

**U.S.-CHINA RELATIONS:  
STATUS OF REFORMS IN CHINA**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON EAST ASIAN  
AND PACIFIC AFFAIRS  
OF THE  
COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE  
ONE HUNDRED EIGHTH CONGRESS  
SECOND SESSION

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## **U.S.-CHINA RELATIONS: STATUS OF REFORMS IN CHINA**

**Thursday, April 22, 2004**

U.S. SENATE,  
SUBCOMMITTEE ON EAST ASIAN AND PACIFIC AFFAIRS,  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The committee met, pursuant to notice, at 2:25 p.m. in Room SD-106, Dirksen Senate Office Building, Hon. Sam Brownback presiding.

Present: Senator Brownback.

### **OPENING STATEMENT OF HON. SAM BROWNBACK, U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. I will call to order this hearing on China. Since the passage of the bill granting Permanent Normal Trade Relations (PNTR), in 2000, and China's accession to the World Trade Organization, the WTO, in 2001, a key issue has been whether or not China has made any meaningful progress in the kind of reforms that are expected of a country like China. Increasