 60 miles from there and go to a town where there's not electricity or running water. Internet has zero impact in that town and on that sector of the Chinese which is the majority of the population.

The central dilemma in China right now is a Communist leadership which is based on control of the politics, whose legitimacy depends on delivering the economic goods to the people of China, in competition with an opening, modernizing economy. They have to be opening up in order to play in the global economy. And so these things are in competition right now and the leadership is trying to figure out how to come to grips with this.

This closed grip is coupled with the succession issue that is going on in China. We should know in August and September, a little more how that's going to play. Then in 2002 there will be a leadership change in China. So we can expect this and the WTO accession will create more churn in the system in China. It is difficult for their leaders to grapple with this conflict they're trying to figure out how to do it—but they know they have to. And it's in our long term interest, I think, that China have a stable and the least turbulent transition possible to a modernizing economy and that we

should avoid unnecessary—and I want to emphasize unnecessary, confrontation with China on small issues.

There are plenty of issues. I'm not really very starry eyed about China these days, but there are some things where we need to confront them directly and openly and at a high level, but there are others where we need not confront them on every single topic. The best outcome in my view that could come out of the committee will be a setup for productive communications with China that open the gates where we can have dialogue back and forth, dialogue that has some teeth in it.

The other thing that I think it important to know is that the big drivers in China are the government, the party and the Central Military Committee. The agent—most of the things that we deal with are with the government because that's what we traditionally deal with. The agent of change in China, however, is that party. It's not the government. And so we have an antipathy for dealing—consorting with the Communists, you know, dealing with the party, but I can tell you quite frankly, if you want to influence change, the working and having a dialogue with the party apparatus in China is very important.

It is interesting that one of the leaders, Hu Jintao—perhaps to be Jiang Zemin's successor, is the head of the Communist Party school. That's his base there. So it's something that, maybe we don't like dealing with the Communists, but that's where you're going to have to push and pull in order to influence this change in the way that we want to. Thank you very much.

Co-Chairman MULLOY. Thank you, Admiral. Now, Ambassador and Admiral, here's the way we're going to go. We're going to go back and forth between the Commissioners appointed by the Republicans and the Democrats but since we have a limited time, we're going to have the lights go on. Each Commissioner is going to get six minutes and then when that red light goes on, try and finish up your answer so that the next person can have their chance. And the first Commissioner who has asked for time to ask questions of this panel is Commissioner Reinsch.

#### PANEL II DISCUSSION AND QUESTIONS AND ANSWERS

Commissioner REINSCH. Thanks, Pat. I just have a couple of questions that are on the implementation topic. And feel free to respond within the parameters of your experience, but I'm not confining the question just to the WTO agreement. One of the Senators, who will remain nameless, alluded earlier to the frequency with which the Chinese have violated their agreements. And my experience, which is less extensive than yours, is that they've been scrupulous in adhering to the letter of their agreements, are adept in creating and then exploiting loopholes in them at the same time, which is a challenge for our negotiators to try to prevent.

What has been your experience? Do you find that generally they honor the agreements that they make or is this an ongoing problem?

Ambassador BARSHEFSKY. Certainly compliance with agreements presents challenges but on the whole China's compliance is no less rigorous than most of our other large trading partners such as Europe, Australia, New Zealand, Brazil, Japan. There is a tendency

among all of these countries, and by the United States, to skirt around a bit if one feels politically one has to. And China is certainly no exception.

What we have found is that China's degree of compliance increases by the extent to which the obligations are very precise and in the nature of quantifiable. So for example, China's compliance with tariff changes has always been excellent because that's a known, concrete obligation and compliance can be objectively judged. When we negotiated the WTO accession agreement, it was with that example in mind, leading to an agreement, which as you know, doesn't read like an agreement. It reads more like a 150 pages of grid. We did this that China in every year, at every point, knows exactly what the obligation is and we know exactly what our rights are.

Commissioner REINSCH. Admiral, is your experience the same?

Admiral PRUEHER. I can add just a little bit that, yes, the experience is the same. When one gets back to the Chinese approach it is not a rule of law approach—so if there are a rigid set of agreements, they will look for ways around it like some others do. The other experience that I've had, even with where we had very contentious issues, if there was good agreement on the objective, what you're trying to achieve and then a meeting of the minds, you could proceed toward the objective without very much framework.

And there are examples of businesses who have had large contracts on a handshake who have been very happy with the relationship, made a profit, done all right. Then there are others that have had very complex negotiations and everything written down and just a hopeless quagmire of trying to get ahead because everyone, they're looking for loopholes without spending the time on the objectives in advance.

Commissioner REINSCH. I'm glad you brought up the rule of law question. To what extent do you think that especially with the WTO agreement we're in a situation where the will to implement may be there but the institutional mechanisms are either non-existent or too weak to permit implementation?

Ambassador BARSHEFSKY. Certainly, institutionally China is going to have to build the kind of mechanisms we would expect to see in order to insure compliance. I think there's no question that in some areas those mechanisms do not exist; for example, in services trade or telecom, areas that for China are relatively new. I think U.S., European and Japanese technical and expert assistance will be necessary. The WTO itself will also have to provide technical assistance. This coupled with the kinds of transition periods that we negotiated, should help to ensure that implementation will proceed on a rational basis.

In addition, as you know, China is the only country that will be subject to an independent monitoring mechanism in the WTO itself—a multi-lateral monitoring mechanism. The theory behind this is that to the extent problems can be uncovered early, one has a much greater chance of full implementation down the road.

Commissioner REINSCH. Thank you.

Admiral PRUEHER. The only part that I would add to that is [I agree with your basic point—that there is a will at high levels to comply.] That there are three levels at the central level, the provin-

cial level and the local level where compliance will be required and it's not well-regimented. Zhu Rhongji brings out the statistic usually that to run their legal system as it's currently set up, needs 180,000 judges. They have nine percent that have any legal training at all and a lot of them, no offense, but they're retired Army sergeants and stuff like that. And so——

Commissioner REINSCH. There's an opportunity for a joke here but I think I'll——

Admiral PRUEHER. Well, no, but implementation will be tough and it will take some time.

Commissioner REINSCH. Final question, if I may, primarily for Ambassador Barshefsky, but feel free to comment, Admiral, I was struck in your testimony by a topic close to my heart which is the agreement you got on tech transfer, and their commitment not to require it. How realistic is that, and looking back, what has our experience been so far with at least the spirit of that recognizing, you know, they're not fully into WTO yet?

Ambassador BARSHEFSKY. I don't think we have any practical experience with that yet because they're not in the WTO and it is difficult to argue that they have to change commitments in current contracts on tech transfer in advance of WTO accession. I do think that this is a very, very important commitment and I think the United States is going to have to be vigilant with respect to it, as well as with respect to the entire agreement vis-a-vis implementation.

Tech transfer, as you know, is a continuing problem. It's not just a Chinese problem. We have tech transfer requirements in many developed countries as well and that is of great concern. The principal source of information on tech transfer requirements will be businesses, who are subject to those requirements, either de facto or de jure. And certainly the U.S. Government is itself going to have to insure that it has a range of information available to it through embassies, commercial counselors and so on, so that that obligation can be fully enforced.

Co-Chairman MULLOY. If I could now turn to Ambassador Lilley.

Co-Chairman LILLEY. Yes. Charlene, I was very interested in your comment on the sixth page of your testimony to the effect that, "Weaken the ability of hardliners in government to isolate China's public from outside influences and ideas". Hardliners in China, it's used all the time that there's resistance inside China to the WTO and to a lot of other things. And after the April 1999 period when Zhu Rhongji went back to China he was absolutely savaged by people in the system.

And Joe Fewsmith wrote a piece on this, an interesting piece, analyzing forces in China. And I hear that even in the delegation in Shanghai with Zoellick and company there was some dissention in the Chinese delegation. The comment was also made that domestic considerations can drive foreign policy. One of the lessons that I suppose the old China hands wallow in is in China there are things going on that are going to drive their foreign policy that are totally domestic. Recently we've gotten these reports of the party document, the dissent and violence and demonstrations in China that's gone on from 60,000 to 100,000 a year. There seems to be real dissent in China. We've talked about disparities, rural, urban,

this sort of thing, and what I'm concerned about, who are these hardliners?

I mean, of course, we have a sense of who they are but you just look at the picture of May 19, 1989 of Zhao Ziyang going down to the bus in Tiananmen Square, and he's with Wen Jiabao and who's standing over there behind him is Li Peng with Luo Gan next to him. There's a very sort of pictorial dramatization of these two lines in China but I think it's very important that we try to figure out who these so-called hard-line leaders are, what their power base is, how they are dealing with these people that we consider to be more anxious for China to join the international community.

There's kind of a caricature of the hardliner which you get from anybody that doesn't think it through very carefully I would insist that you've got to get this one right and you've got to know who these people are, what their agenda is, how much power they have, how they're going to go after the United States relationship, how they're going to try to isolate the U.S. I open it up to you. I'd like your view on what is this creature; is it a creation of the American imagination? I don't think so. There's something there.

Ambassador BARSHEFSKY. Joe is probably better equipped to answer this but let me take a stab—

Admiral PRUEHER. And I'm ill equipped.

Ambassador BARSHEFSKY. Let me just take a stab on one very narrow area, which is not a "who" answer but a "what" answer. The single hardest area to negotiate with China was telecom. Why is that? Because telecom is access to information. The Internet and telecom presents to the Chinese public something actually quite radical. That is to say, substantial information outside the bounds of the Communist Party. This was by far and away the most difficult area of negotiation.

I could probably throw out names as to the "who's" are but I think that's actually—

Co-Chairman LILLEY. I think we know who the guy is.

Ambassador BARSHEFSKY. —less relevant. The point here is that information is a commodity of concern among some in the Chinese leadership. Add to this general concern the fact that "information" to the Chinese leadership also encompasses what we think of as "entertainment". Movies, for example, are not entertainment to many in the Chinese leadership. They are sources of information.

So this fear of information and the broad dissemination of information led to a negotiation on telecom that was very difficult. It would have been the deal breaker for the U.S., but ultimately China moved on the issue. "Information" is one example of a what is feared in China, putting aside the specifics of "who" fears it.

Admiral PRUEHER. Commissioner Lilley, I'm not sure exactly what your question was because the statement is certainly correct and I think the essence is to try to figure out who makes the decisions and how they are made. How those factions play is something to which I quite frankly do not know the complete answer. I know some of it, I think or have a feel for some of it, but I don't think we understand it and I think your point in trying to understand that as we move forward over this range of issues, WTO aside. The security and the political issues as well, are critical and I think it's

something we need to follow to understand how the small advisory groups and the party work and who has that range.

Co-Chairman LILLEY. Well, you know, if you go back in history, you go back to let's say the 1976 period, where it was easy to cartoonize the bad guys, the gang of four.

Admiral PRUEHER. Right.

Co-Chairman LILLEY. The radicals, Mao's wife, this sort of thing against the better guys, Deng Xiaoping and the reversal of verdicts in 1977–1978

Admiral PRUEHER. Right.

Co-Chairman LILLEY. —that was out on the table, we talked about it. We argued about it and we took a position, we backed a faction in China, namely Deng and he prevailed and that made a big difference in Chinese American policy. Is there any relevance to what we're trying to do today? Is there any area where you could engage in this?

Ambassador BARSHEFSKY. Well, let me repeat something that former President Clinton said, which I think is very true. We can't dictate to China what China will do, how it will develop, how it will modernize, how its political system will or won't change. All we can do is try and create the conditions under which change may be possible to create options that didn't exist before that might be effective in bringing about change in China in a positive direction. That's probably about the best we can do.

The notion that we can dictate to China the way in which it ought to change is, I think, a foolish notion, disproved by our attempts to dictate on occasion to other countries that they should change, countries much, much smaller and which we've had relatively little effect. I think what we can do however is to help create the conditions in which change can occur. WTO accession is one such opportunity. It doesn't mean China will make the right choices down the road, but I think we have an obligation to provide it with ample options and ample opportunity, and I think we've done that.

Co-Chairman MULLOY. Admiral, if you want to make a quick comment and then we'll move on.

Admiral PRUEHER. One quick one here. The example you brought up of Zhu coming in April of '99, where I think most would agree at this point that we set back a bit what we were trying to do. We made his position much more difficult in China. We can avoid making large mistakes, I think. But, again, our own domestic situation will drive that. Then second, in my view, is the best we'd ever get is to get it roughly right and not absolutely wrong as we move forward because I don't think we're going—to know exactly how to nuance every little piece of this.

Co-Chairman LILLEY. Since we're quoting Clinton, I think he made one of the more poignant statements I've heard when we went down to the White House and he got us all down there, the people that supported PNTR. And all the other speeches were rather dull, but he gets up and he hits it right on the head. I'm sorry, Mr. Trumka is not here, but Clinton says, "Those who are against PNTR in the United States", he didn't specify whom, "are linking themselves with the most reactionary hard-line elements in China



who are also against WTO”, and I asked him afterwards, “That was a terrific statement you made”.

Well, Sandy Berger wrote it up in the Wall Street Journal, but I asked Ken Lieberthal whether Ken had written that for him. He said, “Hell, no, he winged it. It was his idea”.

Ambassador BARSHEFSKY. Exactly right.

Co-Chairman LILLEY. And anyway, I’m sorry.

Co-Chairman MULLOY. Thank you. Commissioner Wessel?

Commissioner WESSEL. Well, rather than responding to questions from other commissioners, I’ll ask some myself because there certainly are some debates that could go on about President Clinton’s statements. We’ve seen this morning a tremendous amount of questioning and concern about China’s ability to comply with the accession agreement, understanding that it appears to be inevitable, number one, and number two developing the infrastructure—judicial and otherwise—for them to do so is going to take time and effort.

Yet, later this year we’re expecting another ministerial meeting to potentially begin a new round of trade negotiations at the WTO which will bring with it potentially new commitments and we’re not even sure that China has the infrastructure or the ability to meet the current commitments. I’d like your views, number one, on the advisability of doing that, number two, as well as the question since it’s hot in the news, of whether, in fact, we need fast track to do that, and if so, do we need the fast track that was announced by the Republican leadership yesterday? Is that the right approach? That’s a softball.

Ambassador BARSHEFSKY. I don’t think the question of a new Round ought to be in any way linked to China’s forthcoming accession to the WTO. I think these are independent events. There is ample reason to think that a new Round would be a good thing—if not this year, next year. But I think that it is an event independent from China’s accession. To be sure, China as a player in any new Round, will be the recipient of requests for further market opening. There are any one of a number of areas one could posit. On the other hand, I think it is fair to say that China has bitten off quite a bit, and countries would be well advised not to overpromise to their publics substantial additional market opening at any time soon by China beyond this accession agreement.

With respect to fast track, I think my views are very well known. I think fast track is desirable but not necessary, as evidenced in part by the China vote in the House of Representatives. And I’ll ask simply one question of you, that is, if the Clinton Administration had wanted fast track to do the China deal, would it have gotten it? Answer, no, never in a million years. But the China deal passed by a 40 vote margin in the House. So I think just talk is a desirable tool, in the sense, for example, that foreign countries are used to it. It also provides some discipline with respect to Congressional debate and so on. But is it absolutely necessary? No.

Commissioner WESSEL. I’ll leave the last part of the question. We’ll move beyond that. My understanding in the last several days is that there has been a question of whether China has sold weapons to Cuba or transferred weapons to Cuba, Admiral. And I guess there’s a law, 1996 law, that precludes transfer of weapons, lethal

weapons, to terrorist states or states that participate in terrorism. If the allegations are true, what actions do you think we should be taking? Is this, after we've seen the fiber optics earlier this year, which may not be a lethal weapon, but was enhancing the deliverability or the infrastructure, should we be taking action under that law?

Admiral PRUEHER. Well, I have not been following the details of this. If, in fact, there is a transfer than we should take come sanction able action but my understanding of it is such that I don't know the magnitude of the issue.

And so this issue with Cuba, I'd have to get into the details of it and then get back to you with an opinion on it because I really don't know enough to answer it.

Commissioner WESSEL. Okay, no further questions.

Co-Chairman MULLOY. Thank you. Commissioner Robinson.

Commissioner ROBINSON. Yes, Ambassador Barshefsky, you touched on the Internet earlier and the fear of information flows and I strongly take your point on that. I was wondering if you could in the short time allowed, list some of the constraints, the key constraints that exist on unfettered access by the Chinese people to the Internet today and similarly, access of U.S. and foreign firms to engaging in unbridled Internet commerce because it is such an important area? What do you see as the largest obstacles right now?

Ambassador BARSHEFSKY. I don't think I want to get too detailed because there are many, many rules and regulations here and as you know, the Chinese Government has had a penchant for changing them from time to time. But certainly problems that we ran into when I was at USTR included for example, requirements for licensing for Internet service providers with licenses not forthcoming. Requirements that the underlying technology used by the Internet service provider be given to the Chinese Government for review, including underlying codes. Requirements that certain types of information not be provided on the Internet, or if provided, the notion that the service provider would be held liable and potentially subject to criminal sanction if so-called "state security" was compromised.

On the other hand, we have seen Internet usage in China proliferate. The numbers are still small certainly, relative to the size of the population, but two years ago you were looking at probably 9 million users and now you're looking somewhere around 30 million users. It's a huge change in two years and as the technology becomes more diffuse, as foreign enterprises are allowed to invest more freely in China in the provision of Internet services, I think we'll see those numbers rise even faster. We will also see the Chinese Government faced with a relative inability to control content because at some point the technology will simply the leadership. As Internet usage proliferates, controls on content in any foolproof systematic way, are going to be very, very difficult to impose.

Commissioner ROBINSON. Well, we want to definitely keep up with you on that because I think that—

Ambassador BARSHEFSKY. It's a fascinating area.

Commissioner ROBINSON. —my fellow Commissioners are seized with—

Ambassador BARSHEFSKY. It's a fascinating—if I might relate one antidote, not China related but Vietnam related. I was with former President Clinton in Vietnam. We had negotiated a large bilateral agreement with Vietnam—the legislation is now up on Capitol Hill for normalizing trade relations with Vietnam. I did a lecture in Vietnam at a prestigious institution and a fellow, youngish fellow, raised his hand and asked a series of very sophisticated questions. It really took me aback because this was someone not of an academic background but a “worker” background.

I commented before answering, “How do you come to know the information that underlies your questions”, to which he said, “Oh, the Internet”, and I thought that was all I needed to know.

Commissioner ROBINSON. Ambassador Prueher, do you believe that Russian military and—military—I mean, weapon, I should say and military technology transfers to China are genuinely worrisome to our security interest or do you think that they've been somewhat exaggerated by observers say in the non-governmental national security community, the think tanks around town and elsewhere?

Admiral PRUEHER. It's a good question and one that doesn't have a definitive answer but my opinion is, is that the Russian technology transfers like SU-30's and some of the missiles, some of the submarines are of interest, the Sovremenny cruisers are of interest. We need to keep an eye on it because it can grow, and even perhaps grow to a level where it is problematic. Right now the numbers are quite small.

The SU-30's for example, are in the range of 200. The Echo class submarines are six, the Sovremenny's are two with perhaps going up to four. The numbers aren't too big but they perhaps are the start of a trend, but we don't know that. The other aspect is the—what I think is sort of a sophist's view of looking at military readiness is to count equipment, when really one needs to look at numbers of items, plus training, plus support, plus tactics, plus ability to use those things. Those don't come with that equipment.

The Chinese are quite good in their submarine world. They're quite good in their infantry world. They're quite good in their artillery world and rocketry, but with respect to Russian commodities, they don't fly and steam a lot. People who have bought Russian equipment are not generally pleased with it over the long haul. So the net answer to all that is that it doesn't bother me a lot but it's something we need to watch very carefully for the trend.

Commissioner ROBINSON. Thank you.

Co-Chairman MULLOY. Thank you. Commissioner D'Amato, Chairman D'Amato.

Chairman D'AMATO. Thank you, Mr. Chairman. Madam Ambassador, I remember meeting with you one time in my office after you got back from I guess the first intellectual property negotiation. Little did you know you had to do that several times. My question has to do with compliance and monitoring on trade agreements and the question of whether or not we need to be tougher in a sense in making compliance and performance of previous agreements upon future agreements and negotiations.

You know, we met with the Customs folks who say that their compliance with this Customs agreement we have with China is

dismal. Do we have enough tools in our toolbox to insure compliance with this country? Some people say to this Commission, "Well, you've got to figure out other tools for our toolbox here". That maybe we need to have—how do you grade them on compliance and is there—having thought about your experience, are there things that you would do to try and improve that, make our ability to get compliance more effective?

Ambassador BARSHEFSKY. Compliance was always in our thinking when we negotiated the agreement. And there are more compliance-related mechanisms in China's WTO agreement than in any other WTO agreement for any country. Apart from WTO dispute settlement which, by and large, has been quite effective (European agricultural policy aside) we, as you know, retained the right for many years to come to use our special non-market economy anti-dumping methodology as well as special anti-surge protection in the U.S.

Those are defensive weapons, but they can also be used as offensive weapons. Many times disaffected industries that can't get access abroad bring protective actions at home to force market opening abroad, and these two tools are certainly available in that offensive spirit, in addition to their defensive aspect. There will also be, as I said, a multilateral review of China's compliance with its obligations. That is, I think, going to be a very important catalyst for Chinese implementation, as well as an early warning system for countries concerned about implementation.

And in addition, of course, there will be much greater U.S. resources devoted to Chinese compliance, to monitoring and implementation. President Clinton came forward with a large budget request on this which was granted. I suspect President Bush, over the course of his term, will supplement those funds. That will also be very, very important.

Chairman D'AMATO. So you do think additional monitoring resources, we should be looking at that.

Ambassador BARSHEFSKY. I think it's worth looking at. I would first assess what we have, which may be adequate for right now. But a couple years down the road, that level of funding may not be adequate any longer.

Chairman D'AMATO. May I make a—yes, go ahead.

Admiral PRUEHER. In talking to Secretary of Commerce Evans about this, the monitoring and compliance part was important; the foreign commercial service part of this is important. From speaking as a field hand embassy point of view, I think a lot of the effort needs to be on site in China, not just here in Washington. So that balance needs to be beefed up here and also be on site.

Chairman D'AMATO. Thank you. I have another question. We make the assumption, two assumptions that you talk about a tremendous change going on in China, and secondly, no matter how you measure it, the Chinese are very dependent on the American economic connections here. Clearly the dependency on our economy is greater than any other economy by orders of magnitude. The question is whether we really are exercising our influence effectively given those two assumptions.

I mean, there are people who have made the presentation that it's impossible to stand up for our values, vis-a-vis, the Chinese.

They just won't go along with this, so forget about it as to the economic pressure. Forget about human rights, forget about these kinds of things. It's kind of intuitive to me to link and say all those things together, that these beg assumptions of (1) dependency and (2) beg the question: of volatility, how flexible is the Chinese regime to the kind of influence that we could bring to bear—not necessarily with a sledge hammer but with sophisticated tools of persuasion? To what extent are we really being effective in influencing the Chinese regime along the standards that we think are proper for a civilized government?

Admiral PRUEHER. Let me get at this in the human rights area a little bit. We have gone for quite a few years in the human rights arena where the United States has—with respect to some other nations, has led the way on human rights issues with Geneva, with confrontation over particular issues with the Chinese on particular events, but in my view, the confrontation has become—had become so critical that it was not achieving systemic change. It was—we'd get a fillip every now and then—get a release of an important person that we cared about at a time when an important visit was coming up, but it was not engendering systemic change in the system.

The EU countries were not confronting at Geneva. They weren't necessarily confronting except on rare occasions in China. They were having dialogue. They were criticized by the human rights communities for just having dialogue in lieu of progress. I think some combination of the two is required and that's where we are right now. The Chinese have agreed to recommence a human rights dialogue in spite of the Geneva resolution of this past year.

So I think we need to move along, confronting because this is a core issue for the United States. It's a seminal value—the Declaration of Independence, the Constitution—it is a core value for the United States. We cannot abandon it. And so, we need to go forward and continue to confront but realize that the Chinese don't start with our premise but we need to work away at it.

I don't think that can be the only issue. And so I think the discussion, the dialogue, as well as the confrontation need to occur together. Then we need to get labor issues into our contracts and into our negotiations (and we're talking about doing it) to gradually effect change. Change will not, cannot be instantaneous. Systems don't change in a step input, they change gradually but it will not change at all if we don't push.

Ambassador BARSHEFSKY. Well, the only thing I would say is that we know, in terms of modern China—our version of “modern”, not their version of “modern”—that the most repressive periods in China have been in times of isolation, that is, when China has been most isolated from the world. The Cultural Revolution is the perfect example. The level of repression was simply breathtaking and country-wide. I think it's very important that when we disagree with China, or when we have fundamental concerns, those be asserted very aggressively, unapologetically and with the full force that our arguments can muster. But I agree with Joe that change when change occurs, is slow. It is not cataclysmic, and we need to be prepared for that slower pace of change.

But should we hope for change? Yes. Should we do everything we can to push? Absolutely, absolutely.

Chairman D'AMATO. Persistence then in the long run?

Ambassador BARSHEFSKY. There is no substitute for persistence. That is ultimately the key to successful negotiation. There is simply no substitute for persistence.

Co-Chairman MULLOY. And I'm going to be persistent and move along on that to Commissioner Bryen.

Commissioner BRYEN. Thank you, Mr. Chairman. Today we're graced with two great negotiators and if I had my hat on I would take it off. You both have done a wonderful job. Earlier today I was talking about the trade balance with other witnesses. Last year China sold to the United States about \$100 billion worth of goods and we sold about 16 to them, not very good. And if you look at this Department of Commerce chart—that's our sales to China. That's their imports to the United States over the years and that's the going trade situation, the imbalance, which is not a very nice curve.

My question is, isn't it in our national interest to go down this—if this doesn't change, is this in our national interest to have this kind of imbalance?

Ambassador BARSHEFSKY. I think there are a couple of parts to this. First off, why is there an imbalance of that size? We know that trade imbalances, current account imbalances, tend to be a function of macro-economic factors rather than micro-economic factors. And I think it's important to recognize that in the context of WTO accession or trade agreements in general, notions that a good agreement will wipe out a deficit is preposterous. It is simply not going to happen. The aggregate imbalances are too large to be moved by single agreements.

On the other hand, what we find with trade agreements, and we'll find this with the WTO accession, is that with respect to industries for which concessions were gained, those industries often find substantial increases in market access, even if the aggregate imbalances don't change all that much.

Second of all, let's bear in mind that China also runs a substantial surplus with Japan, unlike most other countries with Japan, as you know, and a substantial surplus with the European Union—neither as large as ours but nonetheless, quite substantial. So this is something of a systemic issue, not an issue that is necessarily directed, if you will, toward the United States.

And I think last, you know, there is always this question of who benefits from an open market. I believe firmly the United States is the greatest beneficiary in the world of a market that is relatively open and I certainly can't imagine how we would benefit economically by closing our market to any degree. In addition, China's products tend to be at the lower end. I don't think that the China imbalance is necessarily problematic.

The overall trade imbalance as Alan Greenspan has said, is probably not indefinitely sustainable. But what will change those aggregate balances in toto, I'm not entirely sure, other than macro-economic factors rather than trade agreements.

Commissioner BRYEN. Since 1996 the overall trade there was about \$51 billion with China in terms of their imports to the

United States and now it's about \$100 billion and the improvement in our exports has been marginal in reality.

Ambassador BARSHEFSKY. Yes, I think—

Commissioner BRYEN. And I'm wondering whether Greenspan may have a point here. I mean, if this curve continues, then this could be not in our national interest. That's the point I was trying to raise. And it seems to me a challenge to figure out how to fix that. If you look at Japan, it's true they have a surplus but it's—they had a—let's see, they sent to—they received from China \$55.3 billion of materials and they exported—billion, I'm sorry, 55.3 billion and they exported to China 30.4 billion, almost double what we exported.

Ambassador BARSHEFSKY. There's no question that our exports to China are anemic. We export almost half as much to Chile, which is a country of 14 million people, than to China which is a country of a billion three. So there's no question that our export performance needs to improve, and I think under the WTO agreement opportunity will be provided for it to improve. But I distinguish that from changes in the aggregate imbalances.

Co-Chairman MULLOY. I'm going to have to move it because we have four commissioners who have questions and we don't have a lot of time. Commissioner Becker.

Commissioner BECKER. I have to be very careful in picking out this question. Well, we've heard the argument about PNTR. A lot of the proponents of PNTR were suggesting and sort of promising that if PNTR were granted and China came into the WTO, that their human rights record and their application of the rule of law would improve dramatically coming into the WTO. Yet when we were under the years of Most Favored Nations, the State Department compiled a report and they would submit it to Congress each year, over the last half a dozen years that I've followed it, their human rights record was considerably worse.

And now that we would grant them permanent PNTR doesn't have to go before Congress. What makes you believe that there's any chance for that human rights record to improve?

Ambassador BARSHEFSKY. I think systemic human rights improvement in China has had virtually no relationship to annual NTR. Indeed, the argument of opponents of PNTR suggested ultimately that annual NTR had been ineffective in stopping increases in human rights abuses in China. I mean, you had an odd kind of argument. I think there are two basic points. First of all, I think progress with respect to human rights and religious freedom is not going to be linear. It isn't linear in any country. It hasn't been linear in Russia. I think you will see progress that moves forward by two steps and back by one and three-quarters or moves forward by two and back by three and then up by one and a half again. And I think we should be prepared for those kinds of variations.

But the second point I would make is this. If you look at China today, and you look at the China of 20 years ago, this is not the same country. If you look at standards of living, if you look at private property ownership, if you look at the ability to choose one's job, to move within, different regions of the country—all elements that are critical ultimately to a broader notion of human rights—20 years ago these rights were not available in China, but they are

today. So I think we have to take a long-term view of these issues and I think we have to remember that progress here is not going to be linear.

Commissioner BECKER. Consistent with the approval of PNTR, China almost immediately announced that they felt our trade laws in the United States, particularly the anti-dumping and countervailing duty laws were inconsistent with the WTO and that upon them becoming a member of the WTO, they were going to challenge these laws or have them modified or repealed. How do you feel about that?

Ambassador BARSHEFSKY. Certainly, any country can challenge anything they want but China would certainly lose.

Commissioner BECKER. How do you—maybe that's the answer I want. How do you feel about our trade laws in both countervailing and anti-dumping?

Ambassador BARSHEFSKY. I feel quite secure.

Commissioner BECKER. Quite secure.

Ambassador BARSHEFSKY. Yes.

Commissioner BECKER. One last little point; Commissioner Wessel had asked the question as to how you felt about the Republican's proposal on fast track. How do you feel about that?

Ambassador BARSHEFSKY. I will confess to you, having been out of town and having just came back about 35 minutes before I was called here to testify, I don't know what the Republican proposal is or the specifics of it.

Commissioner BECKER. Well, it's something—I've heard you comment on it before with me about the exclusion of trade and environmental provisions and going forward with fast track.

Ambassador BARSHEFSKY. That's disappointing because I would have thought in trade policy terms we'd made quite a bit of progress on those issues. You know, fast track is the kind of issue where this ideological—I'm losing my words, too—this kind of ideological purist view of trade, is not destined to be successful on Capitol Hill. The world has moved and should move beyond these kinds of sterile philosophical debates to talk about the ways in which trade can also be a catalyst for broader change.

I agree with the notion that with trade comes prosperity, with prosperity tends to come improvements in the rights of workers, tends to come improvements in the environment. But are these things fore-ordained? No. Can trade agreements make an important contribution in these area? Absolutely, of course. And it just seems to me disappointing to hear this. It seems to me that members up here ought to be able to get together on these very fundamental and important questions.

Commissioner BECKER. Thank you.

Co-Chairman MULLOY. Thank you. Commissioner Dreyer?

Commissioner DREYER. A question, I was interested in your statement that the common interest between China and the United States is a stable and secure East Asian system. And we certainly hear you say stability enough of the time but I wonder if that's really true because it seems to me from the United States point of view, that China is currently anti-status quo in the current situation in East Asia; for example, Taiwan. For another example, China claims the islands that the Japanese administer which the



Japanese call Senkaku and the Chinese called the Diaoyutai and a number of disputed claims in the South China Sea and so on and so forth.

There are also against something we regard as contributing to stability in Asia which is our right in international waters off their coast. At the same time when China looks at the United States, they see a power that's profoundly status quo that's trying to induce peaceful evolution of their government and other governments toward democracy that is constantly hammering at them about human rights and religious freedom and offending their sovereignty and so on.

So I wonder if when you get beyond the mantra that yes, both sides favor a stable situation in East Asia if there really is a common interest there.

Admiral PRUEHER. Well, Dr. Dreyer, I tried to make a distinction between a rigid status quo and stability. And the—I would not try to argue China's view of what they would like to be more important. That was my Middle Kingdom point, Manifest Destiny point. They would like to be more important so that people asked, "What was China's opinion about things?" when they did things in their region or in proximity to them.

Also, if you look at the map that is the Guangzhou military region, they have a large tongue that sticks down into the South China Sea that they think is China's territory, their traditional territory such that people ought to come seek their permission to enter. That's anathema to us and to freedom of the seas—though we have not ever ratified the UNCLOS convention. What China wants to do is economically to deliver some better living to their people. They would like to be more important in the region. They will take advantage if they can, not unlike other nations.

They make the argument, which you can argue, that they are not expansionists in their view, though if one looks at the South China Sea you see they seek expanded borderlines. China has not contested troops in Korea. They have not contested troops in Japan. They've not contested U.S. presence in the region. In fact, they have looked at that over the last few years as providing stability but against the Soviet Union in the past. This tone could change and one can hear that in some quarters.

So I think this is a work in progress. My statement about a secure and a stable East Asia Pacific is one where both of us can pursue political stability, economic stability and in fact, military stability in the region that's a common interest. I would expect you to take me to task on the idea that stability in the Taiwan straits is a common interest. I think that's actually a little more perverse point than the one you're making.

Commissioner DREYER. I was trying not to link it specifically to Taiwan because I think there are broader considerations. Again, if you read the Chinese newspapers, although maybe the Chinese have not formally contested the issue with you, there's the issue of the American troops in Japan, the Chinese have certainly reprinted a lot of the anti-troop protests in Okinawa and—

Admiral PRUEHER. They reprint a lot. It's hard to sort the wheat from the chaff.

Commissioner DREYER. Indeed.

Admiral PRUEHER. Yes.

Co-Chairman MULLOY. Thank you, Commissioner Dreyer. Commissioner Lewis.

Commissioner LEWIS. Thank you very much for your presentations. They are very informative. A couple years ago, the Chinese leadership banned the PLA from participating in business enterprises. What's the present status of that?

Admiral PRUEHER. This is very—an interesting point because the leadership did that in '97. And two months, after in talking to the PLA leadership they told me, "Well, PLA business has been banned so we are out of it." Right. The PLA has gotten out of some business enterprises. The PLA grew up as a guerilla type army. They're supported from the Provinces.

They have their own businesses.

Commissioner LEWIS. They're still doing it.

Admiral PRUEHER. They're still doing it.

Commissioner LEWIS. Do you have anything to add to that?

Ambassador BARSHEFSKY. No, the only point I'd make, though, is that I thought the announcement was in part, convenient at the time.

Commissioner LEWIS. That was right.

Ambassador BARSHEFSKY. And it may or may not have related to this but it was an announcement coincident with the announcements on the reform of state enterprises, which raised the question in my mind, were they basically telling the PLA, "As to non-economic state enterprises, we don't care if you're in them, you've got to get out because we want those enterprises to close."

Commissioner LEWIS. Right.

Ambassador BARSHEFSKY. So I always wondered whether there was a connection there, but the notion that the PLA is out of business in China—

Commissioner LEWIS. Is not true.

Ambassador BARSHEFSKY. —Is not true.

Commissioner LEWIS. Okay.

Admiral PRUEHER. May I add one point? In addition to the economic part, there is the part about trying to diminish the influence of the PLA. It came concurrent with a business reduction, there's no PLA on the Politburo, so that's an attempt of diminution of the influence of the PLA in China.

Commissioner LEWIS. Thank you, that's really interesting. In terms of the trade imbalance between the United States and China compared to China and Europe, there's a theory proposed that the Chinese are trying to amass large amounts of our treasuries because five years ago or six years ago, the Japanese Prime Minister hinted they were going to stop buying treasuries, and in the next couple of days, the stock market went down.

Ambassador BARSHEFSKY. Right.

Commissioner LEWIS. And he had to say, "I really didn't mean that". Well, there's a theory now that the Chinese want to amass large amounts of treasuries to have leverage over our financial system. What's your reaction to that? That nothing happens in China by accident and that they're buying from us much less than from Europe not just by accident but as a national policy.

Ambassador BARSHEFSKY. I don't think I'm equipped to respond one way or another except to say that on balance, I don't assume all relations with China are based on fundamental mistrust, which is a little bit what you were getting at, but I feel not—

Commissioner LEWIS. I'm sorry, a Chinese writer has written that, that there's many ways to wage war, one of which is financial. This in the public realm.

Admiral PRUEHER. Yes, I agree with that point, there are many ways to wage war and Premier Zhu says with a smile sometimes that he is the largest holder of U.S. Treasury bills.

Commissioner LEWIS. There you go.

Admiral PRUEHER. Yes.

Commissioner LEWIS. Do you have any references of that being in writing?

Admiral PRUEHER. Not in writing.

Commissioner LEWIS. But he said that to you.

Admiral PRUEHER. But he's said it a couple of times, yes.

Commissioner LEWIS. That's really very interesting. I'd like to ask you, if the WTO fails, if they don't join the WTO, will that help the hardliners?

Ambassador BARSHEFSKY. I think if they don't join the WTO because they've decided they're not going to, that decision would have been made by the hardliners.

Commissioner LEWIS. If they don't join the WTO because we don't let them in, would that help the hardliners?

Ambassador BARSHEFSKY. It would be—yes, it would do everything possible, just as in April '99, to strengthen the hands of the hardliners against the reformers. There's no question about it.

Commissioner LEWIS. Okay, and then finally, China is repressive. They're better off than they were 20 years ago, there's no question. But suppose it turned, they joined the WTO and they become more repressive and things occur there that are more antagonistic to our values; how bad does it have to get before you finally say, "We're not going to trade with you", or do you never say that?

Ambassador BARSHEFSKY. I think that's ultimately, frankly, a call for the Congress. I think it's hard to imagine getting to that point if only because it is, at least at this juncture, hard to imagine things getting that bad. One needs to remember—

Commissioner LEWIS. Well, we traded with Nazi Germany right up to the war and with Japan right up to the war.

Ambassador BARSHEFSKY. I think we would just have to see but I think you're positing a situation that is so extreme, so extreme, like Japan immediately pre-war or Germany immediately pre-war, that one would like to assume one would not have to cross that bridge.

Commissioner LEWIS. Well, Milton Friedman told us in the other Commission that if Nazi Germany were alive today, we should be trading with it. I mean, so that can occur.

And then finally, why do you think China wants to join the WTO since they now have access to our markets and you mentioned in your statement prosperity, security and international respect. I mean, those wouldn't be the reasons why they want to join the WTO. Do you think it's to lock in access to our markets on permanent basis?

Ambassador BARSHEFSKY. I think it has to do with a variety of factors. One is international respect, the notion that it is an international player. One is—

Commissioner LEWIS. Those are factors you think are important.

Ambassador BARSHEFSKY. They are among the factors. One is its ability to help formulate the rules of the road. Right now, China doesn't formulate the global rules of the road. It's the Western governments that do. This would give China an opportunity to help formulate the rules. That is significant.

A third is better to ensure that its trade is governed by the same kinds of protective rules as our and Europe's trade is.

Commissioner LEWIS. Do you think the non-hardliners are trying to lock it in because it's a way to open them up more to the world?

Ambassador BARSHEFSKY. And I think for the reformers, WTO accession is the perfect compliment to economic reform internally generated. In other words, we see a very interesting pattern. If you look at the former Soviet Republics, or even take Laos or Cambodia, you see these governments wanting to effect internal reform. They can't because the traditional monied interests are so powerful and entrenched. So what do they do? They join the WTO. They are then subject to a set of international obligations. This is then beyond domestic politics. They take those new international obligations back home and say to their public, "We have to do it. We have an international treaty that compels us to do it".

We see this pattern quite frequently with many, many countries and with respect to China, we see something quite similar. That is, Zhu Rhongji in particular sees WTO accession as a way to cement internal reform in China long after he's gone.

Commissioner LEWIS. Thank you very much. Thank you.

Co-Chairman MULLOY. Before you go, I haven't asked any questions. I want to ask one. The WTO, we would overwhelm the WTO it seems to me by bringing a lot of disputes into the WTO. It would be better to try and work them out before you get there. The second premise is Professor Cohen points out that they really don't have the adequate legal structure to resolve many of the disputes which are going to arise.

So the question is that with the EU now, it looks like we're trying to work out some mechanism outside the WTO to resolve matters. The interlocutory with the Commerce Department and the Joint Committee on Commerce and Trade was MOFTEC. I thought the feeling within the U.S. Government when I was there was that we didn't get enough leverage inside the Chinese bureaucracy dealing with MOFTEC to try and resolve these disputes, that we needed to get it up higher into some other mechanism.

Do you think that should be something that this Administration and we should really look into and press for, to try and find some way to do that?

Ambassador BARSHEFSKY. There is no question that for resolving certain disputes with China there is no substitute for direct contact with a political level sometimes considerably in excess of MOFTEC, their trade ministry. On the other hand, I wouldn't discount the use of things like WTO dispute settlement. Certainly I wouldn't discount it before we use that approach but I think basically a dia-

logue between China and the U.S. Government at a higher political level, on a routine basis would be advisable.

Co-Chairman MULLOY. Do you agree with that, Admiral?

Admiral PRUEHER. Very much.

Co-Chairman MULLOY. Would you both think about where that—we were trying to figure where that ought to be and if you could both think about that and give us something, that would be enormously helpful.

Ambassador BARSHEFSKY. Well, I'll give you just one suggestion off the top. We have annual summits, semi-annual summits with Europe, for example and with many, many countries, at which their top ranking political people and our top ranking political people get together. In the U.S. Government the top ranking political people are Cabinet Secretaries. In many foreign governments it's actually not the case.

In China, the equivalent to the cabinet secretary is not the minister of X ministry; it's the State Council and so, at a minimum, one would want an established dialogue between the Cabinet in the United States and the appropriate State Counselors as well as the direct analogue which would be the Trade Minister, Finance Minister, Foreign Minister and so on. But you want the State Council level. That's the ultimate political level, and a critical locus of decision-making.

It was for WTO. It was for textiles, it was for intellectual property rights to be sure.

Co-Chairman MULLOY. Thank you.

Admiral PRUEHER. That will be true and also in the regulatory world the State Development and Planning Commission, Zung Peiyan, is—

Ambassador BARSHEFSKY. Key.

Admiral PRUEHER. —carries a lot of water.

Ambassador BARSHEFSKY. Key.

Co-Chairman MULLOY. I can't tell you how much the Commission appreciates both of you coming with us today and spending time working through these issues. I hope we can, you know, count on you in the future if we have additional materials.

Ambassador BARSHEFSKY. It would be my pleasure. Thank you so much.

Co-Chairman MULLOY. Thank you very much.

Admiral PRUEHER. Thank you.

[Off the record at 1:51 p.m.]



(AFTERNOON SESSION, 2:30 P.M., THURSDAY, JUNE 14, 2001)

**PANEL III: TRADE RELATIONS BETWEEN U.S.-CHINA AND U.S.-  
TAIWAN: IMPLICATIONS FOR THE U.S. ECONOMY**

Co-Chairman MULLOY. This is the third panel of witnesses that the Commission will hear from today and we're going to hear from Mr. William Wolman, the Chief Economist of Business Week magazine, who is accompanied by his wife and New York financial journalist, Ann Colamosca, and co-author of the book *The Judas Economy*.

In addition, other testimony will be presented by Jerome Cohen, a Professor of Chinese law at New York University Law School and one of the Deans of American Study of Chinese Law and Institutions. Kevin Kearns, the President of the U.S. Business and Industry Council and Rupert Hammond-Chambers, President of the U.S./Taiwan Business Council.

Again, I want to thank each of the witnesses. There was a lot of thought that went into the preparation of your prepared testimony and Commissioners have all had a chance to look at it and we'll be asking questions, but in your formal presentation now, if you could limit yourself to 10 minutes and it will be timed. And when you see the red light, if you could wrap it up so that we could have time for the Commissioners to ask questions, I would really appreciate it.

So with that, let me call on, in this order, if I could, Mr. Wolman and Ms. Colamosca can go first. We'd appreciate that.

**STATEMENT OF WILLIAM WOLMAN, CHIEF ECONOMIST, BUSINESS  
WEEK MAGAZINE**

**ACCOMPANIED BY ANNE COLAMOSCA, NEW YORK FINANCIAL JOURNALIST**

Mr. WOLMAN. Thank you very much. Neither Anne nor I are deeply prejudiced by knowledge of what's going on in China, but we did write a book on the impact of globalization jointly which interested some of the Commissioners and so—and you invited us and thank you very much. And it's basically on the impact of globalization that we will talk. It's fairly clear that at the end of the Cold War was a transformative thing in the world economy. It is a summing almost on the base—on the level of discoveries which opened America to the thrust of a world economy in which globalization was already beginning to occur.

I don't want to belabor this point but America's victory in the Cold War and the simultaneous sort of disintegration of the Socialist model of development opened the entire world to the free market economy in varying degrees. I'm over-generalizing here but in varying degrees, but that certainly happened. The net effect of that will, in the end, be extremely important. The best way I can sum-

marize this is that before the Communist world and the world relying on Socialist models sort abandoned those views each American worker competed with four workers, roughly speaking, in the world.

At this moment of time, this is in our book, each American worker competes with 20 workers around the world at least potentially. The potential competitors to American workers has increased by a very large factor. At the same time, of course, as the American workers faced more competition, there was an explosion in the demand for capital around the world.

Capital suddenly became free to move around the world. It is in the nature of the world, so to speak, that capital is more mobile than labor and the net effect of this, of course, was that capital began to find places where it could economize on labor in ways it could never economize on labor before because of the way things worked.

Now, this is in stark contrast to the entire history of the United States, the Frederick Jackson—the world of Frederick Jackson Turner and before that the world of Adam Smith. The wonder of this country in its early stages was, of course, that the average working man, that's a generalization, did far better than the average working man in Europe. When Adam Smith wrote *The Wealth of Nations* or published it in 1776, he spoke in that of why the American worker was doing so well as compared to the average European worker.

And the answer roughly speaking is that he had more resources to work with. The ratio of men to resources, especially land and the capital use of the land is relatively low in this country so workers could prosper.

Now, flip this situation around, which is what's happened since the end of the Cold War, has really changed the Frederick Jackson Turner world and basically what you have now is a world in which American labor is abundant relative to American capital because the opening of the world has obviously been a magnet for capital around the world.

What is the evidence of this? Profits have really grown fast as compared to wages and the real GTP since the end of the Cold War and even before that when the country—when the old Soviet empire tended to disintegrate. So under those circumstances we had a relative decline in the position of the American working man.

The first effects, of course, was in goods production which was in manufacturing. There will, however, be important secondary effects which already are starting which will really become intense in white collar work and then finally in the work of the elites of the American work force.

The kind of guys that I went to Stanford with was not smart enough to do the same thing they did, the guys who invented the computer and became electrical engineers and stuff like that.

And to speak of that, Anne.

Ms. COLAMOSCA. Just very briefly, I have a long term interest in covering work issues and I started out in the '70's as a staff writer for *Business Week* and I ended up, the major story that I covered actually in my hometown was the de-industrialization of Philadelphia, the loss of blue collar jobs. And you know having come from



a blue collar family, I knew a lot of the people involved. It's still going on and it was a very painful story. So I have covered that story on and off over the last 25 years.

In the mid-'90's we were in the middle of a book and after doing, you know, a fair amount of interviewing, people told us in Bangalore and we spent quite a bit of time with—his name is Narayana Murthi and he is really the father of the software business in Bangalore and at that time, it was about a \$1.5 billion business and by 2008 McKenzie and Company says that it will be somewhere around an \$18 billion business. The environment around Bangalore is just in some ways—I wasn't working then but it reminds me of the environment in Philadelphia in the '50's and '60's before it started losing all of its blue collar jobs and, you know, there's—first of all, there's a paternalism among the businessmen, really are, you know, helping the workers and there's a real feeling of excitement.

And I think that Bangalore will really end up being a model, you know for all of Asia. They started out in the mid-'90's doing—really doing back office jobs for people like CitiBank and Mruthi himself is really aware of the fact that he has to—that he has to supply more high income jobs for the people in Bangalore because work like transcription is already starting to disappear because of the technology of voice recognition. So they are really working now—actuarial work is now being done through software applications, accounting work, graphic design, and those kinds of jobs are just in their early stages.

And I just think that it's something that we all have to be very, very aware of. There are all kinds of partnerships, you know, that can and will be done among all kinds of international business groups and this thing is already spreading. It's being done in the Philippines and there are some software companies in China. So this is just the very, very beginning of what we see, you know, as the erosion of white collar work.

And if you read Ruy Teixeira and Joel Rogers' book, *America's Forgotten Majority, Why the White Working Class Still Matters*, the numbers involved show an erosion of wages in this group from 1973 to 1998 and there was, you know, a blip in '99 and 2000. But I think because of the combination of technology and software, well, software technology in India and China, the combination will see a continuation of erosion of wages in middle class jobs and there's just much, much more to report and we have to I think start looking at this thing very closely and really start monitoring it.

Mr. WOLMAN. I think the last point I want to make is we should have no illusions about anything. One illusion we should not have is that our elite workers, what I call our elite workers, are going to continue to be elite workers. You know, I went to school at Stanford, and to repeat, I was dumb enough to be interested in economic history and stuff like that, you know, and not in the stuff that would have made me a programmer, actually a guy who could do computer languages.

That was a hot spot in world—and still is a hot spot in world technological development and a lot of what happened in the United States had to do with the development of very specialized

hot spot type things, like that industry. It is an illusion to think that that kind of development will be confined to the United States at this point. The interest in this kind of work is enormous around the world. The excitement generated by the net and the computer is very great.

When I was in India at the same time as Anne, you could just—in incredibly difficult circumstances, you could just sense the excitement that was involved in this kind of a world. And I've never been to China but I'm sure there are places in China where this has got to be true as well. So we can't even assume that, you know, our vaunted leadership in—you know, in the highest aspect of tech will continue unchallenged because the same forces that were unleashed here will be unleashed abroad as well and under those circumstances, it seems to me we have to pay attention to this kind of thing.

We should be aware above all, I'm going to stop at this point, that the world facing the American worker is a fundamentally changed world, that the United States at this time does not live in the world of Frederick Jackson Turner, okay, in which the frontier is there and American workers automatically have a lot to work with. The facts of the matter are that capital in some sense is being spread around the world and becoming relatively scarce for Americans.

In case you guys don't know it and I'm sure you do, okay, up to about 1998 the amount of capital per worker in the American economy actually had declined for about 20 years. It just picked up a little bit in the last few years. We should not—and fundamentally, and Anne and I argued this in the book, that the reason we have high employment and low unemployment in this country was because labor was cheap.

That was the basic reason we had it and it may well be, okay, that given what's going on, okay, in the world right now, that it will be a continuing problem to have the standard of living of the average American rise, because labor has got to be cheap for capital to be willing to employ it.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF WILLIAM WOLMAN AND ANNE COLAMOSCA

It is an honor to be asked to appear before this distinguished Commission. We do not come before you as experts on the Chinese economy or on the specific issues raised by China's application for membership in the World Trade Organization. Rather, we appear as students of economic history and economic journalists who have written about the evolution of the world economy in the wake of the fall of the Berlin Wall. We regard the end of the Cold War as a critical event in world economic history, of equal scope, for example, to the events that followed the beginning of the age of discoveries in the late 15th and 16th centuries. Indeed, the speed with which relatively free markets spread around the world in the past two decades is perhaps unprecedented. And an analysis of the consequences of the emergence of a new style global market economy has been one of our major interests in recent years and led to the publication of our 1997 book, the *Judas Economy: The Triumph of Capital and the Betrayal of Work*. Indeed, it is our understanding that the interest of some of the Commissioners in the analysis presented in that book is the main reason that we have been asked to come before you.

That is not to say that we are bereft of views about the impact of the emergence of China on the world stage. As citizens we deplore that country's violations of human rights, its repression of free political activity and its intolerance of religious freedom. We deplore the absence of a genuine union movement. And we share the

deep concerns over forced labor, prison labor, and restrictions on the free movement of workers within the borders of China.

As economic journalists, moreover, we are well aware of the growing importance of China in world trade. Indeed, because of the size and vigor of its population, the emergence of China on the world economic scene means that the trends set in motion by the end of the Cold War are so far merely in their early stages. Virtually every trend that we foresaw in *The Judas Economy* is likely to work with even more intensity over the next two decades than it has over the past twenty years.

Two ideas are basic to a proper understanding of the new globalization. The first is what might be called the law of one price. The second is the simple but indisputable observation that capital is more mobile than labor.

#### *The Law of One Price*

In a world in which trade is truly free, both goods and services will tend to sell for the same price no matter where they may be sold. It makes little difference if they are sold in Bangor, Maine or in Bangalore in the Indian province of Karnataka. The law of one price, moreover, applies not only to goods but also to the services provided by those who earn their living from work. So that a textile worker in the Carolinas will in the long-run earn no more or no less than a textile worker in Guangdong province of China. In the new world, then, there is a relentless tendency of prices to converge. When American consumers can buy products at lower and lower prices, as production spreads around the world, we all cheer. And rightly so. But when American workers' wages are under relentless pressure to move to a point of equality with those in other parts of the world where population is abundant, but capital scarce, we're not so sure that we should cheer.

Most of us are, after all, workers as well as consumers. And that immediately raises serious questions about the equity and justice of international trade. Indeed what prompted us to write *Judas*, was a deep concern that whatever the benefits of globalization may be Americans as consumers, a disproportionate share of the costs of globalization were being born by those who earn their living from work in the United States.

At the time that our book came out, the excess burden of globalization on workers were mostly being born by those manufacturing workers in the old economy whose wages came under downward pressure because production was being shifted abroad in order to take advantage of lower wage scales.

But in the book we also warned that the wage competition that affected manufacturing workers in the 1980s and 1990s, was beginning to manifest itself in the demand for, and wages of, white-collar workers. We also warned that the top rungs of the American labor market, the workers who were the most visible beneficiaries of globalization and the emergence of the new economy would, in the not too distant future, begin to feel the blows of intensified competition from the emerging world, particularly the countries of Asia.

There were already signs that white-collar workers without special skills and education were beginning to feel the effects of globalization. Indeed, in one chapter of *Judas*, *A Passage to India*, we reported on our findings on the migration of the more routine data processing jobs to Bangalore, the Indian city that was showing signs of fuller and fuller participation in the economy made possible by the computer and the Internet. It is interesting that in our reporting with leading executives in the Indian high tech economy, including N.R. Narayana Murthi, the CEO of Infosys, India's leading software company, the major long run concern was not of competition with the United States, but rather of competition with China. Murthi simply said that his long-run concern was that new Chinese software companies would emerge and financially undercut him since labor was so cheap there and so hampered by government in its effort to raise its wages.

There are, in fact, strong reasons to believe that the movement of white-collar work abroad will, at some point, move more swiftly and with more disruptive consequence than did the migration of manufacturing work. There are substantial home market advantages to goods production. For example, when production adds weight to a product—beer, for example—the local market becomes an attractive option that offsets low wages abroad. And in any operation where the product is bulky or heavy, transportation costs become an important consideration and limit the international spread of production.

These natural protections that once existed are, of course, already dissolving in the goods production area itself. In high tech industry where value is high in relation to bulk, we have already seen the movement of production offshore at a rapid pace. One vivid example is the triangular trade in high tech products, which sees Americans placing orders with Taiwanese firms who, in turn, run many of their operations in Mainland China, where they have become major investors. So effective

has this trade become in reducing costs that some call the American-Taiwanese-Chinese high tech economy, the “Golden Triangle”. It is this trade that is a major cause of America’s severe balance of trade deficit with China as well as Taiwan. It is also this trade that more than any other single factor that has led to the rapid growth of airfreight which supports just-on-time inventory policy for which the high tech industries have become famous.

But the barriers imposed by distance on the division of labor are virtually nonexistent for white-collar jobs. The reason, of course, is that distance is a truly minor factor in what it costs to move information on the Internet. Already, in the mid and late 1990s, a small percentage of white-collar American jobs such as medical transcription, customer phone work and data processing were being done by English speaking workers in India, the Philippines and Ireland. These workers need to have a relatively sophisticated grasp of written and spoken English, so it is not realistic to assume that the entire global workforce will be available to do American white-collar work over the next decade. Nevertheless, year-by-year, an increasing number of foreign students are becoming fluent in English. India and the Philippines, of course, are ready-made for this kind of work.

As we learned in India, it took more than a decade of development to emerge as a major player in information processing. Indigenous Indian companies had to develop a long-term track record with American firms to win white-collar work contracts thousands of miles away. And once they did, American corporations flooded into the country and established their own facilities, not only to process information but to develop software. It started out in the mid-1990s as routine “back office” work, and that is still the backbone of the business and is still growing rapidly. For example, Bangalorean software engineers “fix” Citibank cash machines overnight if they are down, and transmit the fixes on the Internet. Throughout the 1990s many large U.S. corporations came to depend on this back-office work. Later, more traditional white-collar jobs—such as medical transcription, airline reservation and debt collection—were added to the mix. In 2001, a recently hired Indian transcriptionist with a bachelor’s degree in science earns \$150 a month. The point is, it didn’t happen overnight. And as Mr. Murthi at Infosys pointed out, “we worked incredibly hard for years to win their confidence.” (In our book, we use an anecdote in which an American executive patronizingly throws a cigarette lighter across the table during the 1960s at an Indian entrepreneur and says, “When you can make one of these, let me know.” This is the kind of attitude that Murthi had to fight against during the early 1990s to make the reputation that they now enjoy.)

But after the years of hard work, a new global paradigm is emerging. And because of pioneers like Murthi and its huge crop of low-wage, well-educated English speakers, India is leading this global trend. Now, in 2001, much more complex white-collar jobs are beginning to be transmitted globally. Highly educated Indian actuaries process insurance claims for Britain’s Guardian Royal Exchange Group. And there are currently plans afoot in India to produce new software in graphic design, accounting, legal services, and social work transcription that could shift tens of thousands of more and more complex white-collar jobs abroad over the next decade and beyond.

Now that Murthi and others have shown that white-collar work can be successfully transmitted thousands of miles away, it can, of course, be done in countries such as China, where software companies are already beginning to compete with Indians at much lower prices. In India, white-collar work is being done by highly educated workers, with degrees from a deep network of universities and community colleges built under a socialist system set up under Nehru, which worked at educating at least some of India’s poor. This complex of eager, well-educated students have given Bangalore’s software business a lot of the creative energy it has needed to become successful.

Anywhere you go in Asia nowadays—China, India, Taiwan, or Singapore—you can find highly skilled workers designing interactive CD-ROM programs, producing programs that map three-dimensional images to diagnose brain disorders, designing digital answering machines or interactive computers for children. The “back-end” work of product development—the painstaking job of turning a conceptual design into blueprints, computer code, or working models, and testing the final product—is increasingly being done in Asia these days. Citibank taps local skills in India, Hong Kong, Australia, and Singapore to manage data and develop products for its global financial services. Hewlett-Packard encourages each of its manufacturing sites around the world to become a global center for many components used in HP’s microwave products. More and more, specially trained Filipino accountants do much of the grunt work in preparing tax returns for multinational firms. All this overseas work is easily transferred via satellite links, computers, and e-mail.

In fact, pioneers such as Citibank and Hewlett-Packard are only the beginning of the trend toward corporate “outsourcing” of highly skilled labor. Well-paying back-end jobs such as software designers, draftsmen, librarians, and mechanical engineers, in which many Americans make their livings are barely in the first stages of being transported globally. The Bangaloreans get paid roughly one-tenth the \$25,000 average salary of full-time medical transcriptionists in the United States. And some in the large southern Indian medical community are currently hard at work trying to figure out how to use the same high-speed data lines to create more upscale medical jobs for their increasing population of university graduates. In addition, those involved in this first wave of cyberspace skilled labor are working very hard to move up from “back-end” production jobs to the creative, frontline jobs, many of which have been monopolized in the last generation, by American “whiz kids” and foreign “whiz kids” working in the U.S.

We do not know how Chinese software and white-collar workers would be treated in China’s much more restrictive command economy. But it would be imprudent to assume that China’s thrust into the high tech world will not succeed because of its repressive environment. Profits rule the day in the early 21st century. And Murthi’s point to us was the Chinese educated labor is much, more cheap than Indian educated labor. It’s just a fact of life.

#### *Have the Elites Had It?*

It hasn’t happened yet. But it is probable that globalization will end up by hurting those at the very top of America’s new economy, the electrical engineers, physicists and mathematicians who have done so much to create the “hot” centers of the new technology such as Silicon Valley. We would argue that the relative good fortune of the elite workers of the developed world is the product of a phase of economic history that is showing signs of coming to a close. Up to this point, these elite workers have gained all the benefits of globalization and paid none of the costs. That’s because they have been what the great British economist Joan Robinson has called “idiosyncratic factors of production.” Mrs. Robinson, who was a Cambridge University economist in the 1930s and early 1940s, pointed out that in a market economy, the highest rewards were likely to be earned by factors of production that she identified as “idiosyncratic,” having, as *The American Heritage Dictionary* describes “unique structural or psychological characteristics.” These elite workers were ideally suited to lead high tech industry in the 1980s and 1990s, and the U.S. was fortunate for their presence.

What is slightly more difficult to grasp is that the educated elites of the developed world have been an idiosyncratic factor of production as a class for most of the four hundred year history of capitalism. Therefore, they were able to lay claim to a large share of the world’s income. It was the educated classes of West European countries, including the United States, and some of the British Commonwealth countries, which were the repositories of virtually all knowledge needed to apply science to the production and distribution. They therefore had a monopoly on technological advances and the dynamics of capitalist production. And since access to this class and to its knowledge base was limited both by ethnic and racial prejudice among the captains of capital and by limited access to education during most of the history of capitalism, white ethnic Europeans, as a class, also had a monopoly on the vast majority of high-skill jobs.

It is doubtful that these forces that have benefited the United States will work with the same force in the coming decade. In particular we have already seen that there are limits to the speed with which high technology can benefit from new opportunities. Our own expectation, in fact, is that the speed of innovation in high tech will slow somewhat. Indeed, we are already seeing the emergence of a consolidation phase in the high tech business, which is placing more and more pressure on new economy companies to cut costs and employment. It is even likely, in fact, that compensation in the high tech sector will grow much more slowly than it has in the past few decades. This, of course, is an environment in which the business incentives to move activities abroad become more and more intense. And we should not be naive enough to believe that the consolidation phase in the new economy will have some extremely old-fashioned consequences. The basic tool of that economy, the personal computer, has already become a commodity in which price competition is intense. We are also witnessing a phase in which the rate of return to increasing the speed of computing and even increasing its range may well be falling, at least for the next few years. This is a perfect atmosphere for business decisions to locate new facilities and purchase products and components from low wage countries. It is also an environment in which it will pay to move more and more computer processing abroad. The Taiwan-China-U.S. economy will put particular emphasis on locating new facilities in China. We take this as a given of the coming decade.

In nominal terms, profits have increased roughly twice as fast as the gross domestic product since the end of the Cold War. As a consequence, the share of profits in gross corporate income, the share of national income generated in the corporate sector has reached unprecedented heights. There is little doubt that most Americans have benefited by the great investment boom that has resulted from the combination of strong profitability and the technological revolution in the use of information. But the facts are that it is the owners of capital who have received the greatest share of the benefits.

#### *Mobile Capital*

The second idea that guided “Judas” was also a simple one: capital is more mobile than labor. It is far easier for capital to move into zones where the returns are higher than at home than it is for labor to accomplish a similar feat. As the world opened up to the relatively free movement of capital, it was easy for American businessmen and American investors to move their capital into zones where rates of return were high. No such spectacular opportunity was available to those who earned their living from work in the United States. All they could do was sit by and watch production move abroad. The effect, of course, was a weakening in the power of American labor. Wage growth began to stagnate, many high wage jobs disappeared and the American labor movement lost much of its power to bargain effectively for American workers. One effect was a shrinkage in the union movement.

The erosion of the position of those who earned their living from work represents a radical change in the entire atmosphere of the United States. Virtually anyone who has studied economics remembers the vivid celebration of the position of the American worker in the early days of the republic. In “The Wealth of Nations”, published in the year of the Declaration of Independence, the great economist Adam Smith, explained why the average worker was faring better in what was to become the United States than in Europe. He patiently showed that American workers were prospering simply because they were scarce, and small in number, relative to the quantity of resources, particularly land, that was available in the country. The consequence, of course, was that the returns to labor, wages, were under constant upward pressure as compared to Europe where the supply of labor was abundant as compared to land and other resources.

In sharp contrast—a contrast that many Americans still fail to notice—the post Cold War economy has made a critical factor of production, American capital, scarce as compared to work. The result has been a radical change in the American economy. During most of the history of the American economy, the movement of people was matched by a movement of capital—monies used to invest in the economy. Even the size of capital flows roughly matched the number of people who were moving. Thus, in broad outlines, the flow of capital out of Europe followed the flow of people. The United States, the country to which people migrated in the greatest numbers, was the recipient of the greatest flow of capital to build canals, railroads, and other industries. Similarly, in the colonial orbit, the flow of capital from Britain to India was closely connected with the movement of the British into administrative and business positions in India, whose top ranks were made up mostly of British. The symbiosis between labor and capital was maintained, even while emigration provided an important safety valve for European workers displaced by invention and innovation. As the Industrial Revolution swept across Europe, the workers displaced by economic change swarmed into the United States.

It is the vast labor pool that global capitalism has tapped into that is the new leviathan. As capital has become more mobile since the Berlin Wall came down in 1989, the number of workers ready and anxious to find work in the new global market has exploded. The effect, which is barely being felt so far, and which will get worse, is to greatly weaken the competitive position of those who earn their living from work in the advanced countries.

The magnitude of the global increase in workers available for global market production since the end of the cold war has yet to sink in, either in the intellectual community or among average Americans. With the free market suddenly sweeping the globe after the end of the cold war, workers from the developed world are now facing competition in a much more intense, explosive way from middle-class mind workers around the world.

Only after the collapse of the Soviet Union did those populous Asian countries that were not part of the original group of economic “tigers”—China, Indonesia, Malaysia, Vietnam and India—begin changing at dizzying speeds. It wasn’t until the early 1990s that Westerners, along with the overseas Chinese, began pouring large amounts of money into China with a growing confidence that the pro-market revolution would prove permanent and eventually, over a billion Chinese would enter the

pro-market economy. These newcomers would be tapped as both the world's largest new consumer market and capitalism's newest vast and talented labor force.

In all, the size of the globally competitive population rose from under 1 billion to over 5 billion in 1994, and the size of the globally competitive world middle class grew from about 725 to a figure something over 1.2 billion. Around the world, indigent well-educated managerial classes—the likes of which the world has never seen before—have aggressively begun making their presence felt as pro-market reforms have been put in place, changing the demographics of the professional labor force forever.

The effect has been a sharp increase in the return to capital as compared to the return to work. When we wrote “Judas”, the full impact on the emergence of China on the global distribution and abundance of workers had not quite dawned on Americans, even those Americans who specialized in economic analysis. But the past three years has made the impact of China clearer. Many of us are now aware that in one way or another, some three hundred to four hundred million Chinese have entered the global economy. This emergence of a vast new pool of Chinese workers will lead to an increase in the speed in which the post Cold War global economy is being transformed.

But what is also true is that the explosion of the global labor supply has greatly reduced the need for a cadre of middle managers to impose industrial discipline on lower-run workers. Instead of relying on stern bosses to keep workers' toes to the line, companies now make it obvious that they can—and will—move their facilities elsewhere. And now, they no longer need to move facilities. Instead, an e-mail is only a few clicks away.

Over the past two decades there have been enormous benefits from the post Cold War spread of the free market. Around the world, but particularly in Asia, hundreds of millions of people have been raised out of poverty. In the United States those in a position to benefit from the free movement of capital have been enriched particularly by the rise in stock prices. But the ownership of capital in amounts to make a real difference is strictly limited in the United States.

It should be obvious that Americans who earn their living from work have paid more than their fair share of the cost of globalization, however, beneficial that globalization may have been from a historical perspective. It is therefore incumbent on policy including obviously U.S. trade policy towards China to be mindful of protecting those who earn their living from work in the United States. That is the main message that history is sending to Washington at this point in time.

Most economists deny that competition with low-wage workers abroad is a problem for Americans. They tend to view calmly the movement of capital into low-wage areas and expect its effects, in the end, to be benign. Their argument, essentially, is that the wage advantages that make newly industrializing areas effective competitors with the established countries of the world will disappear over time. And it is certainly true that these earnings differentials have had a tendency to diminish in the past. As capital moves to low-wage areas, the employment rate tends to rise, and wages are pushed up. Certainly wages in many countries have been rising faster than in the United States, reducing the gap between the cost of labor in developing countries and American labor and the gap between the prices of goods in developing countries and in the United States.

Economists see the process by which earnings in less developed areas catch up with wages in the advanced countries as an aspect of convergence. In this view over time the advantage that low-wage countries have over high-wage countries erodes. As capital moves into the less developed countries, increasing productivity there, exports to the developed world rise, generating more demand for work in the once disadvantaged areas, and increasing wages there. In an environment of reasonably free trade, the process of convergence proceeds to a point where wages in the developing world catch up with wages in the developed countries.

Particularly reassuring to many economists is the experience of the United States in its trade with Western Europe and Japan after those areas began their post-World War II reconstruction. Wages were far lower in those countries than in the United States at the time, far lower, indeed. But by the beginning of the 1990s, wages in Japan and Europe had caught up with American wages, and now wages are higher in those countries than they are in the United States. And although they have yet to equal wages in America, wages in many of the other countries in Asia are catching up.

Don't worry, say most economists. In their view, wages in the other emerging countries will catch up with those of the United States too, and there is nothing wrong with capital moving abroad because rising prosperity in the emerging world will also increase demand for U.S. goods and services, thereby increasing American production, employment, and productivity.

We do not dispute the first tenet of this argument: the probability is that rising wages and increased demand for American products in the developing world will, in the long run, bring some benefits to American workers. We also join conventional economists in hailing the sharp growth in American exports of both capital goods and consumer products to the developing nations, particularly those nations that are growing rapidly.

Nonetheless, we do not believe that these developments will bring the benefits to the United States that many economists claim they will. The full impact of rapid growth abroad on jobs and incomes in the United States cannot be measured in terms of the growth of U.S. exports; rather it should be gauged by what happens to the margin between the quantity of goods that the United States exports and the quantity of goods that the nation imports. And by both measures that margin, the balance of trade, has been deteriorating because American imports are growing faster than American exports. While American industry is becoming more competitive in some product lines, it is losing competitive advantage for products that have an even greater total value. The widely celebrated American export boom is impressive, but the less celebrated import boom is more telling. And because U.S. imports have been growing faster than U.S. exports, it is likely that the international position of American workers is not improving but deteriorating. That is a major reason why there is no end in sight to wage stagnation in the United States and in other industrial countries.

The optimistic view of America's ability to prosper in the wake of the new demographic revolution is, in our view, anchored in the past. The demographics of a world where the growth of the free market labor force is in hyper drive are far different from those during the cold war, before the free market held unquestioned sway. Because of the seismic impact of the rapid worldwide spread of available skilled labor, the process by which wages will become equalized around the world is almost certain to progress extremely slowly. It is only among the economic tigers on the periphery of Asia and in one province in southern China (Guangdong), and elsewhere just among select members of the middle class, that the process of wage convergence has advanced with any degree of speed.

There should be no mistaking where the logic of a totally free, totally integrated world labor market leads. The very same forces that pit the exchange rate of the dollar against other currencies will eventually guarantee that a programmer earns no more in Boston than in Bangalore, a certified public accountant no more in Baltimore than in Beijing, or an architect no more in New York City than in Kuala Lumpur.

Nor is there any way for those in the industrialized world who earn their living from work to really escape the assault of the market. On the eve of a fight with a skilled defensive boxer, Tony Pastor, the great heavyweight champion Joe Louis once said, "He can run, but he can't hide." And so it is with all those who earn their living from work.

Co-Chairman MULLOY. Thank you.  
Mr. Kearns?

**STATEMENT OF KEVIN L. KEARNS, PRESIDENT, U.S. BUSINESS AND INDUSTRY COUNCIL**

Mr. KEARNS. I am Kevin Kearns from the U.S. Business and Industry Council. I am very pleased to be here today. I see so many friends and associates on the panel. It's a real pleasure to be able to testify before you. I'd like to associate myself with the remarks just made by Bell Wolman and with the excellent book *The Judas Economy* and recommend that you do read it if you have not yet.

At U.S. Business and Industry Council, our bottom line is simply this: that no one wins in America unless everyone wins. The purpose of the American economy is to create a high standard of living for all Americans, not just certain elites. We have had an economy since the mid-'70's where we've left increasing numbers of Americans with stagnating incomes. For families that problem was addressed first by sending large numbers of spouses into the work force in the 1980's, then kids working part-time jobs, and then fi-



nally by easy access to credit to try to keep up a family's standard of living.

But as these American workers compete with workers around the world, it is becoming increasingly difficult for them to keep up that standard of living. And the—I call it a cult, the cult of free trade in this town seems to think that the market economy or markets will solve all problems. I think nothing could be further from the truth. Markets don't take into account national standard of living; they don't have a political dimension; they don't have a national security dimension. And these are the aspects of our China policy and specifically our trade policy, that have been missing to date. So I'm very pleased that the Commission is taking up a number of aspects, especially the security policy, of our overall political relations in the context of trade and economic relations.

We believe at USBIC that our current trade policies toward China are doing irreparable damage to the American economy. The China trade surpluses made available through our very unbalanced two-way trade now approaching \$90 million represent, an invaluable subsidy to China, and best estimates are that precisely monies in this range are spent by the Chinese on weapon systems, on their military. China is a country that regularly challenges U.S. national security interest in East Asia and, in fact, around the world through exports of various weapons and nuclear technologies.

In addition, U.S. multi-national companies routinely transfer advanced technology to the Chinese, which also enhances their weapons development. When I was a staff member on the Senate Foreign Relations Committee, Senator Helms had me write an amendment, this was in 1989, that said no U.S. satellites should be exported to China for launch on Long March rockets until they, that is the Chinese, stop providing weapons of mass destruction to a number of named terrorist states.

The amendment carried in the Senate and was defeated in the House, but that was 12 years ago. People could certainly see the Loral and the Hughes problem coming, people who wanted to see it could see it. Long March rockets blew up a lot, so even though the launch was cheap, you had to pay an awful lot of money in insurance to put your satellite on a Long March rocket. The way around that for the companies—to still have the cheap launch and save on insurance costs, of course, is to improve the capability of the rocket, which, as you all know, has military as well as commercial applications.

Another critical development in East Asia that I would like to highlight is the fact that as our market has remained open to Chinese goods over the last decade and a half in particular, we have crowded out investment, foreign direct investment, in friends and allies in Asia. And that investment has gone into China. So we have, in fact—our policies have in fact, significantly damaged the economies and societies of countries that our security strategy aims to strengthen and defend. So there are of course, strategic and geopolitical consequences from our international trade policies.

Almost all of Asia has export—led economies which are in direct competition in the U.S. market, and the U.S. market can't sustain them all. U.S. Successive White Houses have been unable to connect the dots between the economic gains and the national military

strength in these economies. This is something that Beijing calls comprehensive national power. We don't look at that at all in our trade policy. Free trade isolates simply on the economics, free trade and its adherents which are generally politicians and multi-national corporations.

So China is in a struggle with America's traditional allies in Asia and the contest is for export markets and capital as Bill Wolman has said. China and the Rim countries are all trying to advance up the same ladder in the same way and there's not enough room for all of them on the ladder. During the Clinton years, China more than doubled its share of the U.S. market, mainly at the expense of these Rim rivals. Its 1994 devaluation brought it a lot more business and investment and, in effect, paved the way for the 1997 financial crisis, which weakened the states that, again, are friendly to the U.S.

At USBIC we want to see manufacturing and the jobs associated with it remain in the United States. If they have to go somewhere overseas, we don't want to see them go to an unfriendly or hostile power and that is, in effect, what's happening.

We have examined in great detail corporate investment in China, and we believe that the evidence indisputably shows that most of this investment is targeted at serving the U.S. market, that is U.S. corporate investment in China is targeted at serving the U.S. market and not penetrating the domestic Chinese market, or it's targeted at serving other markets in East Asia.

What this means is that we are not exporting American-made goods, and let me give you the trade theory. If American goods are competitive in terms of price and service and quality, et cetera, we should be able to simply export them from the United States and penetrate these markets. Because the Chinese Government is involved in making sure that there are in effect no real labor unions, their or environmental policies—all the regulatory aspects of doing business in the United States do not exist in China—therefore, making it quite cost efficient to manufacture there, so we can't export our goods from the United States to China.

It is not a level playing field and the lopsided ratio of U.S. exports to and imports from China, which is the widest among any American trading partner, indicates there is something clearly wrong here. The Federal Reserve Bank of New York has estimated this estimate was done for the year 1996, only four percent of U.S. exports to China were consumer goods and only 20 percent of the total exports to China made it into the Chinese market. Thus 80 percent are capital goods or sub-assemblies, which are turned around and come back to the United States or other countries.

Between 40 and 50 percent of Chinese total exports are now sold to the United States. And that gives us tremendous leverage with China. You know, it's really interesting to see every year during the MFN debate, the previous years when we had the MFN debate, the first thing that the Chinese would do would be to threaten to close their market. "If you stop MFN, we're going to close our market to your goods." And the multi-national corporate line here in Washington is, "Oh, my gosh, you know, we can't do this," but the fact that the Chinese themselves, that's their first resort in terms of a threat to try to change American Government behavior and

thinking, indicates that blocking Chinese exports to the United States would have some effect, otherwise, they wouldn't use that argument in reverse on us.

We're particularly concerned with the plight of America's small and medium-sized manufacturers whom we represent. I can tell you many stories. One quick one, the General Motors plant in Shanghai put out an RFP, request for proposal. In that proposal it says, "If you get this contract", American subcontractors, "you will transfer all your technology to a Chinese partner. You take a joint venture partner and transfer it over five years". Well, at the end of five years, guess who General Motors is going to be supplying from? Not the company that I represent in rural, Tennessee which employs 400 Americans, but they're going to be supplying their worldwide operations out of China.

So there's a real split, as we see it, in American business between what the multinationals want and what smaller manufacturers might want. And we see over time, not only are we losing control of our security policy, but we're losing control of our economy. If the multi-nationals are supplied by Chinese firms, it gives the Chinese or whatever government it happens to be, but in this case the Chinese, tremendous power over the multi-nationals.

If I could make one final point in one minute, there is this nonsense notion that free trade is going to solve all problems. First of all, I don't see much free trade in the world, otherwise we wouldn't have to negotiate all these trade agreements. If anyone were interested in free trade, they could sign a one-page document that says, "We agree to remove all barriers, tariffs, et cetera, immediately and open our markets". So we have highly managed trade; but there's this notion that free trade equals democracy and democracies are always friendly. Someone who tells you this—that China is going to be a democracy because we trade and, therefore, friendly to the U.S.—is selling you a bill of goods. It ignores Chinese history; it ignores the history of trading among European states, for instance, in the 19th and early 20th centuries. It's simply unsupportable based on the evidence.

China is going to do what China wants to do. Japan is a democracy. We have many economic problems with them. With China we will have economic and security problems as well. So it's simply happy talk to assume that we trade with China and there are going to be no problems in our relationship. Thank you for the opportunity to testify.

[The statement follows:]

PREPARED STATEMENT OF KEVIN L. KEARNS

Good afternoon. My name is Kevin L. Kearns, and I am President of the United States Business and Industry Council. It is a great privilege to be invited to testify today.

The U.S. Business and Industry Council represents more than 1,000 domestic companies—companies dedicated to producing their goods and services in the United States, where business conditions and genuine free market forces militate for this. We are also dedicated to ensuring that U.S. government policies encourage the strengthening of the U.S. domestic industrial and technology bases.

The establishment of the U.S.-China Security Review Commission holds the promise of bringing about an urgently needed transformation of America's economic and security policies toward the PRC. USBIC—which has worked for a strong national defense and defense industrial base throughout its seven-decade history—is especially pleased that the Commission's mandate recognizes that these policies cannot

be implemented or examined in isolation from one another. The compartmentalization of economic and security issues has been one of the great failings of America's recent China policies.

To take in order the questions presented in your invitation letter, our Council strongly believes that our current trade and investment policies toward China are undermining U.S. national security. These policies threaten America in several ways. The huge China trade surpluses made inevitable by these policies—nearly \$85 billion in 2000 alone—represent an invaluable subsidy for the economy of a country that is clearly unfriendly to the United States, and that regularly challenges U.S. national security interests around the world. Indeed, the forthcoming Pentagon strategic review is widely expected to place China at the top of America's international threat list in all but name.

Because money is fungible, these surpluses clearly free up major resources for the Chinese military. In fact, the \$85 billion current annual Chinese trade surplus with the United States is approximately as large as the best estimates of China's current annual level of military spending. And it should not be forgotten that many of the businesses accruing profits through international trade are in fact owned directly by the People's Liberation Army.

In addition, U.S. multinational companies routinely transfer militarily-relevant advanced technology to China through their extensive investment in high-tech manufacturing and research facilities in the PRC.

Another critical development is that the openness of the U.S. market to Chinese goods has crowded out the goods made in developing Asian countries, as well as diverted foreign investment from these countries. The result: We have significantly damaged the economies and societies of countries our security strategy aims to strengthen and defend.

There are strategic, geopolitical consequences from international trade and investment flows. Last month, President Bush wrote to officials of the Asian Development Bank, "I give you my personal pledge that the U.S. market will remain open so that we can continue to contribute to Asian Pacific prosperity." This is the same pledge President Bill Clinton made when Asia was rocked by the 1997 financial crisis.

America had a merchandise trade deficit with Asia of \$168 billion in 2000, a figure that has grown by \$73 billion since 1997. So what more can the U.S. do? One thing: it can be more selective as to who it helps in Asia by integrating its economic policies with its geopolitical alliances.

The Asian export-led economies are all direct competitors in a U.S. market that cannot support them all. Singapore's Senior Minister Lee Kuan Yew warned in February that China's growing trade "dominance" could put its neighbors out of business. A recent cover story on China in *Business Week* reported, "China is fast becoming a manufacturing threat to many Asian countries." And a new white paper being prepared by Japan's Ministry of Economy, Trade and Industry (METI) worries that China is becoming "the world production center."

For a White House that considers China as a "strategic competitor"—a correct assessment in our judgement—this cannot be a good trend. Yet, President Bush seems unable to connect the dots between economic gains and national strength—what Beijing calls "comprehensive national power."

The Bush team needs to understand that in commerce as well as in arms, China is in a struggle with America's traditional allies in Asia. The contest is for export markets and capital investment. China and the Rim are all trying to advance up the ladder of more value-added export goods with higher technology; and to attract the money needed for economic growth and improved living standards.

During the Clinton years, China more than doubled its share of the U.S. market, mainly at the expense of its Rim rivals. This performance was based in part on its 1994 devaluation, which helped bring on the 1997 financial crisis that weakened the Rim states. Beijing is attracting not only American and European capital that might have gone to develop Rim economies, but capital from businessmen in Japan, Singapore, South Korea and Taiwan. This further shifts the balance of power in the region.

Slower growth since the 1997 crisis has had a negative impact on defense modernization efforts among many of America's allies. Meanwhile, China's continued economic growth funds its military buildup as foreign investment improves its industries and infrastructure.

In the annual report of India's Ministry of Defense released May 31, it is noted that in South East Asia "the economic crises have also created additional opportunities for extra regional powers to gain increased security leverages in the region. . . . At a strategic level, the military balance between China and the other countries of South East Asia is altering further in China's favour." This is due both

the China's military buildup and to the fact that "most of the countries in the region have had to reduce their defense expenditures" due to slower economic growth.

But Beijing's beggar-thy-neighbor strategy could not have worked had Washington not continued granting China "most favored" or "normal trade" status throughout the 1990s. Only trade with allies, friends, or non-belligerents should be considered favored or normal; the privilege should be withheld from a bellicose China.

USBIC and its related Educational Foundation have examined in great detail U.S. corporate investment in China. We believe that the evidence indisputably shows that most of this investment is targeted at least as much at serving the U.S. market as serving China's market—and therefore displaces production here at home. The lopsided ratio of U.S. exports to and imports from China—the widest among any of America's major trade partners—is one strong indication. So is the clear record of U.S. multinationals of engaging economically with China by investing in the PRC rather than exporting to China—which, at least theoretically, is the way free trade is supposed to work. As our 2000 report *Factories, Not Jobs* documents, most of these investments by American multinationals are aimed at serving not only the U.S. market, but third country markets as well—meaning that they preempt many direct U.S. exports to these regions.

In addition, several respected scholars have compiled data strongly indicating that most of what America (and other countries) export to China are not goods intended to be consumed in the PRC, but products that contribute to Chinese export activities. For example, researchers at the New York Federal Reserve Bank estimate that only four percent of U.S. exports to China in 1996 were consumer goods, and that only 20 percent of China's total imports reach China's domestic markets. The other 80 percent consists of capital goods and industrial inputs used in the country's vast network of export processing zones—which, of course, support the manufacturing of goods destined for foreign markets. And up to 40 percent of China's total exports are sold to the United States.

Finally, the growing tendency of Chinese companies to sell shares in U.S. financial markets opens up a spigot of money to the Chinese economy that could eventually dwarf the country's net export earnings. The money raised by the PetroChina IPO—although greatly lessened by the activities of a number of American organizations, including my own, dedicated to openness and accountability in foreign securities offerings in U.S. markets—subsidizes the Chinese economy and Chinese military as surely as that generated by the export of machinery.

We hope that the full implications of these trade and investment patterns will be investigated thoroughly by the Commission. In particular, we hope that the Commission will examine the impact of these economic flows on the small and medium-sized manufacturing companies that comprise such a vital but neglected part of America's manufacturing base. These companies, which typically supply U.S. multinationals, have been exposed by U.S. trade policy to predatory competition from Chinese rivals not burdened by labor or environmental regulations, and aided by numerous formal and informal trade barriers and subsidies—including forced technology transfer from American firms. If this predatory competition continues unabated and unaddressed or ineffectively addressed by U.S. policy—as it has been until now, the future of small manufacturers in America is bleak—and the independence of larger American manufacturers could be fatally compromised.

In reference to the enormous size of America's trade deficits with China, the obvious cause is that America's trade barriers are low by any measure, that its market is indeed wide open to Chinese products, and that China's trade barriers remain very high. But this answer also indicates that the U.S. government has failed miserably to secure equitable terms of trade with China, and to promote any U.S. exports other than those that increase the capacity of Chinese manufacturing to compete with American.

Despite China's heavy dependence for growth and economic development on selling to the United States, and despite China's clear technological inferiority, Washington has long acted as if the United States needs China more than China needs the United States. Consequently, China has an almost unbroken record of violating its trade agreements with the United States, and the United States has an almost unbroken record of failing to enforce the treaties it negotiates.

USBIC believes that this situation is not simply a puzzle. We consider it be strong evidence that U.S. trade policy—and the multinational companies that so decisively influence it—care little about opening China's market to products made in America. Their top priority is keeping the U.S. market open to the goods they produce in China. In this vein, a desire to make China invulnerable to U.S. national trade laws is surely the prime reason for ardent multinational support for China's entry into the World Trade Organization—a development we strongly oppose at this time.

Although China runs trade surpluses with most of its major trading partners, none of these comes close to its surplus with the United States. In addition, a 1997 USBIC Educational Foundation study titled *Made in China* found that both the European Union and Japan had better trade balances with China in high-value manufactured goods than did the United States.

The trade and investment policies of China's non-U.S. trade partners unavoidably affect U.S. national security. China's surpluses with these countries also subsidize the Chinese economy and in turn the Chinese military. These countries transfer technology to China as well. Japanese firms have traditionally withheld much of their advanced technology from foreign business partners. But recent reports indicate that European companies like the Dutch lithography giant ASM are planning to sell very advanced semiconductor manufacturing equipment to China—possibly equipment more advanced than that proscribed in the Wassenaar agreement. Moreover, the likelihood of Taiwan's semiconductor industry moving most of its advanced production to China greatly expands the possibility of the PRC's securing access to the world's most sophisticated equipment for producing information technology products.

U.S. Trade Representative Robert Zoellick is just completing his first direct talks with China on WTO membership. Serious issues remain to be resolved, especially on agriculture. But we fully expect an agreement to be reached relatively soon. We would highlight two reasons. First, American multinational companies will continue to lobby intensively for U.S. negotiators to close the deal, and their campaign contributions play a large role in American politics. Second, the Chinese must know that the Executive Branch has shown little interest in enforcing trade agreements once they have been negotiated. Therefore, China might show new willingness to compromise.

We believe that the picture of powerful interests in China fighting tooth and nail to oppose WTO admission is greatly exaggerated, and possibly a propaganda product aimed at foreign audiences. This is not to deny that China faces major economic challenges in the future. The leadership has clearly decided to pursue politically risky economic reforms—mainly, privatization of much state-owned industry. But as Beijing has openly acknowledged, these policies would be pursued whether the WTO existed or not. We believe that the Chinese are fully—and justifiably—confident of their ability to resist foreign pressures to speed up or broaden these reforms, and will be able to comfortably control the pace of change in their economy.

USBIC believes that the best policy for handling the problems likely to result from China's admission to the WTO is to withdraw from the organization. We strongly opposed U.S. entry into the WTO, and still consider it a major policy mistake. Outside the WTO, the United States would regain full legal authority to respond to predatory Chinese trade practices through its own trade laws. As we suggested above, the United States has more than enough leverage with China to ensure the success of this unilateral approach. We also believe that similar U.S. leverage exists with our other trading partners, and that unilateralism would achieve similar success on these fronts as well.

Thank you again for the opportunity to appear before the Commission.

Co-Chairman MULLOY. Thank you, Mr. Kearns.  
Professor Cohen?

**STATEMENT OF JEROME A. COHEN, PROFESSOR OF CHINESE LAW,  
NEW YORK UNIVERSITY; ADJUNCT SENIOR FELLOW, COUNCIL  
ON FOREIGN RELATIONS; AND OF COUNSEL, PAUL WEISS,  
RIFKIND, WHARTON & GARRISON**

Professor COHEN. Thanks. I've had a very good time here since 9:00 o'clock and I've learned quite a lot. And now we're going to go more from the macro to the specifics because I was quite interested in your discussion with Ambassador Barshefsky, particularly you're obviously focused on enforcement. Enforcement is the name of the game in dealing with China in many respects and today I've been asked to talk about the legal aspects of the accession of China to the WTO and essentially cover four questions.

The first is, what are the legal commitments that China is being asked to fulfill. The second is, is China now ready to fulfill those commitments. The third question, since we know China isn't by

and large ready to fulfill all those commitments is how long will it take and the fourth is, what will it take to enable China satisfactorily to fulfill those commitments.

So first the commitments are familiar to you, I suppose by now. One is so-called transparency. That means we need to know not only at the central level, but the local level, what are that laws, what are the regulations, what are the administrative rulings of general applicability and what are the relevant judicial decisions? How can we find out about them?

The second question is, to what extent can China now produce uniform impartial administration of all these rulings, laws, regulations, judicial decisions, administrative rules, et cetera. Can we expect uniform application and if not, what can be done about it? And the third commitment of course, they're supposed to provide an institutional arrangement for objective, impartial, independent review of how they have fulfilled their rulings, et cetera.

So you have do we know about the rulings, what are the rulings and how do we get review of any failure alleged to live up to the rulings. Well, on the first question, transparency, I should say first of all for someone who's not in the U.S. Government, to try to learn what the commitments are that China is being asked to make raises a serious question of transparency in the United States Government, because it took me quite a few phone calls and we talk about guanxi's importance relationships in China without guanxi in Washington, I wouldn't even know how to focus on this question to you.

But as I understand it now, and nothing has been made public yet, China's commitment with respect to transparency is first of all, they are going to publish and make readily available all these relevant norms, including so-called maybe wongen, internal documents, normative documents that aren't normally available. I've sat across in 20 years of dealing with China at many negotiating table where actually in some cases they have the regulations in their laps and they keep it sort of under the table, like a good poker player. And they say, "I'd like to tell you what these rules are and why they're against you, but I'm sorry, I can't show them to you".

And supposedly we're now going to do away with that. Now we've heard that before going back about 15 years in our talks with MOFTEC, but I think this may have some teeth in it and all I can say is we'll put them to the test, I assume. The second—under the normal WTO system, a country is supposed to have a so-called single point of inquiry where you can go and get all relevant local as well as national legal regulations, judicial decisions, et cetera. It's quite unrealistic.

I don't know any place in the United States where we can meet that single point of inquiry and China fortunately our negotiators have realized it's quite unrealistic to think there's just going to be one place but they seem quite confident that the Chinese are now committed to have at least a number of points of inquiry, particularly journals, particularly Internet sites where these norms that are supposed to be transparent will be, indeed, readily available.

So I hope we can say goodbye to the old internal documents and I think prospects for complying with this transparency requirement

are good. It's not going to be done this year or next year. It's going to take several years. And it will be expensive, burdensome but I think it's quite doable. I think China will do it because I think they know it's in their interest to know better what's going on in their country, especially in light of the eternal struggle between the central government and the local government for who was going to control day to day activities in any given field.

And the real questions are will these norms that we gradually know more about, will they be evenly, fairly carried out and if not, what can be done about it? Will there be adequate review? China has agreed, apparently to establish an inquiry point within the central government not yet identified, an office, to which anybody with a grievance about the way the law is being applied to them in Guanchi or Beijing or wherever can go. Now, that office is supposed to have a real budget, a staff, be effective, given the proper support from the government and they're not only supposed to receive your grievance but to do something about it and that would be important.

In my dealings with China, including these recent criminal cases where people are locked up and one of my clients was here this morning, his wife is an American university teacher, has been locked up since February 11th.

In all these cases, civil or criminal, the terrible thing you encounter in dealing with China is, putting it in imperial Chinese terms, how do you ring the imperial gong? How do you get the attention of the central government and the situation cries out for somebody to be available to hear you out and to provide you with a remedy and that's what this office is supposed to be, an office where if you feel the law is being misapplied to your case, you can go and they're going to do something about it.

As I say in my formal statement, to those of us who work every day in China, China is not a totalitarian dictatorship, except with respect to the Falun Gong religious sect they feel so threatened by for reasons they fail to make clear, where so-called espionage cases. The resources available and applied by the central government to any given activity are actually too limited.

China is a weak state in most respects and if you talk about the protection of intellectual property, the enforcement of environmental protection, the enforcement of securities, stock exchange regulation for example, China's central government is not strong and that's the reality and will it be strong in this respect with respect to the office that's being set up to cure these problems? I think expectations have to remain modest.

As I say in my paper, China is more like a series of futile baronies than an effective totalitarian dictatorship. So what do you do about it if you're not getting the administrative actions that you feel are fair, just and due to you? Is there some institutional review available? Normally, the shorthanded people say the judicial review requirement.

But actually it isn't a requirement that there be a court that review potentially arbitrary administrative action. It's a requirement that there be some effective, fair, independent institution. It need not be a court but in most places we function with courts, we focus on courts.



Now, China has done a lot since 1978 to build a legal system. In 1978 China really was a shambles with respect to laws, with respect to many things. I'm the glass is half full. I give you an account that shows a mixed picture, but the courts have made considerable progress and legal education and all the underpinnings are making considerable progress but it's not enough. Right now, I cannot tell you that the courts provide an adequate, fair, consistent, independent review of administrative actions but they're doing better. In some cases they really do and I'm impressed.

In many cases, however, they don't. They don't have the professional level yet. They don't have freedom from corruption. Guanchi, the social network of relations in which judges are embedded really is perhaps the greatest vice. The courts are nominally independent of the administration.

Co-Chairman MULLOY. Mr. Cohen, I know the red light has come on but, I just want you to realize that you don't have to stop. This is of such interest to the Commission and since you and Commissioner Lilley were college classmates and have added so much to our knowledge of China, we want you to continue until you feel—

Professor COHEN. I'm sorry, I won't be much longer but I do look forward to the discussion—

Co-Chairman MULLOY. Continue on. Absolutely.

Professor COHEN. —because I've heard your questions this morning and I know this seems to be responsive to your interest. Nobody's interested in empty clichés that aren't going to prove workable.

I think the critical factor with reform of the courts, the critical factors are not these band-aids that the Supreme Court is now in the process of putting on a very, very serious illness. They are making some important reforms but the critical factors are structural and we don't see so far a willingness in the leadership of the Chinese party and government to make those reforms.

If they wanted to really stop local protectionism that's such a vice and deprives not only foreigners but people from other cities and provinces of a fair judicial decision, very often when they go to a particular locality, they know how to do it. The Manchu Dynasty knew how to do it.

They didn't let their judges come from the place where they worked, and when they assigned them to some other place, they only kept them there three years. They didn't want them to have this network of connections that corrodes the judicial process. They could move the power to appoint judges up to Beijing to promote, compensate, fire. That power shouldn't be at the local level because it puts judges in the hands of the same people who own the companies that come to court and that bias the judges in terms of not giving a fair hearing to outside interests.

Moreover, real reform in the Chinese judiciary would require the end of the Communist party control over specific cases decisions. In China today, the party political legal committee that controls every area's court system, also controls the police, the prosecutors, the judicial bureau and they are the real power of determination. They can tell the court leadership what to do and the court leadership in turn, can tell individual judges what to do.

Will we ever see that kind of reform? We almost saw it in the late '80's. Zhao Ziyang, before he was removed, as a result of the Tiananmen crisis was really trying to do that, get the party out of specific judicial decisions. But there was a big setback. It hasn't happened yet and yet forces like WTO accession are really gathering strength again, and it's coming. In the meantime we should remind ourselves courts aren't the only way to guarantee this kind of review.

And something interesting has happened recently. Last March 2000 China put out a so-called law on legislation. It's trying to rationalize and clarify the relations of all these different norms and hierarchies of norm makers and in it is really an interesting set of provisions that for the first time says if an individual or a company, foreign or domestic, has a grievance against an administrative action, there's now a process by which it can go and not only get compensated, we already have that at least in principle, but invalidate the administrative action by going at the national level to the standing committee of the National Peoples Congress, not a court but a political agency. Now, that's a really interesting idea. I'm excited about it. I've talked to many Chinese lawyers about it. They seem cautious.

The scholars are hostile because the scholars were disappointed in that law. They would like to see an independent constitutional court in China. That's not in the card politically for a long time. I think they ought to use what they've got, which is the basis for creating in this legislative body a standing committee of the NPT, a semi-adjudicative body, not so different from what took place in England over the centuries, where you had the judicial committee of the Privy Counsel in the House of Lords.

This is an opportunity that lawyers should be exploiting. I think the regular judges are not happy with this. They'd like to have the power to invalidate legislation. They've been denied that. Nobody has confidence in the courts including the leadership of China. And there's a rivalry between the courts and the standing committee of the National People's Congress or who's going to have power. So it's an interesting situation. What can we do about it finally?

I think China is going to be able increasingly to meet these requirements of uniform administration of rules and eventually will have some form of adequate, at least in a formal sense, review of administrative action but will it be independent? It's not going to be really independent unless they get serious about this. They want help, however, and the more help we can give them, the better.

I think we ought to let this process of China's integration with the world continue for reasons many people have evinced this morning and we ought to be cooperating with them. When President Jiang came here in September '97, he and President Clinton made an agreement. One of the so-called baskets of the agreement was legal cooperation. Nothing happened afterwards to implement it.

Clinton went back to China in '98. They reiterated the importance, again nothing happened. It's only very recently that the Congress has shown some awareness of the importance of putting our money where our mouth is.

It's not good enough just to get up and make speeches that play in Peoria about the beauty of human rights and how China needs a rule of law. You've got to help them and they're asking for our help. And I think we ought to take them up on it and finally \$2 million did get appropriated last year and I said in my talk I hope in my lifetime the state department will finally move itself to distribute that money.

And in next year's, this current budget, I understand there's \$5 million in the budget. So there is some hope but that's a drop in the bucket. And when you think, as I say at the end of my talk, what a missile costs or a bomber, and you think of the potential importance of the growth of law in China and what it means for American values, for American security, indeed, and for American business, including labor and farmers, and what it means for Sino-American relations, I think it's worth the cost of a few bombers.

[The statement follows:]

PREPARED STATEMENT OF JEROME A. COHEN

Mr. Chairman and Members of the Commission, Sino-American relations have come a long way since I started my study of China's law and language in 1960. At that time relations were still extremely hostile, and our government was vigorously enforcing its embargo against trade and investment in China. As the embargo began to lift in the early 1970s, I served as a lawyer for American and foreign multinationals in their trade with China. After the PRC launched its twin policies of moving toward a "socialist market economy" and opening to broad cooperation with the world in late 1978, the Beijing Municipal Government invited me to be the first foreign lawyer to establish an office in China, in return for training its officials in international business law. Since then I have specialized in the legal aspects of U.S.-China trade and investment, focusing in the 1980's on the making of contracts and, inevitably, in the 1990's on the breaking of contracts—i.e., the settlement of disputes. At the same time, I have continued my teaching of Chinese law, first at Harvard and now at NYU. For the past five years at the Council on Foreign Relations I have also been responsible for a program on the rule of law in China, and I have recently advised, on a pro bono basis, the families and employers of a number of persons of Chinese descent who have been detained by the PRC on criminal charges.

On the basis of this experience, today I have been asked to discuss China's legal institutions, especially the PRC's ability to comply with three basic legal requirements for WTO accession: (1) transparency of relevant laws, regulations, judicial decisions and administrative rulings of general application; (2) uniform, impartial and reasonable administration of those legal norms; and (3) institutions that guarantee independent, objective and impartial review of all relevant administrative actions.

*Background*

China's anticipated entry into the WTO is already stimulating a new, third wave of law reform in the PRC. The first wave rose in late 1978, following the end of the Cultural Revolution, with China's momentous decision to open the country to international cooperation and specifically to welcome foreign direct investment (FDI). Over the next decade, this resulted in development of a legal framework that has helped China to become, far and away, the most attractive FDI destination among the world's emerging economies. The second law reform wave, which required another intensive decade of legislative innovation, began in the early 1990s with the decision to establish securities and other financial markets that would be increasingly open to foreigners. The current WTO-inspired wave has already witnessed prodigious PRC efforts to revise existing laws and regulations relating to trade, technology transfer, investments, banking, insurance, securities, taxation, customs, intellectual property, telecommunications, health, professional services and a host of other subjects in order to bring them into compliance with the WTO regime and to make the adjustments required by market access commitments.

China's WTO accession will also be the capstone of its substantial post-'78 achievements in acceding to virtually all of the significant multilateral conventions that grease the wheels of international commerce. In addition, the PRC has concluded a vast network of bilateral business-related agreements with the world's

trading nations that have enhanced investor security and incentives, avoided double taxation, promoted a broad range of cooperative projects and facilitated dispute resolution.

Of course, it is easy for specialists to find flaws in these domestic and international rule-making accomplishments. For example, there are inconsistencies between some of China's international agreements and its legislation, between the promulgations of different central government institutions, between central and local norms and between the regulations of one locality and another. Last year's poorly drafted but important Law on Legislation, which was designed to clarify legislative confusion, has added new complexities, and many more laws in critical areas such as telecommunications and antitrust are yet to come.

#### *Transparency*

In light of this background, the PRC will undoubtedly find it burdensome, but feasible and even useful, to meet WTO transparency standards. First of all, China will be expected, at all levels of government, to publish and make readily available all relevant laws, regulations and administrative rulings of general applicability, including internal "normative documents," prior to their enforcement. This requirement is designed to allow an adequate opportunity for potentially-affected parties to comment, consult, and have their views considered before the norms in question become legally effective. Implementing this enormously important change will take a few years to achieve, especially regarding regulations and local norms. Second, although in view of China's size and complexity it does not seem wise rigidly to require that all norms slated for promulgation be made available at a single inquiry point, the PRC will be expected to make them available in a number of convenient ways including publication in journals and on Internet sites. In certain designated emergency situations the opportunity for advance comment need not be provided, but in no case will a norm be enforceable prior to official publication.

Thus, at least in principle, gone will be the days—and there have been many—when foreign firms and their lawyers have been told that the problem under negotiation is controlled by an "internal document" that, unfortunately, cannot be shown to them. Again, it will take years consistently to abandon old habits, but those who have been negotiating the details of China's accession seem to have wisely avoided the imposition of a precise schedule in this respect as in others. Finally, the transparency requirement should stimulate PRC courts, which have been publishing only selected judicial decisions, to make available all their relevant judgments, an expensive but desirable task.

#### *Uniform, Impartial Administration of Norms*

Yet the major legal challenges confronting China's WTO accession do not lie in transparency and law-making but in application and enforcement of the law. Can Chinese administrative agencies, so traditionally intertwined with the enterprises that they have controlled and usually owned, become impartial and independent agencies that have no substantial interest in the outcome of the matters they must decide? Will provincial and local government institutions, enmeshed in conflicts of interest and political/economic struggles, learn to resist the very strong pressures of "local protectionism"? Will it be practical or even wise to attempt to enforce uniform administration of rules in different parts of a country possessed of such diverse regional conditions?

The PRC has reportedly agreed to establish an inquiry point within the Central Government to which complaints concerning differing provincial and local implementation standards can be referred, and this office—yet to be designated—will be obligated to take prompt action to address such complaints. How effective this office is likely to be in attaining remedies for aggrieved parties when confronted by the acute sensitivities and obstacles that mark central-local relations will depend, of course, on its staff, its budget and the leeway granted by central leaders. Experience thus far with similar problems in China suggests that expectations for this office's effectiveness in the near term must be kept modest.

The fact is that, contrary to American images of the PRC as a ruthlessly-effective authoritarian regime whose writ runs from the Standing Committee of the Party Politburo in Beijing to the most remote hamlet, in many respects contemporary Chinese government resembles a series of feudal baronies more than a totalitarian dictatorship. To be sure, when it comes to suspicions of espionage or the "threat" of the Falun Gong, the Central Government allocates maximum resources to carrying out its will. But most economic matters cannot consistently make equivalent claims upon central resources. Thus, whether one speaks of enforcing upon a far-flung populace national environmental standards, intellectual property protections or securities regulations, the Center's will is often deflected and indeed frustrated.

*Independent, Impartial Review of Administrative Actions*

China's courts, to which WTO members would normally look for the independent, impartial review of all relevant administrative actions, suffer similar problems. This is not to say that the PRC's post-'78 law reform program has neglected legal institutions. A court system that now handles well over five million cases a year has been erected from the shambles of the Cultural Revolution, as has a nationwide organization of prosecutors. The legal profession has also been revived and includes about 120,000 practitioners plus large numbers of government legal specialists and in-house counsel to PRC companies. The China International Economic and Trade Arbitration Commission (CIETAC) has become the busiest international commercial arbitration organization in the world, and virtually every Chinese city of any size has its own domestic arbitration commission eligible to handle foreign-related as well as domestic disputes.

Civil, administrative and criminal procedure codes and an arbitration law have been enacted to guide the operation of these burgeoning institutions, and laws governing the conduct of judges, prosecutors and lawyers have also been adopted. Specialized court divisions have been created to deal with intellectual property matters and other foreign-related economic disputes. From time to time Chinese courts hand down well-reasoned judgments in cases important to economic development, such as recent decisions settling disputes over contested Internet domain names. The Supreme People's Court has specifically sought to educate the courts about the new tasks to be thrust upon them as a result of China's WTO entry, and a court leader has announced that, in cases where WTO rules prove in conflict with Chinese laws, the former should prevail. A much-needed evidence law is also being drafted. All of the above activity has fueled a boom in legal education and scholarship, and there is widespread hope among China's rapidly growing legal elite that WTO entry will boost the country's prospects for establishing a genuine legal system—not merely rule by or through law but a rule of law to which the Party and government as well as all other people and entities are subject.

Despite all these positive developments, however, the sad truth is that, for the foreseeable future, China will have great difficulty providing independent judicial review of administrative actions. Although improving every year as tens of thousands of bright young law graduates join the many former soldiers and police who were the mainstays of the judiciary, the professional level of the courts outside the major cities is still quite low. Corruption is a depressingly serious problem for judges, who are underpaid and generally treated like other officials rather than instilled with a distinctive professional and ethical spirit. Even more widespread is the responsiveness of judges to "guanxi," the personal network of social relations in which they are embedded and that exposes their decision-making to a range of distorting pressures.

Moreover, judges, who enjoy no tenure of office, are, by and large, appointed, promoted, compensated and removed not by the Supreme People's Court or Ministry of Justice in Beijing but by the local party and government elite. Thus, they and their courts are usually responsive to local influences more than legal norms, notwithstanding the Constitutional guaranty of the independence of courts. This is the root cause of the "local protectionism" that the Supreme People's Court condemns in its annual reports but that it is helpless to eliminate. Although efforts are under way to introduce adversarial trials and to render trials more meaningful by often allowing trial judges to decide the case, matters of any importance continue to be decided by leading court officials, either individually or through "Adjudication Committees", even though these court administrators may have only rudimentary legal training and limited acquaintance with the case. Moreover, the courts are under control of the local Party Political-Legal Committee, which coordinates their conduct together with that of the local prosecutor's office, police and justice department. Over 90% of the country's approximately 180,000 judges are Party members.

The Supreme People's Court itself, which has done so much to improve the system in recent years, has nevertheless contributed to the widespread lack of confidence in judicial professionalism and impartiality. It has tolerated and even fostered non-transparent communications between lower courts and higher courts, allowing lower courts to obtain the advice of superior tribunals with no notice to the parties, or opportunity for them to be heard, thereby often nullifying the significance of any subsequent appeals taken from the lower court decisions. And in its own handling of individual cases the Supreme Court has violated civil procedure rules that call for transparency, setting a poor example for the lower courts.

Because of lack of confidence in the courts, foreign companies have long preferred to insert arbitration clauses in their contracts with China. Their PRC counterparts usually agree, but strive to persuade the foreign side to accept CIETAC arbitration. Yet there is no escaping PRC courts, whether arbitration is conducted in China or

abroad, if the foreigner wins and the Chinese side refuses to comply with the award. Because the Chinese company's assets are usually in China, the foreigner must then look to China's courts to recognize and enforce the award. Since PRC civil procedure law was amended to require the foreigner to seek the assistance of the court located where the liable party or assets are located, thereby maximizing the prospects for "local protectionism" enforcement of the award has been uncertain, even if a foreign award that falls under the relevant UN Convention is involved. We should note that the record of Chinese courts in enforcing their own judgments and orders is amazingly poor, even in purely local cases, vividly demonstrating the weakness of judicial institutions in the PRC.

Further, the longer my experience as either an advocate or an arbitrator in disputes presented to CIETAC, the graver my doubts have become about its independence and impartiality. I used to believe that CIETAC panels offered PRC courts an encouraging example of the possibility of becoming respected, independent adjudication bodies. Yet several recent experiences have opened my eyes to the fact that, despite CIETAC's impressive progress in improving its rules and administration, much remains to be done. At a minimum, I would surely no longer advise clients to accept CIETAC jurisdiction unless the contract's arbitration clause requires the appointment of a third country national as presiding arbitrator. And CIETAC needs to improve the ethical and professional standards of its staff, prevent breaches of confidentiality and conflicts of interest and insulate its arbitration panels from the hazards of politics, corruption, guanxi and exparte communications that plague the courts.

Yet it would be mistaken to believe that China's prospects for developing independent judicial review of administrative actions are entirely bleak. Efforts since 1990 to implement the PRC Administrative Litigation Law and related legislation, including even the State Compensation Law's limited provisions for responding to the grievances of victims of unlawful official conduct, suggest that better days may be on the way, especially if these laws are revised to expand their scope, remove existing obstacles to their use and strengthen their remedies. Yet, unless national Party and government leaders give a much higher priority to judicial reform than they have to date, we can expect progress toward independent judicial review to be slow, piecemeal and disappointing.

What is needed is not a succession of bandaids for a patient that is severely ill but radical surgery and structural rehabilitation. For example, a leadership that is sincerely determined to overcome "local protectionism" guanxi and corruption in the courts, and that can summon the necessary political will, can dramatically improve the situation by transferring the powers to appoint, promote, compensate and dismiss judges to the Supreme People's Court and by granting judges security of tenure subject to conditions that are common to other countries with a judiciary of the continental European type. Even imperial China took stronger measures to fight the perennial problem of "local protectionism," prohibiting its magistrates from serving in their home districts and requiring their rotation to new places every few years in order to reduce the risks of local embeddedness.

A far-sighted PRC leadership bent on swifter modernization and greater national and international legitimacy would go further by prohibiting and punishing the interference of Party, as well as government and other influences, in judicial determination of concrete cases. There was a period in the late 80's, just prior to the Tiananmen tragedy, when it seemed that then Party General Secretary Zhao Ziyang had decided to try this. In the conservative climate of today, as Zhao's successors seek to cope with the profound economic challenges of WTO accession, the selection of a new generation of leaders and a restless populace over which they have diminishing control, they are too nervous and timid to surrender control over court decisions. What even Prime Minister Zhu Rongji fails to see is that, without systemic court reform, none of his essential programs to reform state-owned enterprises, the banking and tax systems and the securities markets and to create a market economy that will inspire the confidence of foreign financial investors can fully succeed.

Courts are not the only PRC institutions that might develop into fora for independent, impartial review of administrative actions. Neither Chairman Mao nor Deng Xiaoping accepted Montesquieu's doctrine of the separation of powers. Thus, PRC Constitutions, following the Soviet model, have purported to confer supreme governmental power upon the National People's Congress (NPC) and its Standing Committee. Although the NPC Standing Committee (not to be confused with the real locus of political power, the Party Politburo Standing Committee) has long possessed the formal power to review and invalidate administrative actions that violate Chinese law, it was only the March, 2000 Law on Legislation that spelled out broad procedures for how individuals and entities that desire such review might proceed at the national level. Indeed, the Law on Legislation even introduces the possibility

of seeking a determination by the NPC Standing Committee that certain governmental actions violate the PRC Constitution.

I was excited when I read these provisions of this little-noted, complex and inadequate law, for they open up, however tentatively, a potential path toward the implementation of government under law. Yet many Chinese law reformers and scholars, disappointed at the Law on Legislation's failure to establish an independent constitutional court, which would be a major milestone en-route to the rule of law, have downplayed the possibility that the NPC Standing Committee, a highly political legislative body, might some day become an effective functional substitute for judicial review. China's judiciary, which has never been allowed to wield the power of constitutional decision-making, was undoubtedly relieved that the NPC had not authorized the creation of a separate constitutional court that would have upstaged the regular courts. Yet the Supreme People's Court, which has long annoyed the NPC Standing Committee by its frequent resort to the device of "judicial interpretation" as justification for what can only be recognized as the functional equivalent of legislation, was presumably not pleased by the NP's go-ahead for its Standing Committee to undertake important adjudicative functions that in other countries might be allocated to the judiciary.

Thus far, Chinese lawyers I have spoken with seem either cautious or uninformed about the possibility for reviewing administrative action apparently offered by the Law on Legislation. Perhaps the PRC's WTO entry, with its requirement that China provide some type of independent institutional review of administrative actions, will stimulate interest among lawyers and scholars in cooperating with the NPC Standing Committee to develop a credible quasi-adjudicative body even within the bosom of the legislature. This would give flesh to informed speculation that, while an independent constitutional court is not currently acceptable to Party leaders, formation of a new constitutional committee within the NPC Standing Committee might receive political approval. Of course, the Standing Committee has thus far failed to develop into a credible quasi-adjudicative institution the Basic Law Committee of legal experts that was added to the Standing Committee by the PRC's Basic Law for the Hong Kong Special Administrative Region. So it may well be that nothing significant will be built on the possibility offered by the Law on Legislation. Yet, nothing ventured, nothing gained. Chief Justice (and former California Governor) Earl Warren once remarked: "California wasn't built by pessimists!"

*The Need For Post-WTO Legal Cooperation*

Virtually every supporter of the PRC's WTO accession has noted that it is likely to promote those forces in Chinese society that favor development of a genuine rule of law. Many believe that progress in law reform will inevitably, if indirectly, help to improve the human rights situation in the PRC. China has long welcomed and benefited from cooperation on legal matters with foreign governments, public international organizations, charitable foundations, NGOs and foreign universities, law firms, bar associations and individual lawyers. Given the immensity and duration of the task, U.S. Government assistance would be extremely desirable. In 1997 in Washington Presidents Jiang and Clinton formally agreed to undertake a bilateral program of cooperation on legal matters, and they reaffirmed this goal during President Clinton's return visit in 1998. Last year, thanks to the efforts of Senator Arlen Specter and others, the Congress for the first time appropriated \$2 million with the recommendation that it be allocated to projects relating to the rule of law in China. I hope that, at some point before I meet my maker, the State Department will distribute these funds and the next year's budget will appropriate a much more substantial sum. Fostering a more open, law-abiding China will facilitate the PRC's compliance with WTO accession requirements, promote American business as well as our national security and values and strengthen Sino-American relations. I think it's worth the cost of a missile or two.

Co-Chairman MULLOY. Thank you very much, Professor Cohen.  
Mr. Hammond-Chambers.

**STATEMENT OF RUPERT J. HAMMOND-CHAMBERS, PRESIDENT, US-ROC (TAIWAN) BUSINESS COUNCIL**

Mr. HAMMOND-CHAMBERS. Commissioner Mulloy, thank you very much, indeed. I'd like to start by saying what an honor it is to testify today. I wish to start by briefly addressing the questions posed in your letter of invitation detailing Taiwan's intricate involvement

in China's economic development and how the United States is becoming increasingly involved in that triangular relationship.

Taiwan's Board of Foreign Trade calculate Taiwan's exports to mainland China in 2000 at \$26 billion with imports from the mainland at \$6.2 billion, making Taiwan's trade surplus to China in 2000 the highest on record at approximately \$20 billion. It's important to note that Taiwan prohibits a significant number of goods and services from being imported from China and therefore, we see a consistently high trade imbalance between the two.

If we consider the amount of investment that Taiwan has in the PRC and vice versa, Taiwan's government heavily restricts direct investment in China. In spite of these restrictions, domestic companies and individuals have invested about 50 billion in China over the past decade according to an estimate by Taiwan Central Bank. Taiwan companies have become adept at using offshore banking such as the Cayman Islands to route investments that would be deemed too high under Taiwan's law. Around 40 percent of Taiwan's total foreign investment is in China and two-thirds of that amount is invested in electronics and high technology.

A survey by the Ministry of Economic Affairs shows that 25 percent of companies in Taiwan plan to increase their investments in China after both enter the WTO. Mainland Chinese investments in Taiwan on the other hand, are negligible as Taiwan strictly prohibits such investments. In 2000 Taiwan exports to the U.S. reached 34.8 billion and imports from the U.S. reached 25.1 billion making for a trade surplus for Taiwan of 9.1 billion. The U.S. served as Taiwan's largest market for exports and the second largest source of imported products.

Taiwan is out seventh largest market for U.S. products and its eighth largest trading partner. In regards to Taiwan's WTO accession and Taiwan's expectations for that, there appears to be a certain resolution amongst mainland officials that Taiwan will accede to the WTO in a short period after China itself becomes a member. As I understand it, the U.S. Government both under President Clinton as well as under President Bush has taken lengths to both inform the Chinese that the blocking of Taiwan's accession is not acceptable and to assure Taiwan that they will accede in a timely manner following Chinese accession.

Logically, it makes no sense for the Chinese to block Taiwan's accession. It would cause enormous problems for them in their relationship with the U.S. particularly as both sides work to place trade in a positive and central framework. Also Taiwan is a major investor in China and WTO accession will almost certainly start a new round of aggressive investing by many of Taiwan's companies. This sadly does not mean that we can be 100 percent sure that China will not attempt something in the eleventh hour. This is a relationship that is frequently difficult to understand and it is important to note that what may seem logical us frequently has no relevance in China.

It is, however, my belief that Taiwan will accede to the WTO within a brief period of time following the accession of China. In addition, Taiwan's accession to the WTO proffers enormous economic benefits for America. A fact that will help insure Taiwan's entry to the WTO, the U.S., Taiwan and China have been able to



take a step forward in the WTO process by separating politics from economic objectives. Taiwan views WTO accession as an enormous opportunity. Direct, cross-strait trade should the barriers be unwound following accession will allow Taiwan to increase their exports while foregoing the expense of shipping through third parties as they do at the moment.

In addition, after widening profit margins by producing low end products in the mainland, Taiwan companies will be able to invest more in R and D and to focus on creating more patents and establishing rights to intellectual property where the true value lies. Trade liberalization will enhance Taiwan's comparative advantages in local Chinese markets while promoting their ability to compete with other leading IT based economies in Asia and in the West.

Finally, WTO will provide Taiwan with a platform to resolve disputes bilaterally in an internationally recognized framework. The China WTO package could allow China to leap forward in its economic development, it would foster competition as an important impetus for restructuring state owned enterprises and could advance the expertise of its work force. On the other hand, China has to maintain political and regional stability while maintaining investor confidence as foreign direct investment has fed the continued growth of China's economy. As China has so much to gain from a productive membership in the WTO, I believe that they will sincerely try to live up to their obligations to their trading partners. However, I do believe that China will try to take as much advantage of that position as possible as do most members of the WTO including the United States, maneuvering to receive favorable terms and conditions.

Indeed the behavior of the Europeans over banana quotas and commercial airplane equipment subsidies is ample proof that that WTO is not immune to abuse. In regards to the actions of the United States if China fails to live up to its WTO obligations, the Council feels that the U.S. should not take any unilateral action if China fails to live up to its WTO obligations. All disagreements should be solved through the WTO dispute resolution process. It is the position of the council that a strengthening of the process is needed as we have a selective compliance record by some of our largest trading partners.

Finally, most of the Sino-American dialogue of late has focused on the military relationship between the United States, China and Taiwan. However, there are other important considerations beyond the military perspective. These economies are more closely linked today than ever before and while their inter-dependency is producing important economic gains, it is also further exposing the U.S. economy to the risks of conflict in the Taiwan Strait. American companies are increasingly relying on Taiwan companies to supply them with computer products and components. Already Taiwanese technology companies have achieved a great deal of success in providing those components. That's success has been driven by robust investments in China.

Taiwan has committed about 50 billion in funds to the PRC of which 25 billion was paid in capital. The impact of this investment is felt most profoundly in the realm of information technology. Taiwan's push to become and even more player in the global IT

market will be influenced by the entry of both Taiwan and China into the WTO. Direct trade relations with China providing a pool of skilled low cost labor will increase Taiwan's ability to cut production costs, thus increasing their ability to lower costs for their American buyers while offering access to the vast and rapidly growing IT market in China.

This is particularly significant today with the United States economy slowing and China's appetite for PC's and other technology products growing rapidly. As Taiwan's manufacturers seek a new base for low cost production, they're increasingly producing that technology components, the components the U.S. relies on for our domestic productivity gains in China. It is likely that American companies will become increasingly reliant on Taiwan as a source for the technology equipment U.S. businesses use daily. However, the extent to which the U.S. Government and the policy community is aware of this independency is really not clear.

The opening of cross-strait trade and the accession of Taiwan and China to the WTO will highlight this trend and further strengthen the economic inter-dependency between them and with the United States, but that will make the U.S. that much more reliant on an improvement in cross-strait relations for its own economic well-being as American technology products are increasingly produced in one of the world's most potentially danger areas. Thank you.

[The statement follows:]

PREPARED STATEMENT OF RUPERT J. HAMMOND-CHAMBERS

*Taiwan-U.S. and Taiwan-China Trade and Investments*

Taiwan has been one of the world's fastest growing economies over the past ten years and more, and the island is the seventh largest market for U.S. products and the eighth largest trading partner for the U.S., behind Canada, Mexico, Japan, mainland China, Germany, the U.K., and South Korea<sup>1</sup>. In 2000, the United States was ranked the top market for Taiwan exports, accounting for 23.5% of the total. The U.S. also served as Taiwan's second largest source of imported products, behind Japan, accounting for 17.9% of the total. In the ten years from 1990 to 2000, the value of Taiwan's exports to the U.S. grew by more than 60%, while the import growth rate was almost 100%.<sup>2</sup> (Figures 1-3)

Much of Taiwan's success can be attributed to effective positioning strategies and sound economic policies. Taiwan's IT manufacturers have been able to maintain a competitive edge in the global IT outsourcing marketplace, and as a result, U.S. companies have increasingly come to rely on Taiwan manufacturers for IT products and supply chain management expertise. In respect to economic policy, strong government support for the IT sector has encouraged innovation and increased trade in information technology products. Taiwan's IT companies have strategically positioned themselves to meet increasing global demand, and their success in this area has elevated Taiwan's status as an important player in the global economy.

Mainland China has played an important part in the success of Taiwan's IT companies, as those companies are increasingly investing in the mainland as a way to raise their profit margins. Manufacturing costs in China can be 15-30% lower than in Taiwan, which is significant in an industry where gross margins are generally very thin. Taiwan's government officially forbids direct investment in China, but domestic companies and individuals have invested about U.S.\$50 billion in China over the past decade, according to an estimate by the Taiwan's Central Bank.<sup>3</sup> (Figure 4) Around 40 percent of Taiwan's total foreign investment is in mainland China, and two-thirds of that amount is invested in electronics and high technology. Mainland

<sup>1</sup> Taiwan Economic News, March 22, 2001.

<sup>2</sup> The Board of Foreign Trade.

<sup>3</sup> Taipei Times, April 19, 2001.

Chinese investments in Taiwan, on the other hand, are negligible, as Taiwan strictly prohibits such investments.

The mainland is also becoming an important trade partner for Taiwan, and according to the Board of Foreign Trade, Taiwan exports to mainland China in 2000 reached U.S.\$26.1 billion, marking a 23.3 percent annual growth and accounting for 17.6% of the island's total exports. Taiwan's trade surplus to China was also the highest on record in 2000, reaching U.S.\$19.9 billion.<sup>4</sup> (Figures 1–3)

#### *WTO Accession*

China's pending membership to the World Trade Organization (WTO), immediately followed by Taiwan, offers potential economic benefit for all parties, as well as opportunities for resolving the political controversies that has complicated the WTO entry process. The China-WTO package has a direct impact on U.S., Taiwan, and China business interests, as under WTO rules and regulations U.S., Taiwan, and Chinese companies will be able to expand their business operations abroad. On the political front, many proponents of China and Taiwan's entry into the WTO maintain that political differences between the two sides will be alleviated as economic relations improve. That would, to some degree, calm U.S. worries over the politically charged issue of Taiwan's sovereignty and its independent entry into the WTO.

There are two central issues relating to the China-WTO package. One issue involves the political factors that convolute the WTO process, while the second issue involves Taiwan's role in the global technology supply chain, and how the WTO trade deal strengthens Taiwan's position in the global technology-driven marketplace. There are three overarching areas of question that warrant examination and analysis in delineating the implications of China's pending accession to the WTO. First, how do trilateral political considerations affect the WTO process, and how do they affect potential political gains and business opportunities for the three sides? Second, do the WTO provisions outlined in the China-U.S. bilateral trade agreement have a direct impact on the business environment in China, and on the global technology supply chain? How will those provisions affect the information technology regulatory regime in China? How will a shift in free trade and investment patterns in the PRC complement U.S. and Taiwan business partnerships? Third, what are the potential risks facing U.S. and Taiwanese firms given China's past record in creating a strong regulatory environment?

#### *Political Controversy in the Context of the WTO*

The WTO agreement presents some interesting challenges, because the non-political nature of the WTO process is increasingly being challenged by political considerations that relate to U.S., China, and Taiwan interests. China's ultimate accession to the WTO is a complex process affected by political dynamics in U.S.-China relations, U.S.-Taiwan relations, and cross-Strait relations. Many of the political issues affecting this process overlap with economic interests, thereby potentially threatening the business benefits the WTO has to offer. In order for Taiwan, China, and the U.S. to reap the full benefits of the WTO agreement, a number of political issues must be resolved. In an effort to understand those issues, it is necessary to provide a brief history of the political forces that surround China and Taiwan's accessions to the WTO.

Some of the political dynamics that have created controversy during the WTO accession process involves the political relationship between China and Taiwan that first began at the closing of the Communist Revolution in Mainland China. The outcome of this conflict set the stage for a diplomatic tug-of-war between China and Taiwan, with both fighting for international status and political legitimacy on the international stage. Both have tried, with varied success, to isolate the other from the international community by attempting to influence international organizations. More specifically, this battle spilled over into international organizations such as the General Agreement on Tariffs and Trade (GATT), and later into the World Trade Organization (WTO), and the United Nations (UN). After the communist victory on the Mainland, the Taiwan government claimed that they were the only legitimate government of China. Later, Taiwan authorities conceded that there was "One country" but two systems, with Taiwan being the only legitimate government of China and the other system being the communist system in place in the Mainland. However, the Mainland Chinese government has maintained their version of a "One Country" policy, stating that Taiwan is a "runaway province", and they later went on to modify this position by adopting a "One Country, two systems" policy approach. Under this approach, China maintains that they are the sole government

<sup>4</sup>Central News Agency, February 27, 2001.

of the People's Republic of China, an approach that is used for Hong Kong and Macau today.

In 1965, Taiwan was successful in achieving observer status at sessions of the GATT. However, in 1971 Taiwan lost its status in GATT because of a decision by the UN Assembly recognizing the legitimacy of the People's Republic of China.<sup>5</sup> In 1992, Taiwan was able, through diplomatic maneuvering, to influence GATT's Council of Representatives to establish a separate working party to examine a request for accession of the separate customs territory of Taiwan, Pengu, Kinmen and Matsu (referred to as "Chinese Taipei"). The conclusion of this examination led to a consensus recognizing the "One China" principle, in which the PRC would take priority over a "Chinese Taipei" initiative to establish a separate customs territory. When GATT evolved into the WTO council, a similar rule was adopted for the process of accession for "Chinese Taipei" and Mainland China. The agreement was that "the Council should give full consideration to all views expressed, in particular that the Council should examine the report of the Working Party on China and adopt the Protocol for the PRC's accession before examining the report and adopting the Protocol for Chinese Taipei, while noting that the working party reports should be examined independently."<sup>6</sup>

Today, Taiwan's leadership must overcome the political adversity that the Beijing leadership has created, if it is to reinforce its economic strength in the world community. By gaining accession to the WTO, Taiwan's business community will get an opportunity to maintain and increase its access to the global economy. This will empower Taiwan in the expansion of its multinational manufacturing base in business environments such as China. Although Taiwan's efforts to achieve member standing in international organizations has been largely unsuccessful, Taiwan has been able to achieve a significant amount of success through their continual economic liberalization. The fact that they are currently ranked the 14th largest trading nation in the world bears some consideration, which should promote accession of Taiwan under protocol for Chinese Taipei. In the past year, Taiwan has witnessed some extraordinary political change, which have added some interesting dynamics on cross-Strait relations. President Chen clearly supports China's WTO membership and welcomes an expansion of cross-Strait economic relations. Chen has officially stated that Taiwan "would welcome the normalization of U.S.-China trade relations, just like we hope the cross-Strait relations (between China and Taiwan) can be normalized; We look forward to both the People's Republic of China's and Taiwan's accession to the WTO."<sup>7</sup>

Taiwan's long-term political goal is to increase economic cooperation with China while coming to a consensus over the interpretation of the "One China" principle. In order for Taiwan to take advantage of the benefits offered by the China-WTO deal, Taiwan must ensure its own entry to the WTO. Furthermore, if China is successful in implementing the WTO provisions, Taiwan will be more empowered to expand its investments in Mainland China by increasing its base of operations in high-tech manufacturing in the Mainland. In addition, Taiwan's import/export industries will make significant gains through open trade. Much of this, of course, depends on a resolution of current political differences stemming from the issue of Taiwan's sovereignty. If political considerations are put outside the WTO process, or resolved through cross-Strait dialogue, then both sides will be in a better position to gain mutual economic benefit from their membership in the WTO.

China has, for the most part, aimed at blocking Taiwan's accession to the WTO. A political mandate by the Communist leadership seems to be driving a great deal of this initiative. China's goals are to politicize the WTO process over the issue of Taiwan's entry. If successful, that strategy would reinforce political legitimacy for China on the international stage, while adding impetus to its growing nationalism. As a measure to meet this objective, China has insisted in the final stages of the protocol agreements that the WTO use legal language that recognizes its sovereignty over Taiwan, although, to date, the U.S. government has rejected this language. Furthermore, the Mainland has taken the position that Taiwan should only be allowed to join the WTO as a customs territory, part of their notion of a "Greater China". This is a gambit by China to ensure its position of international primacy over Taiwan. Taiwan's entry to the WTO is something that threatens this notion, and consequently the leadership in Beijing is willing to disregard the potential economic benefits of Taiwan's entry. This stance has increased tensions in China-Taiwan political relations, and has stalled economic cooperation as well. How effective

<sup>5</sup> "Accessions", WTO Archives. (<http://www.wto.org/about/china.htm>). 3-23-00

<sup>6</sup> *Ibid.*

<sup>7</sup> "Taiwan leader backs WTO for China report", Reuters. 3-22-00

China is on this policy position depends greatly on how effective the WTO is in adhering to the nonpolitical criteria for admitting entry.

WTO requirements are based on nonpolitical considerations, and if China's political pressure proves successful, the "Taiwan issue" threatens to undermine WTO procedures. The implications are that U.S. and Taiwan business interests will not benefit from the concessions outlined by WTO guidelines. This is of enormous importance, as it has direct bearing on Taiwan's high-tech manufacturers who are working to expand their operations in China in order to lower production costs and access the market. It is also of importance to American firms that would reap the benefits of lower production costs of Taiwan manufacturers, as they represent an integral part of the global technology supply chain.

Taiwan's accession to the WTO proffers economic and political benefits for the U.S. In economic terms, membership for both economies promotes technology investment. On the political front, the U.S. would be indirectly adding a small amount of international legitimacy to Taiwan's economic importance without compromising U.S. political commitments to Mainland China. The U.S., Taiwan, and China would then be able to take a step forward in the WTO process by separating politics from economic objectives.

Moreover, Taiwan's eventual accession to the WTO would lead to a more liberal trade regulatory environment in Taiwan that not only advances U.S. and China economic interests, but also empowers Taiwan's economic strength globally. This will enable Taiwan companies to expand their operations in China under WTO rules and regulations and therefore give U.S. companies more business opportunities in China, through their relationship with their Taiwan manufacturers. Moreover, assuming China is successful in meeting WTO obligations as outlined in the agreement, Taiwan companies will have an added advantage in performing business operations in Mainland China. A freer and more transparent Chinese business environment greatly complements Taiwan's position in the global technology supply chain by enhancing its ability to meet the growing demand from American high-tech manufacturers.

#### *WTO Implications for U.S., Taiwan, and China Companies*

Provisions and requirements for China's entry into the WTO, as outlined by the U.S.-China WTO trade agreements, represent solid concessions in free trade, and a large number of those provisions focus on information technology trade issues. Taiwan and U.S. companies stand to achieve enormous economic gain from concessions outlined in the U.S.-China WTO trade agreement.

#### *Taiwan's View*

If China's accession immediately follows that of Taiwan, Taiwan views their combined accession as an enormous opportunity for business on both sides of the Taiwan Strait. At a Ministerial Conference in Singapore in December 1996, former Taiwan Economics Minister Dr. Wang Chih-Kang further expressed Taiwan's commitment to cooperate with the WTO process in the areas outlined above by stating:

"In the area of further liberalization, we support the proposed Information Technology Agreement which we believe will achieve the full liberalization of the market for information technology products, what is particularly worth mentioning is our commitment under the TRIPS and the GATTs; Our protection of Intellectual Property Rights (IPR) has much exceeded the requirement of the TRIPS, especially in the area of border control."<sup>8</sup>

In addition to Taiwan's efforts to meet WTO standards, Taiwan has been moving in a direction towards more liberalized information technology policies on issues of trade, while also supporting China's goals for entry to the WTO. Taiwan is supporting China's bid for WTO entry, because a more liberal free-trade environment in China will improve Taiwan's economic and trade position. One forecast predicts that WTO accession, will add a further NT\$30 billion (U.S.\$0.95 billion) per year to Taiwan's export growth.<sup>9</sup> The incentives are great and the implications are that the U.S., China, and Taiwan have a great deal to gain by pushing China's accession forward. For the first six months of the year 2000, Taiwanese investment in Mainland China reached U.S.\$1.03 billion. Although that figure is down 17 percent for the same period in 1999, contracted investment is up 31% (valued at U.S.\$1.99 bil-

<sup>8</sup>"Accessions," WTO Archives (<http://www.wto.org/wto/archives/st130.htm>). 3-23-00

<sup>9</sup>"Taiwan Exports May Increase U.S.\$0.95B. A Year Upon WTO Accession," Taiwan Central News Agency. By Deborah Kuo. (<http://www.taipei.org/teco/cicc/news/english/e-11-26-99/e-11-26-99-2.htm>). 11-26-00

lion), which is significantly higher than the same period in 1999.<sup>10</sup> Much of this reflects how China-bound investments are on hold until the WTO deal plays out. After accession, the increase in foreign investment flows gives impetus to economic growth while also providing incentives for the Chinese government to adhere to WTO principles and rules to further encourage this flow of funds.

In examining Taiwan's approach to economic growth, it is clear that the trade concessions offered by China in the WTO trade deal complement Taiwan's industrial goals. Taiwan's approach to economic development consists of minimal government intervention, diversification of products, and a movement away from labor-intensive products. This has led to a great deal of success in small and large-scale business operations, and has led to increasing competitiveness. The added competitive edge has enhanced the ability of Taiwan companies to penetrate the global market. The opening up of China's markets, and a more transparent regulatory regime, will enhance Taiwan's comparative advantages in local Chinese markets, while promoting their ability to compete with other leading information based economies in Asia and in the West. One reason why Taiwan has been successful is due to its ability to upgrade its production standards. Taiwan has been moving away from labor-intensive products, and thereby away from direct competition with the other Asian "Tigers", toward more innovative trade strategies and diversified product lines. Moreover, they have been successful by emphasizing more effective globalization strategies. This means the Taiwan government has avoided choosing which industries to develop, but rather has adopted a functional policy that provides incentives or levies to influence companies' external behavior. Consequently, Taiwan companies have been able, with a high degree of success, to expand the development and export of information technology products.

Today, Taiwan represents one of the top producers of information products. WTO free-trade rules help create a more open market where Taiwan's industries can further grow. In the future, Taiwan manufacturers will be empowered through the WTO to increase its trade in information technology products. As this trade increases, so will their continued success in the production of information technology products. Taiwanese firms will be able to achieve this through a production shift, whereby manufacturers can focus on different approaches that promote product differentiation in high-tech and high-quality products. Furthermore, an important area of note is that Taiwan governmental policy has led its domestic industry core to upgrade its quality product standards during a relatively short period. The implications are that Taiwanese companies have a tremendous ability to compete in the dynamic, fast-paced global technology market. Eventually, Taiwan's domestic environment will reflect higher standards in its legal system, higher manufacturing capacity, and a product mix equal to most advanced countries.

One implication of WTO accession is that as China and Taiwan become members of this global trade body, China will help accelerate upward, as well as downward, trends in the technological evolution of the global supply chain. These trends will contribute to the evolution of information technology industries by promoting the expansion and diversification of multinational operations for the U.S. and Taiwan business community. This will empower all three sides to gain a comparative advantage in international markets by enabling them to use their economic strengths in a triangular relationship. For the United States, this strength involves the ownership of intellectual property (IP), while for Taiwan its strengths are marked by their advancement in high-tech manufacturing and production, coupled with their success in sourcing those operations to or in China. As WTO provisions for China's entry are phased-in, local Chinese firms and foreign businesses will have a greater opportunity to develop trade dialogues, to operate in a freer and more liberal business environment, and to utilize dispute settlement mechanisms offered by the WTO forum. China's membership in the WTO will advance Taiwan's end goal by involving greater participation from Taiwan manufacturers in the production of computer-based products and further opening the China market for the sale of those products.

As WTO principles and guidelines help ensure a more friendly business environment in China, inviting more foreign direct investment, it will help upgrade Taiwan's manufacturing capabilities, adding impetus to President Chen Shui-bian's plan to achieve a "sustainable green silicon island." After widening profit margins by producing low end products in the mainland, Taiwan companies will be able to invest more on research and development, and to focus on creating more patents and establishing rights to intellectual property. As a result, a significant portion of Taiwan's high-end business activities will remain in Taiwan, thereby reinforcing President Chen's economic plans. This has already hastened some substantial devel-

<sup>10</sup> "Taiwan Investment In China \$1 Bln In 1H 2000; down 17%," Dow Jones Newswires. By Stephanie Hoo. 8-7-00

opments in R&D. For example, “the average number of patents filed in the U.S. each year by ROC citizens per one million people is approaching 70, behind only a handful of nations such as the U.S., Japan, Germany, Switzerland and Sweden. This is three times the number filed by its fellow high-tech “Little Dragon” economies, such as South Korea and Singapore.<sup>11</sup>

#### *American Business Benefits*

American companies can gain a great deal from China’s membership in the WTO. The heart of the U.S.-China trade agreement are information technology trade issues, and with the WTO trade provisions U.S., Taiwanese, and Chinese companies will have more latitude in formulating their global business strategies. This means that global players in IT will be able to shift their patterns of investment in the global market, which in turn, will spur IT policy reform that directly relates to the business environment in China. Consequently, one can expect fundamental changes in China’s IT regulatory regime. A different IT regulatory environment creates a great deal of opportunity for local, Taiwan, and American companies, working together or independently in the China market, if implementation proves successful. In many ways, U.S. high-tech manufacturers will be able to improve business strategies in the China market as trade access improves. For example, China’s participation in the Basic Telecommunications Agreement, as outlined in the WTO agreement, will create greater access for U.S. and Taiwanese business interests in the China market. By liberalizing telecom, U.S. and Taiwanese companies investing in Internet ventures will be in a better position to operate in China as Internet services liberalize, and as China’s Internet use dramatically increases. The burgeoning Internet market in China offers tremendous business opportunities for foreign investors. According to a report issued by the China Internet Network Information Center, the latest total for August 2000 indicates that the number of online users has risen to 16.9 million people.<sup>12</sup> This represents an increase of 8 million users since the second half of 1999. In addition, the number of Chinese websites has risen from 15,153 in 1999 to 27,289 for June 2000.<sup>13</sup> China’s online business is estimated to have reached U.S.\$220 million in 2000, and by 2005 online transactions are expected to reach levels as high as U.S.\$11 billion.<sup>14</sup> According to a different report, issued by NUA Internet Surveys, Asian Pacific online transactions are expected to reach U.S.\$1.6 trillion by 2004.<sup>15</sup> Most of this will be Business-to-Business transaction (B2B), and it illustrates the enormous growth potential for Taiwanese and American technology firms planning to expand their services and operations region upon the entries of China and Taiwan to the WTO.

After the phase-in schedules are implemented in accordance with WTO provisions, U.S. and Taiwanese firms will be able to devise better investment strategies relating to the China market, either through cooperative business strategies or through independent initiatives. They will face lower tariffs on information technology products; and will be operating in a business environment that is more transparent and where risk assessment is easier. In addition, they will have the option to shift investment vehicles. This in essence means that U.S. and Taiwanese firms will be empowered to offer after-sales service and customer support services, which will promote their ability to penetrate the China market.

Finally, the WTO will provide U.S. and Taiwanese companies with an outlet for trade disputes. This will empower foreign companies, as it provides them with a means to overcome the challenges they face when doing business in China. Trade dispute mechanisms encourage transparency between the business space and China’s government regulatory structures, while also rapidly modifying China’s system of trade.

#### *Conclusion*

The China-WTO package offers the potential for a liberalized and more open Chinese market, and could allow China to leapfrog in its economic development. China’s economic policies can either promote or impede a direction that fosters economic en-

<sup>11</sup>“Specific Measures for Taiwan’s Economic Development and Liberalization over the Past Decade and into the Future,” Government Information Office, Republic of China. ([www.taipei.org/press/gio04301.htm](http://www.taipei.org/press/gio04301.htm)). 3-28-00

<sup>12</sup>“China Internet Network Information Center: Chinese Internet users soar to 16.9 million,” Nua Internet Surveys. 8-02-00

<sup>13</sup>Ibid.

<sup>14</sup>“Foreign Investment in China’s Internet Business: Forbidden, Forgiven, Forced Open?” Center for Strategic and International Studies. By Frank Xing Fan (<http://www.cisi.org/ics/foreigninvestchina.html>). 09-00-00

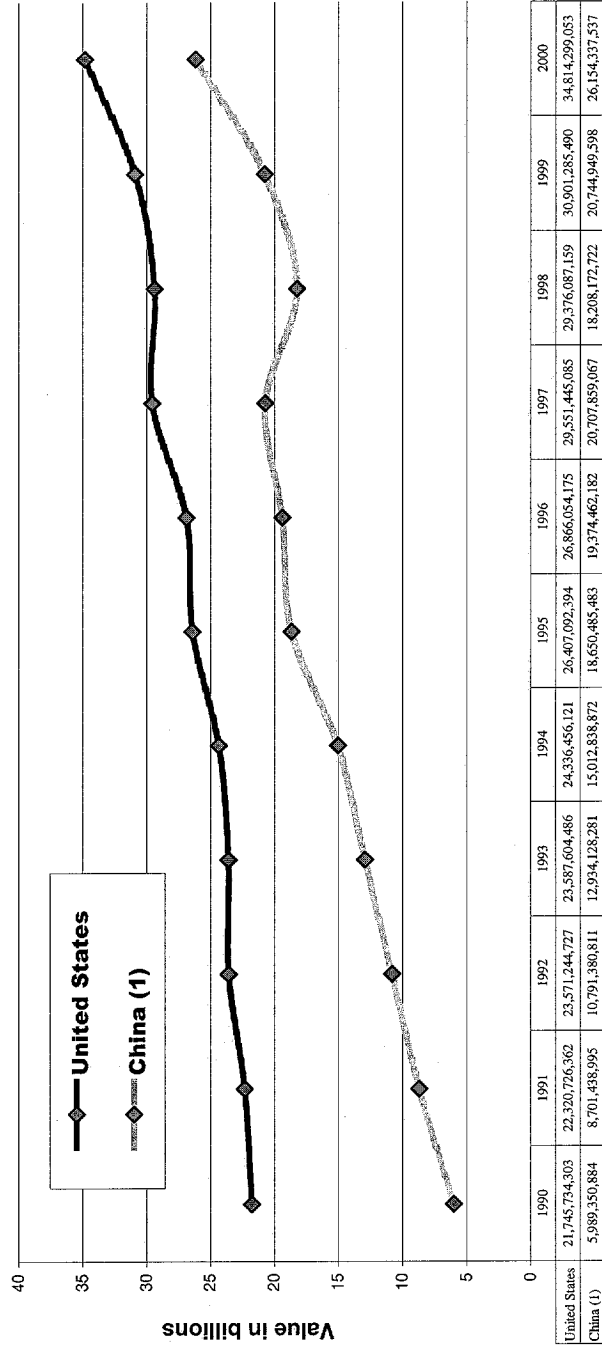
<sup>15</sup>“Forrester Research: USD7 Trillion in E-commerce Revenues by 2004,” NUA Internet Surveys. 4-21-00

gagement, elevates human resources, and advances its expertise in technology development. The struggle for China lies in maintaining political control and regional stability, while creating a more transparent regulatory environment and inducing renewed confidence from foreign investors, which include Taiwan's myriad technology companies and entrepreneurs. As information becomes more accessible to its citizens, it is likely to corrode social cohesion and political identity. The increase in imports of new technologies and Western ideas will ultimately force the leadership to shift some of its domestic practices if social cohesion and political stability are to be maintained, and if economic cooperation is to be advanced. Ultimately, how effective China's behavior is regulated through the WTO will, for the most part, be determined by how successfully economic and political interests merge to produce a freer, more open, and more transparent Chinese market.

China and Taiwan's accession to the WTO, coupled with cross-Strait trade policy reform, should further strengthen the role Taiwan plays in the international trading community. In a self-propagating cycle, lower costs for Taiwanese companies due to investments in the Mainland will continue to promote offshore operations and trade, as greater profit margins attract further investments in China from Taiwanese companies. Increased trade will accelerate capital flows from Taiwan into China, as Taiwanese companies develop more ways to form joint business ventures with their Mainland counterparts. As trade levels increase, so will access to the Chinese market. This trend will bring direct benefits to international corporations who have forged business partnerships with Taiwanese companies. To be successful in developing service and marketing networks in China, international companies must first gain access. Taiwanese companies' success in this area proffer opportunities for foreign companies targeting China's growing markets. By forging closer business arrangements with Taiwanese companies, American companies will then be in a unique position to grab a foothold in the China market. The most important beneficiary of direct trade between Taiwan and China under the umbrella of the WTO is the global technology-driven marketplace, which is dominated by U.S. companies.



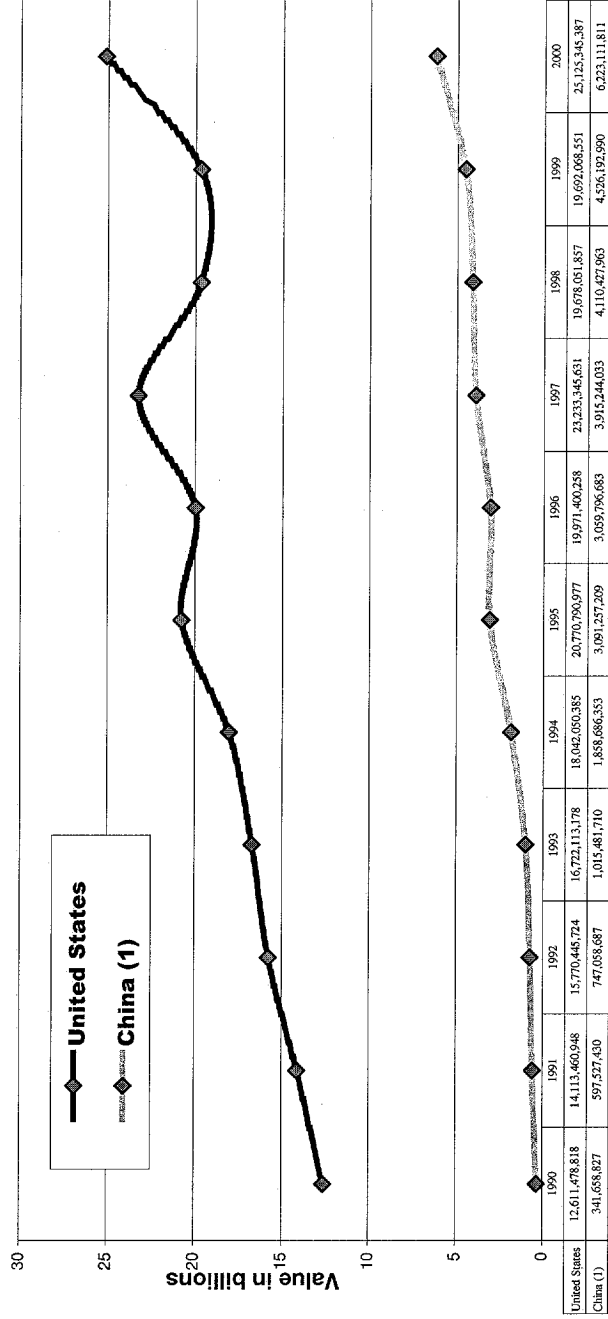
Figure 1: Exports from Taiwan to China and the US, 1990-2000



Actual Export Value

(1) 70% of exports to Hong Kong are calculated as exports to the PRC. Export numbers reflect both exports directly to the PRC and this calculated percentage.  
Source: Board of Foreign Trade

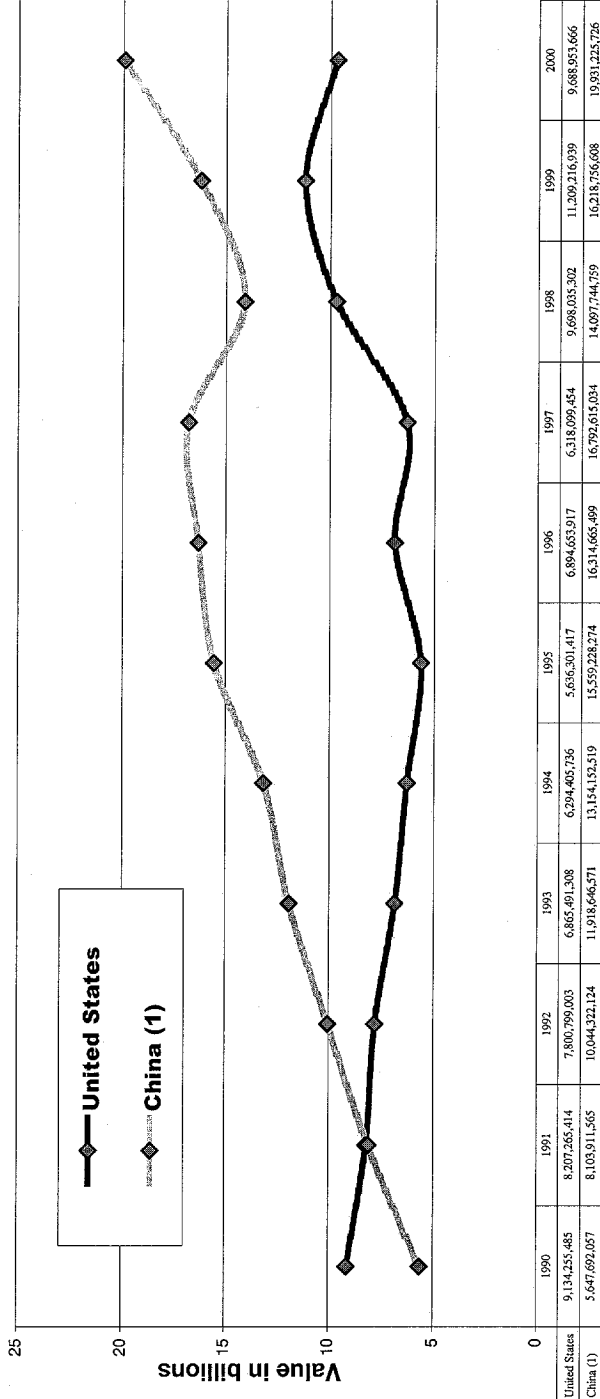
Figure 2: Imports to Taiwan from China and the US, 1990-2000



Actual Import Value

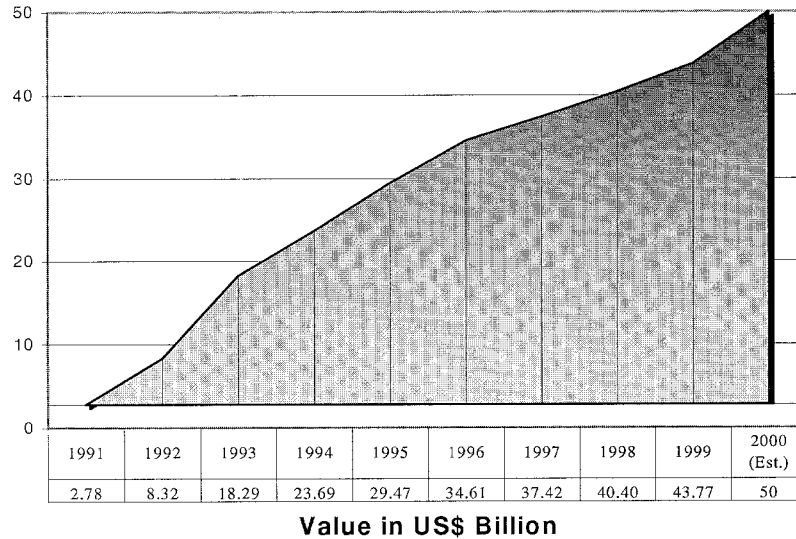
(1) Import numbers reflect imports directly from the PRC, but not imports from Hong Kong.  
Source: Board of Foreign Trade

Figure 3: Taiwan's Trade Balance (Exports-Imports), 1990-2000



Actual Trade Balance Value

(1) 70% of exports to Hong Kong are calculated as exports to the PRC. Export numbers reflect both exports directly to the PRC and this calculated percentage.  
Source: Board of Foreign Trade

**Figure 4: Taiwan's Pledged Cumulative Investments into China**

Source: Mainland Affairs Council, ROC

#### PANEL III DISCUSSION AND QUESTIONS AND ANSWERS

Co-Chairman MULLOY. Thank you, Mr. Hammond-Chambers. Mr. Lewis, Commissioner Lewis.

Commissioner LEWIS. Thank you very much for your really informative presentations. I'd like to ask each of you a question. Mr. Hammond-Chambers, as Taiwan begins to shift the production to China, what will happen to employment in Taiwan?

Mr. HAMMOND-CHAMBERS. Unemployment is, in fact, rising in Taiwan at the moment. We've seen some unprecedented levels for Taiwan, I might add.

Commissioner LEWIS. How high?

Mr. HAMMOND-CHAMBERS. It's about 4.6 percent right now, according to the Ministry of Economic Affairs.

Commissioner LEWIS. And what will happen as these—

Mr. HAMMOND-CHAMBERS. Unemployment will almost certainly continue to rise until the government comes up with comprehensive policies to re-employ its people. That, in a short term, certainly does not look likely as domestic economic reform is in stalemate in a standoff between the President's office and the Executive Yuan and the KMT Legislative Yuan.

Commissioner LEWIS. Okay, thank you.

Professor Cohen, I gather that you are and advocate of China joining the WTO?

Professor COHEN. Absolutely.

Commissioner LEWIS. I'd like to ask you and the Wolmans and Kevin: you're also all concerned about what is happening to the

American economy as a result of globalization. What can we do about this? I'd like to ask each of you that question.

Professor COHEN. Well I think——

Commissioner LEWIS. What should the U.S. Government policy be? In an earlier Commission I asked somebody what should the U.S. foreign trade policy be and one of the people said we shouldn't have a foreign trade policy. What should our foreign trade policy be?

Professor COHEN. Well, I don't want to go too far beyond my last, but you've asked me. This morning we heard some suggestions, including retraining of our own workers to adjust to the needs of an international increasingly integrated world economy. Taiwan is going to have to do the same thing. I should point out there are about 300,000 Taiwanese working on the mainland now. So they're not looking for jobs. They have jobs to do. But we have to adjust to the realities of the world. I don't think we can——

Commissioner LEWIS. Can we ever compete with Bangalore or Chinese wages?

Professor COHEN. We'll have to do what we are doing. We can do different things. We can't compete flat out in the same identical industry and the same wages. We have to always keep ahead of them. That's the meaning of high tech of course.

Commissioner LEWIS. Thank you.

Mr. WOLMAN. We basically failed to do that, may I say, since the real income of American workers, except for the window of the——

Commissioner LEWIS. Right.

Mr. WOLMAN. —last couple of years, has been declining.

Commissioner LEWIS. For 25 years.

Mr. WOLMAN. It has not been rising——

Commissioner LEWIS. Right.

Mr. WOLMAN. —since 1973 basically.

Commissioner LEWIS. Right.

Mr. WOLMAN. My own view of this is somewhat complex. I believe that we should allow China to join the WTO. There's just too much at stake in the world. I've never been to China. I've just seen too much good being done by opening up the world in other countries. Wonderful things have happened to very, very, many people. Wonderful things have also happened to many, many Americans, including thee and me—and I guess most of the people in this room, including me. I've benefited, you know, because our business has prospered because of this. This is not a great year but on average it really has.

The problem is that there are groups of Americans, especially workers, who are bearing an undue part of the cost of the globalization. That is basically the point. They get some benefits, but they sort of have to pay a lot of the costs. Some of the rest of us get huge benefits and don't have to pay much of the cost.

The implication of this is, to me, very, very simple. We simply have to do things to, in a sense, give them a much fairer shake than they've gotten up to this point.

In this respect, for example, the last tax bill is bizarre; because fundamentally it does reward those who have gotten most of the benefits of globalization. It's payroll taxes, for goodness sakes, that

should have been cut, not income taxes and particularly not in the top brackets.

The second thing is my own instinct is that the education efforts of this country are something of a joke still at this point. I mean, the love of learning has been expressed by no one in Washington as the guide to good education just in general terms. Okay? It's got to do with something else. Goodness knows what. But the fact of the matter is that the expenditures in this area should really rise as compared to other expenditures. There's simply no doubt about that.

One of the great things that has got the world to move since the end of the Cold War is our military spending has been reduced. We should fight a war on the lack of education on a much larger and major scale. Not doing so is totally irresponsible, particularly for those who are bearing the costs of globalization and sort of subsidizing the rest of us as a consequence.

So, this retraining—I don't know what retraining means. This training is a very, very serious matter.

Finally, in this circumstance, and because I do think these forces will continue to work to hurt American workers, I really believe, for example, that their health needs and stuff like that ought to be met more thoroughly. I can't oppose globalization. I don't want to screw a particular group of Americans because of it however, as we've screwed them since 1973.

Commissioner LEWIS. Thank you. Thank you. Kevin?

Mr. KEARNS. Well, I think I differ with both the speakers on this. What can we do in our trade policy? It seems to me that we have to run our economy for the benefit of Americans, not for the benefit of other global groups. George Bush's statement a couple of weeks ago that there's a moral imperative for free trade to provide good jobs for others by, in George Bush's case or Bill Clinton's case, trading the jobs of the Americans. So step number one is withdrawing from the WTO.

The GATT system was fine where we had a veto over things. We're the Big Kahuna. We have the world's largest market. We believe in bilateral relationships and agreements where we can engage in unilateralism, where we can enforce our trade laws when we see situations that are unfair, dumping, subsidies, et cetera, I think that's the way to go. We're Americans. What can we control? We can't control what the Chinese do with their legal system, what they choose to enforce, what they choose to neglect. Let's concentrate on what we, as Americans, can control with our political process.

Retraining is a joke. I'm sorry. 60 to 70 percent of the cost of a manufactured good is in labor. If you have an excess of labor, as China does, and lax or no environmental, labor, other types of regulations.

Commissioner LEWIS. Safety.

Mr. KEARNS. We you will never compete—you don't shift into different areas, you don't retrain people for different areas. We will never compete, period. That's the end of the story. We can get all our cars, all our clothes, all our high tech, all our steel, et cetera, overseas. So we have to run—yes, we have to do things differently. We have to go back to the old system and run the American econ-

omy so that cartelized economies in Europe and Japan and Korea and these very low wage economies elsewhere in the world don't take all our jobs, hollow out our industry.

You know, the best training program is to put a man or woman together with a machine. That increases their productivity tremendously, it increases their wages. And if they're not fighting against Chinese or others armed with American capital and American technology, we'll do quite well. We did quite well in American system here for, 200 years.

Commissioner LEWIS. Kevin, thank you. Ms. Colamosca, do you want to add anything?

Ms. COLAMOSCA. No, I just wanted to repeat that I think that both political parties over the last 20 years have really underplayed the loss of manufacturing jobs. And I found it to be particularly disappointing in the 1990's. It was a story that should have been covered much more than it was. Nobody had any solution to it and I just think that as the white-collar jobs start to disappear and they will, that they have to be covered by the press and by the Administrations in power. I mean, much—they can't be ignored the way the loss of blue-collar jobs have been ignored.

Commissioner LEWIS. Thank you very much. Thank you. Co-Chairman Mulloy.

Commissioner DREYER. A question for Professor Cohen. You know, we all see a different part of China, I think. It's the old cliché about the blind man feeling the elephant. The China I see is the China you've described in many ways. It's a weak state and in some ways it seems to be getting weaker. You mentioned that they could stop local protectionism if they really wanted to and I wonder if that's really true.

I mean, I know that they have the ability to stop local protectionism in Village X or County Y, but I don't think they have the—at least, well, from what I see, they don't have the resources to stop it everywhere. It's the old Chinese saying that heaven is high and the emperor is far away. And the Qing actually wasn't all that good at stopping it either. You know, I think you may have just slightly exaggerated the degree there. The only one—

Professor COHEN. I didn't talk about their success. I said, they had these rules that recognized the problem.

Commissioner DREYER. And which often didn't work since they didn't get down below the county level. And so there's plenty of local protectionism it has a long history in China and as governments get weaker, their ability to enforce the laws they have gets weaker still and I wonder if you wouldn't apply that to the legal system you've described in terms of WTO.

Professor COHEN. I think it's a question of priorities. First of all, China's financial intake at the central level is insufficient. They do not get enough share of the taxes they collect and they have a poor inefficient, often corrupt system of tax collection. So the central government is starved for funds.

With the funds they have, they have to have a sharp set of priorities. They give too low a priority to these questions of structural reform except when you get a security case involving so-called spies or religious elements, whatever because they think that goes to their own ability to hang onto power.

I think that I say in the paper, the Zhu Rhongji, a brilliant, dynamic executive, himself although he talks the talk of law reform and the importance of fulfilling contracts, doesn't really give it the same priority by any means as state owned enterprise reform, banking reform, tax reform, securities regulation reform, but he doesn't see there's a connection. They'll never fully succeed in these reforms if they don't have a credible legal system. They'll never attract sufficient financial investors to meet their huge needs if they don't have a credible system.

People call me up every day and they say, "Can you tell me about the enforceability of contracts in China, can I get security and property in China, can we rely on enforcement"? When I tell them what the facts are, they say, "Maybe we'll wait a little longer". So it's a question of priorities and obviously, behind all this insecurity of the leadership that's leading to these espionage cases, et cetera, is a sense of loss of control.

The Communist leadership in China sees it's losing control gradually. That's really—I share your perception of that and they're fighting a rear guard action trying to hold out but their power is shrinking. And the only way I think they're going to pull it all together is to reform their political system and they have to include the courts in that reform.

Commissioner DREYER. A quick question for Mr. Rupert Hammond-Chambers; I just came back from Taiwan 10 days ago and I found a great deal of concern there, from Tsai Yin-wen and others, about what computer manufacturing on the mainland by Taiwan firms is doing, and tremendous concern that this is undermining not just their, Taiwan's, security, but our security as well. I suppose there could be a cutoff of computers. And would you address that question, please?

Mr. HAMMOND-CHAMBERS. It's a big question. The Taiwanese use the term "hollowing out", increasingly, particularly for the southern parts of Taiwan where we'd seen some of that traditional manufacturing be based and now we're seeing it predominantly in Fujian province directly across the Taiwan strait.

Taiwan's optimists believe that this is a natural progression and that Taiwan should take the next step just as the United States did in its evolution as a technology based economy and focus more on the owning of its own intellectual property as opposed to manufacturing somebody else's, given that the real value is in the ownership of that IP.

However, it does not address the issue of a growing number of Taiwan's workers who are not employed as a consequence. If you do travel to the south of Taiwan, you're led to believe that the actual figure of 4.6 in and of itself is not accurate, as you need only see the myriad of noodle vendors to know that possibly unemployment is far higher. These men and women just aren't counted on the rolls. From the council's standpoint and our relationships with U.S. technology companies, they are themselves innovating in attempting to take into consideration this evolution in the production of these products, particularly as we move into a post-PC environment. You're seeing now companies like Microsoft, Palm, IBM with Linux, moving in and really starting to work with the Taiwan companies on the next generation of products.



And I fully expect Taiwan's position in the IT technology supply chain not to decrease but, in fact, to increase for they have positioned themselves better than anybody to be the base or the main cog, if you will, the central cog, in the IT supply chain. Where these products are produced is incidental. They will still be produced for the most part, by Taiwan companies. They will just be produced in China.

From America's standpoint, as I touched on in my formal remarks, I do happen to believe that we need to spend some more time thinking about how that exposes us and our economy. If we look at the two scenarios for a PRC attack on Taiwan, you've got the highly unlikely invasion and the far more likely blockade scenario.

Well, a blockade would in essence end the movement of most of these technology products almost overnight just, indeed, as the awful earthquake that struck Taiwan almost two years ago did. And if you read some of the quarterly results of some of our pre-eminent technology brands like Compaq or Dell, in the formal announcement going with those results, their chief executives cited the earthquake and the brief end to the supply chain of technology products like chips, as a reason that they had a slight blip at a period of actually extraordinary growth for these companies. It hurt them a little bit.

And I think that is a small indication of the problems that we would face if something more serious were to take place in the Taiwan strait.

Commissioner DREYER. Thank you.

Co-Chairman MULLOY. Thank you. Commissioner Reinsch?

Commissioner REINSCH. Thank you, Mr. Chairman. I had an absolutely brilliant question for Mr. Wolman, but Ken Lewis already asked it, so I'll move on to something else and perhaps save a little time.

Commissioner LEWIS. It was a brilliant question.

Commissioner REINSCH. It was.

Commissioner LEWIS. Which one was it?

Commissioner REINSCH. It was also a thoughtful answer on globalization, and I was interested in it.

I want to ask a couple questions, if I may, to dig a little deeper and cover your points. I think at one point you were talking about how American investment in China has crowded out investment elsewhere in Asia, and it seems to me that from the point of view you're articulating, you really are probably more concerned about not more U.S. investment elsewhere in Asia but U.S. investment outside the United States.

I mean, isn't it your view that we'd rather have that investment here than there?

Mr. KEARNS. Sure, I think I said that in my remarks. I mean, to the extent that we can arrange a system where the investment goes here and you get the volumetric effects of the investment in our own economy, that's fine. If it has to go somewhere overseas, I'd prefer it go over the right seas, so to speak, that it go to friends and allies as opposed to hostile powers.

Commissioner REINSCH. Well, let's talk about here for a minute and not there. How do we keep it here? Do you want to just let companies invest abroad?

Mr. KEARNS. Well, of course, it's a complex question but, you know, if you look at the genesis of why all this investment started to go overseas and continues to go overseas, part of it is the fact that Communism as a system fell apart so you have the Soviet Union, former Soviet Union and you have China as it shifted at least part of its economy to a capitalist or state-directed capitalist system, putting all these workers at the disposal of western corporations, in other words, political barriers for many years prevented those things from happening.

You have a country like India or Indonesia opening up to a certain extent to market economics. So certain factors are beyond our control in that sense.

Commissioner REINSCH. Well, wait a minute, though. You were talking earlier that what we ought to be doing is managing the economy for us.

Mr. KEARNS. Yes, yes.

Commissioner REINSCH. There are things that are under our control.

Mr. KEARNS. Yes, sure.

Commissioner REINSCH. And to me, one of the things we ought to be able to control is what American companies do with their money. Now, are you suggesting that we do that?

Mr. KEARNS. Well, I'm trying to lay down the historical track of how we got to where we are today.

Commissioner REINSCH. Well, sure. I mean, there's a lot of reasons why they've done what they've done. The question is, at this point do you think we should try to change that.

Mr. KEARNS. Yes, I think we should, absolutely. I think that Japan, China, Europe, all these economies, various countries, trade blocks that are not open to U.S. exports. We long ago should have engaged simply in reciprocal trade relations—if they didn't open up adequately to American goods, that is a direct export of manufactured goods there, we should reciprocate and not let their goods in. I think that the trade deficit with Japan is as much of a disgrace as the trade deficit with China.

The Chinese trade deficit is more troubling simply because of the security implications.

Commissioner REINSCH. You're slipping away from me here. I'm not talking about trade. I'm talking about investment.

Mr. KEARNS. Bill, I'd like you to follow what I'm saying. What I'm saying is that a reciprocity-based trade policy, simply will prevent American investment from going overseas. If those countries are shut down through various actions that America takes, because they're unfair. I mean, the reason to go overseas is we can't get our goods in there. So let's take Boeing for example.

Boeing has a strategy. Phil Condit says they're going to be, if they're not now, an international company, a company of the world, that type of thing, manufacturing all over the world. They have a philosophy that giving Japan, China and Korea part of their manufacturing, in other words, making investment over there, is going to help sell aircraft—but it doesn't work that way apparently. So

they come to the Ex-Im bank for \$3.3 billion worth of subsidies last year.

I don't know why they didn't go to the UN or some other international agency. I don't know why since they're an international company they come to the U.S. taxpayer. So I think it's a complicated answer but the simple answer is, yes, we can control it and we ought to.

Commissioner REINSCH. Okay, well, I think that we're probably not in agreement about that but—

Mr. KEARNS. No, I'm sure we're not.

Commissioner REINSCH. But let me move on because time is limited. I'd also, just as an aside, dispute your comment about the Export/Import Bank being a subsidy. I've been working on that one for 20 years. Apparently, thanks to this Administration, we have to fight it again, but—let me just ask you one more quickly that I'm just curious about.

I can't help being sort of in the weeds for the moment, but I am struck by your comment about the satellite amendment. That happens to be one of the few subjects that I have some background in. I assume that in view of what you've said that you were probably happy with the action of Congress two years ago that addressed that problem.

Mr. KEARNS. Well, again, it's a complicated problem and we've done the wrong thing in the past and the horse is out of the barn.

Commissioner REINSCH. So do you think that Congress fixed it or not?

Mr. KEARNS. Well, they're trying to fix it again this year, aren't they? No, I don't think it's fixed.

Commissioner REINSCH. They're trying to put it back the way it was before then changed it. I mean, the consequence of the action that Congress took in 1998 was to reduce the domestic satellite industry's world market share from 75 percent to 45 percent which I think was probably not good for American jobs among other things and also for American technological leadership, but it seems to me that was in line with what you were advocating.

Mr. KEARNS. Well, you know, you're again trying to isolate on one point. If we had a sensible program for a launch industry in this country, we wouldn't have the satellite problem that we did and that goes back—

Commissioner REINSCH. I agree with that entirely.

Mr. KEARNS. You know, that goes back to the Challenger disaster, et cetera.

Commissioner REINSCH. No question about that, but here we are. We have to deal with the—

Mr. KEARNS. Yes, we can undo certain things and we can still have a more effective launch industry. Boeing, of course, as you know, has been trying to do something along those lines with the offshore platforms. I mean I don't advocate—there are no quick fix answers, but there are complex policies that can be put into place by reasonably knowledgeable people in the American Government and private industry as opposed to looking for the fix by always investing overseas.

Commissioner REINSCH. Thank you.

Co-Chairman MULLOY. Commissioner Bryen?

Commissioner BRYEN. Thank you, Mr. Chairman. This question is for Mr. Hammond-Chambers first but I think Mr. Kearns may like to comment and others may comment. In the case of Taiwan and their investment in China, you were talking with Commissioner Dreyer about some of the impacts on the computer industry.

I'm more interested in the impact on Taiwan itself and whether they've put themselves in a precarious position, vis-a-vis, China in terms of their freedom of action in the future, whether they've created potentially inside of Taiwan a Fifth Column that weakens their ability to have a flexible policy and aside from my concern about Taiwan, given the level of investment of the United States, is that just—are we seeing in the Taiwan case a pre-cursor of what we might see in the U.S. case. That's my question.

Mr. HAMMOND-CHAMBERS. Certainly Taiwan has increased its vulnerability through the aggressive investment that we saw through the 1990's in China. There's no denying that. However, it is noteworthy that China, for the most part, almost exclusively has shied away from using Taiwan's investment in the mainland as a political tool to force concessions out of Taipei.

Now, there were some slightly alarming statements post the election of Chen Shui-bian and this committee of advisors that was put together to help Chen beef up his credentials prior to his election.

And we had some PRC officials stepping up and questioning their loyalty, if you will, to the concept of unification. But really, that didn't amount to anything at all and for practical purposes, Beijing has an open arms policy towards Taiwanese investment in the mainland.

To the extent that WTO accession, and we hope the breakdown of the barriers to cross-strait trade increase that investment, there is always the chance that Beijing may be feel it's forced into a corner and look at this as a solution.

Commissioner BRYEN. You're getting away from what I was—

Mr. HAMMOND-CHAMBERS. I'm sorry.

Commissioner BRYEN. I mean, look there's over 200,000, someone gave a number, 250, 260,000 Taiwanese working in China.

Mr. WOLMAN. At least.

Commissioner BRYEN. At least, probably a lot more, who are essentially hostages, if the Chinese government wants to treat them that way. There's nothing the Taiwanese can do about it. It's a very politically risky situation, don't you think? I mean, I wonder, we have one or two American citizens put in jail by the Chinese arbitrarily which caused great concern here. Look at the potential for trouble that's there. That's what I was—

Mr. HAMMOND-CHAMBERS. Oh, okay, then, in that respect, you know, that's the high wire that Taiwan walks in so many of the aspects to its relationship with China, whether it's its investment policy or the fact that it has a myriad of executives working in the companies that have now based themselves in Taiwan, or whether it's an actual—you know, whether it's some sort of conflict situation arises between Taiwan and China, I—

Commissioner BRYEN. I'm glad you said that because it's a very risky profile and therefore, adds to overall insecurity rather than to security. The argument's been made a lot today that all this

trade stuff is adding to security but, I think there's the other side to the coin.

Mr. HAMMOND-CHAMBERS. There is the other side, but I happen to believe that actually it's good for them.

Commissioner BRYEN. Well, it depends if you were one of those 260,000 Taiwanese, you may have a different—Mr. Kearns, did you have something to say about that?

Mr. KEARNS. Well, I am increasingly disturbed by the high tech investments from Taiwan in the computer area, in semi-conductor lithography equipment, et cetera, going from plants in Taiwan or businesses in Taiwan to China and I think that that can—by giving the Chinese—and they're not necessarily just Taiwanese companies, ASML, for instance, of the Netherlands giving the Chinese .25 micron lithography machines and helping them step them down through phase masks. From a strictly security point of view, not just an economic point of view, there's a lot going on that I think enhances military capabilities and developments in China.

Commissioner BRYEN. Do we have time for a follow-up?

Co-Chairman MULLOY. Steve, if we get finished, we'll come back and we'll do another round that might be the better way.

Commissioner BRYEN. Okay.

Co-Chairman MULLOY. Ambassador Lilley?

Co-Chairman LILLEY. My questions follow right on Steve Bryen's and others. The first thing, Rupert, do you realize that you're going to cause a great unemployment problem in the United States if some of the things you've said actually transpire? You just put the China watchers out of business. These hand-wringers that say, "War is going to start in the Taiwan strait, the issue is deployment of missiles and missile defense and sovereignty, unity, independence and China is going to go to war". I heard this all day yesterday from some of the most eminent China watchers.

It was right out of Alice in Wonderland. And you said, there are linkages, there's a inter-dependence. Steve raises the 300,000 Chinese—Taiwanese in China as hostages. I think it could be a Trojan horse. I think the Chinese have got a tiger by the tail in this one. The Taiwanese have their own churches, their own associations, their own schools and some Chinese are even saying, "How about a special political zone in Dong Guan". A process is taking place and if people worry about Taiwan, they must also know China is dependent on Taiwan inputs to keep its growth rates up and thus to keep stability in China.

If they cut that off, they've got big problems and I think it's an inter-dependence, which plays in our favor. It links the supply chain. Some of our so-called China watchers that stress war and spend their time looking at it, call it the dirty little secret.

That is the United States dependence on Taiwan in the time when the earthquake happened. What happened is we've suddenly figured out as you've figured out a long time ago, the dependence of Taiwan on Chinese manufacturing, and one of the leading Taiwan manufacturers, the best in the business on chips. Last year he wouldn't touch China. This year he's over there saying it's economic imperative to go in.

And he's went there right with the former premier Vincent Shao and Shao talked about common market. These are positive trends,

which are ignored here to a large extent in the intelligence and in the State Department. It's very complex and we do not know of the contents such as the conversations between Chang Jung Fa and Chen Shui-bien, which can affect the whole balance between the two sides of the strait.

But having said that, do you think that the people in Taiwan have a real strategy of any kind in marshalling their impact on China? I mean, when I asked them about the impact of their groups in China they often draw a blank. Are you getting the impact that the Chinese are receiving from Taiwan the way—Hong Kong for instance has changed the environment in the Pearl River Delta, and that Taiwan's investment is now going up towards Shanghai. There's about 70,000 Taiwanese that are buying up the villas in Shanghai and there's something happening there that has a dynamism. Our time here is spent on missiles as you have said.

We miss the point and that's one thing that strikes me. Jerry, you know, I had this experience with Ren Jianxing, do you remember that old guy, I think we called him the wall man in China. He would never admit that China's courts were linked to the party. He said we have an independent judiciary.

Professor COHEN. He was the head of the party political legal group as you know.

Co-Chairman LILLEY. He stood there and looked me right in the face. I had the documents. I put them in front of him. He wouldn't change.

Professor COHEN. That's great. Well, that's why they fired him.

Co-Chairman LILLEY. Ren said he was independent. Now when you deal with that kind of double think and when you are trying to influence their legal system and then they try to get away with that double-talk they've in fact done it for years, it's almost Orwellian. You could try to crack that I suppose. One of the best programs I've heard about is the Temple Law School Program, transferring the whole law school in China. And I think Yale law students started something fairly—

Professor COHEN. NYU and Temple are now cooperating in that.

Co-Chairman LILLEY. Are they? But that is a whole law school in China giving Americans LLB's.

Professor COHEN. That's right. LLM's, masters of law, yeah.

Co-Chairman LILLEY. But that's a real step forward.

Professor COHEN. Absolutely.

Co-Chairman LILLEY. Without government money?

Professor COHEN. No government money yet. We're hoping to have some, some day.

Co-Chairman LILLEY. But that would seem to me to be the area where you could make a lot of progress.

Professor COHEN. You know, if you link law reform to economic development especially foreign investment, Chinese leadership will go a long way in working with you, as long as you don't use the phrase "human rights", even though they know law reform is obviously going to enhance the likelihood of human rights getting enforced. You've got to link it to the magic words and they've gone a long way.

The other day, one of the major courts in China came to see me and said, "Can we cooperate with your law school on the improve-

ment of our court trials in criminal matters"? I almost fell over. Now, there are a lot of people of goodwill, more and more younger people, better trained, coming into the system. I admire the courage of many of the lawyers in the big cities of China. I've been dealing in criminal cases lately as I've said and I've met a whole new cadre of Chinese lawyers who weren't known outside of China because they don't speak English.

But these are gutsy, able lawyers who are trying to fulfill the traditional lawyer's role at great risk to themselves. Lawyers are getting locked up in the provinces in China if the prosecutors think they're too vigorous in their defense. They're are lots of people here that we could be cooperating with and giving more than moral support to. And I think we've got to look at that.

Now, we've been talking about risks. There are all kinds of risks in everything you do. Doing nothing has its risks. I think you're right, the likelihood of the PRC trying to use 300,000 Taiwanese as hostages upsetting the whole PRC economic development program, is very, very limited. We have hundreds of thousands of Americans in China, too. The greater likelihood is what's taking place on the ground.

And there's one other point, I think we should keep in mind. So far we keep bilateralizing this discussion. It's not like we can control things in China by refusing to cooperate with China by not letting them in the WTO or getting us out of WTO. There's something called Europe and Japan. They're going to go on with this process. We can't stop it. The only question is, are we going to ride the horse, benefit from it and manage it as well as we can.

And finally, I want to associate myself with Mr. Wolman's remarks about our government should be paying for the cost of the painful readjustments the minority of our population has to suffer as a result of the greater economic benefit that comes from our integration with the world.

Co-Chairman LILLEY. Rupert, there's one other thing that Senator Sarbanes raised this morning, you weren't here but he said, one of the big problems we have in China is our investment is getting way ahead of our trade. We've got this terrible imbalance which is all wrong and the investment in China goes to produce products for the United States exported from China whereas our trade exports to China keep shrinking.

Taiwan has a huge trade surplus with China, gigantic investments.

Mr. HAMMOND-CHAMBERS. How do they do it?

Co-Chairman LILLEY. Well, I know how they do it.

Mr. HAMMOND-CHAMBERS. They prohibit most of the goods and services that China produces from being imported, so they export but they don't allow imports from China. That's how they do it.

Co-Chairman LILLEY. There's also very shrewd businessmen in Taiwan that go into China and they looked at me and they say, "We don't know how you Americans do business in China". It's money under the table. It's keeping your investment at a certain level. It's getting to provincial officials. It's using our geography, using all of these advantages we have and we can lay terms on the Chinese, A, 75-year lease, B, hire and fire, C, no party in the organization, D, they go right down the list and the Chinese say, "Yes,

yes, yes, yes, yes”, and there’s a little exchange that goes on there that gets this thing done and the places absolutely proliferate all over China, because it’s a hell of a good business.

Mr. HAMMOND-CHAMBERS. If you go—sorry.

Co-Chairman LILLEY. Yeah, so I’m just saying Taiwan has a real formula for getting a lot out of China. They’ve outsmarted the Chinese at their own business in some ways, whereas the game goes back and forth.

Mr. HAMMOND-CHAMBERS. Just quickly a couple of things, to go back, you actually labeled a quick question about what sort of impact Taiwan felt it was having on China. I actually subscribe to your sort of Trojan horse theory that all of a sudden, there’s going to be a sort of crack and Taiwan’s going to come out in China and all of a sudden, China will become Taiwan and not visa versa.

If you visit with America’s technology companies in Taiwan, if you go and see the heads of these businesses where they have—where most of them, if you think about Intel or Motorola, for example, you have a terrific amount of devolved power into these offices to manage their regional relationships and they’re responsible for the management of these Taiwan company accounts.

Now, these companies have now straddled the strait. They’re in Taiwan and they’re in the mainland and this is presented over the past couple of years particularly a problem for some of our pre-eminent technology brands because they’re models for servicing their clients weren’t designed to function both in Taiwan and in China. So what you’re seeing now is far more regional cooperation between these offices.

Intel is a very good example because I happened to be with those guys just on my last trip to Taiwan this spring and listening to them talk about their meetings that they’re holding in Taipei, in Singapore, in Shanghai where they’re talking about this trend and the need for U.S. companies to continue to look for ways to better service the Taiwan companies that they have relationships with, not just from the aspect of servicing the interests of those clients but increasingly because Taiwan companies have demonstrated an ability to be successful on the mainland and because traditionally our companies have had so many problems. They’re recognizing the benefits there of going into China together and that’s a very real trend.

Co-Chairman MULLOY. Good. Thank you. Commissioner Wessel.

Commissioner WESSEL. Thank you. I’d like to go back to the—which, of course, underlies all our questions, the question of security and the question of manufacturing that several of us are very concerned about the hollowing out, as you use the term, in Taiwan, the hollowing out of manufacturing here.

How concerned should we be about what has happened to the manufacturing base in this country as we look at our overall security interests? Anyone who wants to respond.

Mr. KEARNS. Well, something that seems to be missing from today’s discussion is the overall American trade deficit and according to neoclassical free trade theory, there has to be some major adjustment coming up soon. We can’t continue to run trade deficits at this level and inspire world confidence in our economy—which means people are going to unload these dollars that they’re holding



now and interest rates will have to go way up and it will plunge us into a very deep recession or depression.

So all the various aspects of China aside, whether it's the legal system or the military, potential military threat, et cetera, the overall trade deficit with China, with Japan, with rest of East Asia, with Europe—China has to be seen in the framework of this, the worst offender, as it were, in terms of the trade deficit, but certainly part of this picture.

The dollars that people earn through the trade deficit, through their surpluses with the U.S. come back to the U.S. They buy high technology companies, well, they buy all sorts of companies but under the CFIUS process we've seen 1300 high-tech companies in the last 12 years bought by foreigners, defense-related companies.

If we don't have the technologies here, if we don't have the money to invest in high technology, if we don't have the manufacturing processes, that's what modern weaponry is all about. It's about computing and optics and lasers. The next war, if it comes, is going to be fought on the basis of technologies like these. To the extent that our manufacturing is hollowed out and our high tech is hollowed out, we are not going to be as effective in that war as we were, say in the Persian Gulf War.

The Europeans realize this. Certainly the Persian Gulf War gave China—set off alarm bells there and has led to their—it's one factor in their defense modernization. So I would be very concerned that the overall trade deficit, specifically that the China portion of it, but the overall thing, is hollowing out our manufacturing, our ability to defend ourselves.

Mr. WOLMAN. I'd like to play another kind of a little game if I might. Fundamentally, you know, the amounts of payments works in two ways; either the trade account adjusts to the capital account or the capital account adjusts to the trade account. I mean, apparently, you know, there's a bit capital inflow in the United States so the trade account may simply be adjusting to that. And everybody, you know, says this is a wonderful thing because, you know, for whatever reason, people love to invest their money in the United States, which I do not dispute.

I'm not too dumb about why they love to invest their money in the United States and the reason for that is, is that profits in the American economy have been very strong for a long time now. The profits are growing, you know, in case you don't know, in nominal terms about twice as fast as GDP over the past 15 years or so. It's a big number and the proportion of profits in total American—in national income has risen, you know to virtually unprecedented levels, which one can ask questions about whether they will be sustained or not.

Now, just for fun take another case. If what we're really seeing is massive portfolio investment by the rest of the world in Wall Street, imagine the following scenario. Unless something terrible happened to the stock market today, the price earnings ratio on the S and P 500 had the moment is 27, okay, on trailing earnings. That's a very big number, folks. The post-World War II average is something more like 15, PE is 15 and, you know, Jeremy Seigel's 200-year average is more like 11 or 12 or something like that, okay.

So the American market is still very, very highly valued. There's no question about that. Now, suppose the rate of profits starts to decelerate, which I guarantee you that it will because we're now—we had this little lead for awhile but the fact of the matter is that competition tends to erode profits, particularly in the high tech sector and that's what we're really seen.

Now, suppose for fun that the American market goes down, I mean, to say 15 or 16, I'm just giving you a scenario in which you're going to get your thing, okay. Under those circumstances, of course, you will not see this flow of capital in the United States, you know. So then the trade account is going to have to adjust to the balance of payments. The capital account is going to have to adjust to the trade account and we could get into a real mess and that's the end of my story.

I take this very cynical—I mean, I work for Business Week. I love business, I love profits, but I just think things have gotten out of line to a very considerable degree here and I think, really, that we're going to get a very large—I mean, this hasn't been already positioned, folks. We're going to get a very sharp readjustment on the stock market and that's what's going to trigger the problem with the American balance of payments.

So, I'm not very—if you want to be complacent about the future, be my guest. If you don't want to be complacent, be my colleague.

Commissioner WESSEL. Let me ask another question. Thank you for that. Let me ask another question. I wish you had been available during our trade deficit hearing.

Mr. WOLMAN. I'm sorry, I was ill at the time.

Commissioner WESSEL. No, no, we appreciate that because we had wanted you to participate. The steel industry is currently undergoing a crisis and perhaps deeper—not perhaps but deeper than it had during the 1980's. At that time the steel industry paid roughly \$100 million in legal fees to bring their cases. As a representative of smaller sized businesses, predominantly, how do you view access to the trade laws? If we're all talking about the need to monitor and enforce the WTO agreement, if China accedes, can your clients, can your member companies afford to do that?

Mr. KEARNS. Well, we have been to USTR on two occasions with member companies and because they're small businesses, small manufacturers, in terms of getting into the Chinese market, USTR won't even look at us. You know, they just don't have the resources.

To be absolutely fair, if you want to try to open the Chinese market, the amount of market opening that will be done for these two small companies getting into China, vis-a-vis, maybe some other larger problems, is a smaller benefit to the U.S. economy. So the U.S. Government does not, in my opinion, dedicate the resources it needs to, to market opening and it certainly doesn't dedicate the resources it needs to compliance.

I don't know if Harry Wu has appeared here or will appear here but you know, he can tell you an American businessman goes over, thinks he's dealing with a Chinese businessman and then the sub-contract goes from the Chinese businessman to the prison labor factory, for instance, and there's no way that two or three Customs visits a year to China in a country that vast are going to, turn up these things.

So, yes, it is a question of money and resources and they're absolutely inadequate, which is why I want to try to focus on what we can control here as opposed to trying to change behavior in Japan or China.

Commissioner WESSEL. But just as a priority as we—or a creature of Congress, if I remember NFIB and other small business organizations have told members of Congress and their staff that 80 percent of the new jobs created are in small businesses. So if employment, wealth creation portion of economic security is important, then our priority should also be helping clients of your organization and others who need the resources, who need the help.

Boeing can afford to be able to press its case forward. Your companies are the ones who need help.

Mr. KEARNS. Yes, I won't dispute that. NFIB, of course, is mainly service businesses, it's not manufacturing. And I think the emphasis has to be on manufacturing. Again, you put a man or woman together with a machine, they can command higher wages than stocking a shelf at WalMart.

Commissioner WESSEL. Thank you.

Co-Chairman MULLOY. If I can add just one thing to that discussion, the Commerce Department is trying to build a good—USTR is too small of an agency to really do compliance. They've got 175 people over there and are negotiating. You need compliance and they're trying to build a unit in the Commerce Department which I headed for a couple of years and we got some additional resources precisely to take on those types of cases that you're talking about Kevin.

Now, I don't know how effective they'll be but I do think that's where we really need to press because USTR is not going to be an adequate mechanism to do the compliance work in my view.

Mr. KEARNS. No, I agree with that.

Co-Chairman MULLOY. Commissioner Robinson.

Commissioner ROBINSON. Rupert, we're delighted you're here today.

Mr. HAMMOND-CHAMBERS. Thank you, Roger.

Commissioner ROBINSON. I think it was a very interesting exchange we've had on your portfolio more generally and, of course, Jim Lilley has a view on this as does Commissioner Bryen and others that make for a very animated debate and I think it's going to be an important element of our work to flesh this out, particularly the issue of who has the leverage here. Is it indeed Taiwan that is perhaps becoming over-exposed from an investment potentially debt which is going to get to the root of my question and other accounts, or in fact, do we have the tail wagging the dog.

Are they actually a good deal more clever than we might imagine and in fact, insinuating themselves into Chinese society and political life to a greater extent, et cetera? In that connection of just trying to basically flesh out some of the statistical side of this, you may not have it available and I'm not trying to put you on the spot. I'm the last one that would, but I was wondering if we might be able to acquire a sense of Taiwan's total credit exposure to the mainland both in public and private sector debt. I can't imagine that even you have that off the cuff, but it would be something that if it is around, would be useful, I think, to us.

And similarly, the idea of if many Chinese imports are, indeed, restricted, is it also true that China is not able to float equity and debt offerings in the Taiwan securities markets? Is that likewise restricted?

Mr. HAMMOND-CHAMBERS. It is but just to go back to your first point, I don't have those figures off the top of my head. However, I would be very happy to generate some statistics for this Commission if you would wish and submit those in a timely manner.

Commissioner ROBINSON. That would be very helpful because, if we do have, God forbid, something take place in the Taiwan Strait or whatever, it is going to be important to understand what the equities—what the balances are, so to speak literally and figuratively. But as I say, your testimony has been of great value.

Mr. HAMMOND-CHAMBERS. Thank you very much.

Commissioner ROBINSON. As far as the next hearing of the Commission is concerned, and I certainly don't mean to jump ahead but we are going to be looking at Chinese fundraising in the U.S. capital markets on July 6th for those interested and that will likewise be a public hearing.

But I did want to ask Kevin Kearns while we have him here, about his view and I'd be interested in the views of others on the panel, Mr. Wolman and certainly, Mr. Cohen, if—but Kevin, your view on the rapid escalation of Chinese fundraising in the U.S. capital markets via principally the offering of securities by Chinese state owned enterprises. Do you have a view on that?

Mr. KEARNS. Well, we do in the written testimony we've submitted. We clearly oppose this. We believe that no Chinese state-owned company or even if it's partially owned, any company with Chinese Government involvement should be allowed to raise capital, period. All the issues of accountability and transparency, normal accounting practices, et cetera, all go by the boards and you don't get any transparency. So the point is that investors cannot make rational decisions in the vast majority if not all of these cases.

And the second thing that worries me just in terms of capital flows is that Chinese ability to raise money. I remember at one point last year we talked and there was—China had a backlog of 200 IPO's that they were about to bring or willing to bring or ready to bring to U.S. capital markets, and I know we did a quick calculation. The amount of money was several times the trade deficit, hundreds of billions of dollars that would be involved in capital going to China.

Capital is fungible gets transferred there perhaps into Chinese military. It's a question of how much military involvement there is in these various companies, et cetera. So I think it's very problematic and I think it's something that this Administration needs to look at and we all need to look at much more closely. The large pension funds, potential holders of these IPO's need a new set of principles, whether it's Chinese or companies that invest in oil in the Sudan—which Chinese companies are involved in but Canadians and others are involved in.

Commissioner ROBINSON. But benign civilian, to the extent that they have them, private sector firms, would be another matter?

Mr. KEARNS. Well, if it's completely private, which is somewhat unusual, and if they can satisfy western accounting standards and things aren't papered over by Goldman Sachs the way they were in the Petrochina IPO, I'm willing to consider it, but I see very little of that.

Commissioner ROBINSON. Thank you.

Mr. WOLMAN. I have a couple comments on this.

Commissioner ROBINSON. Yes, please.

Mr. WOLMAN. I think the most relevant one is the one I would make. I have no—I want to make two points. First, I have no problem with going to state enterprise because I'm not enough of a free enterpriser to say I don't want state enterprise, okay? So to me that's, you know, an irrelevant question.

The thing that interests me in the Petrochina thing is, is it possible for the investment bank—to find some kind of a Sullivan system, you know, as we had in South Africa, of the investment bankers. What the hell are these guys doing with the money, what are they doing, the people with the money, what is it they're doing to our people. So the fact of the matter is, I'd like some sort of set of Sullivan rules so I want—I'm really going to change my metaphors now, the investment to be kosher from our point of view before they do them.

I have no problem with the idea. I think it's a great idea as a matter of fact.

Professor COHEN. I think it would be a great mistake to try through government control to limit access to U.S. capital markets to Chinese enterprises even state owned enterprises that have converted now to joint stock companies. We have standards. If they're not adequate, we should improve the standards.

Secondly, we have mechanisms for enforcing those standards. I've been involved in litigation that's been brought against investment banks that have helped certain joint ventures between North American companies and Chinese companies that have gone onto U.S. capital markets and they've been accused of not making accurate reporting disclosures, have been insufficient, inaccurate. We have mechanisms for going.

Also, I don't know of any scandal of any significant proportion where the American public has been bilked by these enterprises. I say leave it to the market, leave it to the democratic process to do things as we've done with South Africa, more recently with China. Let people decide whether they think these risks are worth it or not. The market has already put its own evaluation on a lot of these Chinese state owned enterprises and they've been seen to be both in Hong Kong and here, not great investments.

Mr. WOLMAN. I've learned a lot from what you've just said, but I would like Sunshine to—

Professor COHEN. Sure, I'm not against that.

Commissioner ROBINSON. To strengthen disclosure requirements would not be something that you would oppose, I take it, because that's a market-oriented event.

Professor COHEN. Not at all but we ought to have adequate disclosure requirements for all companies and not only Chinese companies.

Commissioner ROBINSON. Right.

Mr. KEARNS. But the Sullivan principles did not leave it to the market. I mean, that is not markets doing their magic. The Sullivan principles were anything but.

Professor COHEN. I simply want to say, leave it to the market and the democratic process.

Co-Chairman MULLOY. If we could now, I'm going to call on Commissioner Becker.

Commissioner BECKER. It's getting late in the day and I'll make it as quickly as I can for everybody. I would have liked to have felt encouraged, Mr. Wolman, in reading, following along, in your remarks. I can't say that I was, as far as the future is concerned, as far as workers are concerned and as far as the transfer of capital and the effect that this has on workers and families and communities.

One point that you raised in there of—in that you drew a correlation with Germany and with Japan after World War II and talked about 30 or 40 years of catch-up time, so to speak for wages and benefits and all that to catch up.

Mr. WOLMAN. Yeah.

Commissioner BECKER. One thing I would point out, there was a free trade union movement in Germany following World War II which was sponsored and helped fostered by the United States Trade Union Movement that went over there, the same thing happened in Japan. You had a Free Trade Union Movement so that the workers were able to, when circumstances permitted, they were able to share in the wealth that they helped create. Can that be in China where you have a repressed society and you do not have a free trade union movement? Can that be in a totalitarian country? Can we have that catch-up?

Mr. WOLMAN. If you're asking what we pressure for, to me this is basically unacceptable. What you're saying is basically correct. A lot of the reconstruction of Europe and of Japan actually after World War II—I mean, those were my days in some sense. I was relatively young and under those circumstances, I knew a lot of guys who ultimately were involved in this kind of thing and some of them were from the Trade Union who had an integral—had a really integral role in those countries. I mean, I can remember this very, very well.

And I think there's a lot to be said in favor of that kind of thing. The trouble is that the, you know, the movement has eroded. Now, again, I'm not enough of an expert to really say about this thing, but the other question you asked is am I very cheerful about the future? I speak neither for Business Week magazine, or for the McGraw Hill companies, but I'm not particularly bullish, okay. I think the Bush 43 economy is going to look a lot like the Bush 41 economy.

Commissioner BECKER. But my question though, my question though, really is can we have a catch-up—

Mr. WOLMAN. I haven't wrote the book about this thing.

Commissioner BECKER. —situation in China? Can we have a catch-up situation in China without having a free trade union movement? Do we have a free trade union movement in Taiwan?

Mr. WOLMAN. Go ahead on this one.

Mr. HAMMOND-CHAMBERS. Taiwan's trade unions are actually quite evolved and very active particularly within the state owned enterprises.

Commissioner BECKER. The answer is yes.

Mr. HAMMOND-CHAMBERS. Yes.

Commissioner BECKER. We have a free trade movement in Taiwan and the answer is we don't have one in China.

Mr. WOLMAN. Well, you guys go do something about it, okay?

Commissioner BECKER. Well, can we rebuild? My question is, in your opinion, can we rebuild—can we get into a catch-up, can we catch up to the standards like we did in Germany and Japan to the United States without developing a Free Trade Union Movement in China?

Mr. WOLMAN. I think we'd be very hard pressed to do so.

Ms. COLAMOSCA. No, just if you look at some of the numbers going back to Bangalore, the medical transcriptionist here is paid about \$25,000.00 a year and there and their wages are fairly good, you know, for Southern India, they're being paid \$125.00 a month. And Mr. Muhrti said that he is frightened to death of the Chinese software companies coming on line because they're being paid a tenth of what his workers are being paid, so I don't see how we can catch up.

Professor COHEN. That sounds exaggerated.

Ms. COLAMOSCA. Really?

Professor COHEN. Yeah.

Ms. COLAMOSCA. Which numbers?

Professor COHEN. A tenth?

Commissioner WESSEL. I'll yield my time.

Co-Chairman MULLOY. Okay, he's yielding a second to you.

Commissioner WESSEL. A quick question; I believe it was in '94, it may have been '95 that the administration proposed—wrote and proposed a voluntary code of conduct for U.S. businesses doing—having operations in China. Following up on the disclosure issue that Roger has raised here a number of times today, is it appropriate for us to ask as a matter of disclosure if those companies should disclose whether they were abiding by the voluntary code of conduct in terms of their access to capital markets?

Professor COHEN. Sure.

Co-Chairman MULLOY. Let's turn to Commissioner D'Amato.

Chairman D'AMATO. I'm going to be very brief but I just wanted to mention that I think that the discussion on Taiwan that we've had today is really rather important for this Commission. We'd like to work with you in terms of developing a better understanding of the nature of that relationship and the puts and takes and what those flows are like. I think we're interested particularly in not only who's dependent on who which I'm not clear who's dependent on who, maybe there's something in a third place that's controlling everything, I don't know, but the transfer and—that transfer of high technologies via Taiwan into the mainland, I don't know to what extent that is the developing issue, whether the mainland—whether the PRC is using the tremendous relationship now developing with the Taiwanese business community to try and acquire technologies more conveniently than it otherwise might or just what the nature of this relationship is in terms of, you know,

maybe the whole military overlay is more and more irrelevant to what the importance of the Taiwan relationship is to the PRC.

Mr. HAMMOND-CHAMBERS. Firstly, it would be an honor to work with this Commission on this issue to the extent you feel that there is value in doing so. Secondly, in respect to the triangular relationship between the United States, Taiwan and China and the technology space, this is not, for the most part, cutting edge technology, not yet. Really, the evolution of the global technology supply chain and Taiwan's role in that is really characterized by the production of low end technology products, the sorts of products that go into our personal computers and our laptops that you can buy now for \$799.00.

You know, quite frankly, the majority of those products now probably have been made by a Taiwan company even though they reflect the United States brand. In respect to intellectual property itself, what we are beginning to see now is U.S. technology companies in Taiwan still, not really in the mainland, but in respect to R and D, you're seeing U.S. companies start to construct quite significant research and development facilities in Taiwan's technology parks with the idea of producing technology specific for a greater China market.

For them that first and foremost interestingly encompasses the overseas Chinese, all the global Chinese communities that are now interwoven by the Internet, who can access goods and services through the Internet and who can purchase things through the Internet. It is this community that is invariably well educated, quite affluent and Internet savvy. And you're starting to see high end products starting to be developed by some of Taiwan's technology companies in conjunction with U.S. companies.

A good example is Microsoft's relationship with a company called Gigamedia, and they're starting to focus on the more high end products specific for Chinese around the world. And it's that joint development of intellectual property for the market itself that I think is something to keep an eye on. I don't believe at the moment that we're circumventing any laws, certainly not that I'm privy to.

Chairman D'AMATO. There's one matter that came to my attention. I don't know how true this is, that the Deputy or Vice Chairman of the Koumintang apparently went on kind of a state visit to Beijing and recently was greeted by the visiting potentate or that sort of thing. Is that accurate?

Mr. HAMMOND-CHAMBERS. Well, Vincent Siew, who is the Vice Chairman of the KMT, just did travel to Beijing in his capacity as Chairman of the Cross-strait Common Market Foundation, which is a concept that he's pitching in Taiwan which has, in fact, the backing of Chen Shui-bian and in the mainland where he got a relatively cool reception, I'm not sure specifically because of the concept that he was pitching and more because he has sort of attempted to push the Beijing leaders to start talking with Chen. I think that was probably the reason that he received the relatively cool reception while he was there.

But this concept of the cross-strait common market is an intriguing one since the Europeans have used the common market concept to either build walls or tear them down, depending on your perspective.



Professor COHEN. I just wanted to say in this regard one ought to give some attention to the implications of WTO entry for both Taiwan and the mainland because people don't see clearly enough what this will mean and many of its reverberations, but I think they'll be significant.

Chairman D'AMATO. And does that mean that there will be more U.S./Taiwan combinations of business that will then try to penetrate the mainland?

Mr. HAMMOND-CHAMBERS. I believe that that's the trend to be perfectly honest. It's going to be—if you focus in on the World Trade Organization, there are actually a number of very significant issues in the Taiwan/China relationship coming down the pipeline that we're not talking about at the moment, specifically, again, we come back to this issue of Taiwan's sovereignty.

And a working example of that would be if Taiwan allows its banks to go to the mainland, who would be the entity within Taiwan to guarantee the legitimacy of those banks? Will the Chinese Government now start recognizing and talking with the Ministry of Finance or is there sovereignty issues there and it's not clear what mechanisms they're going to need to develop, whether those are NGOs or some other mechanism that we're not aware of to allow the different governments to talk with one another in an acceptable framework.

Professor COHEN. Also the mainland wants access to the markets in Taiwan and I think the next step is those markets will start to open to investment, et cetera.

Mr. WOLMAN. But there is the other side which has been made before, which is that this triangular thing, I mean, does give China a great deal of power over the American economy because my understanding is they can shut down the computer—I mean, I'm probably exaggerating, they can do great damage to the computer business at this very moment.

Mr. HAMMOND-CHAMBERS. They could but it wouldn't serve their interests—

Mr. WOLMAN. No, no, but it depends on how they—you know, not the way you define their interests but they may change the way they define their interests.

Mr. KEARNS. You don't need to shut it down and cut off all your profits. Merely the threat of action in some cases, the threat of cut-backs, et cetera, are enough to produce results, political or economic results that you want.

Co-Chairman MULLOY. Now, I want to ask a question. Ambassador Barshefsky stated on page 1 of her prepared testimony, quote, "The November 1999 agreement that she negotiated on China's WTO accession, secures broad ranging, comprehensive, one way trade concessions on China's part, granting the U.S. substantially greater market access across the spectrum of industrial goods, services and agricultural", end quote.

Some critics of the agreement contend it is unfair to depict this as a one-way concession. They contend that the Chinese are not stupid negotiators and what they got was to lock the market open of America.

In other words, giving China permanent MFN and entry into the WTO means the United States gives up its option which it pres-

ently has, to use its market as leverage on the Chinese in either commercial or political disputes. This assurance, they contend will encourage U.S. manufacturers to invest in China and sell back here to increase profit margins and I wanted to start with Professor Cohen.

Do you think such criticisms of Ambassador Barshefsky's depiction of a one-way concession by the Chinese has any merit?

Professor COHEN. Well, I'm glad you asked that because it raises a question I had in listening to other testimony. On the one hand, we heard from Mr. Trumka that China's WTO entry means we have given up all our unilateral trade measures against China, 301 and all that.

On the other hand, Ambassador Barshefsky assured us those aren't effected at all and I assume we also have our anti-dumping, et cetera. So that if we find violations on Chinese—on the part of Chinese entities and government agencies, et cetera, I take it we still have options to bring pressure against them, apart from doing it through the WTO, but we have to ascertain what's the correct understanding of the legal position.

Co-Chairman MULLOY. We asked for CRS to give us a legal memo on 301 and they did, and the way it works is, you have to first win your dispute in the WTO, then you use 301, but you can't use 301—

Professor COHEN. That explains that apparent contradiction between the two statements.

Co-Chairman MULLOY. Right, that's what the CRS analysis would suggest. Do you have any comments on that, that it was a one-way concession on the part of the Chinese? Kevin?

Mr. KEARNS. Yes, I guess I would say, has anyone in this room ever heard a U.S. trade negotiator come back from a long and arduous trade negotiation and say, "I've failed"? No. I mean, every trade agreement that I have witnessed in the past 30 years has always been the greatest and it is going to increase our access, it's going to do X, Y and Z and then two years later we are back negotiating some sort of protocol.

We negotiated three separate intellectual property agreements with the Chinese during the last decade. Each one, if you look at the announcement was going to end the problem and it didn't. I think that Ambassador Barshefsky means well. She worked hard on it.

The fact that it's taken almost two years to get where we are today, that is the recent agreement that Mr. Zoellick concluded where apparently we agreed on an agricultural subsidy at 8.5 percent, between five and 10 percent but closer to the 10 percent, indicates that a lot of things weren't nailed down in that trade agreement. The figures on their, grain supplies, grain reserves, et cetera, indicate that a lot that was negotiated in agriculture and promises made to the farming community simply are not true in terms of China being a market.

Again, I think the WTO is a mistake; that we should use U.S. unilateral actions; and we can enforce access to foreign markets by denying access to ours. I think that's the most effective. We don't oppose greater trade. The question is, it has to be balanced. It is not in balance. It is terribly imbalanced right now and it is going

to lead to some sort of financial catastrophe, a collapse or some sort of rejiggering.

Co-Chairman MULLOY. Jerry?

Professor COHEN. I think we do need greater transparency in the U.S. Government with respect to learning about the details of a lot of things that has been indicated here are not really given to us up front. The truth seeps out gradually.

I think secondly, however, to the extent we know this, we are benefitting from this deal. It's going to be a better situation than existed prior to China's WTO entry but I can't tell you there aren't going to be a lot of problems and a long process but Barshefsky herself recognizes this. I like the Chinese phrase, Xu yao yi ge guo cheng, which means Rome wasn't built in a day. Everything requires a process. And I think we've seen huge progress since 1978 December when this whole thing started. We mustn't lose sight of that but it's been inch by inch by inch.

But looking back over 23 years and I've been involved from Day 1, the progress is tremendously significant but insufficient.

Co-Chairman MULLOY. Let me thank all of you on behalf of the Commissioners and the Commission for being here today and presenting very, very thoughtful testimony and for being very responsive to the questions.

Mr. Wolman, I thought the point you made about what globalization is doing to working class and it's going to move up the food chain, and the need to really take care of those issues in our own society was right on the mark and I think it will cause us to think through some of these issues as we move along, but thank you all for being here.

Mr. WOLMAN. Thank you very much. I would just like to say that I learned a great deal during the time I was here and thank you.

Co-Chairman MULLOY. Thank you.

[Whereupon, at 4:42 p.m. the proceedings were adjourned.]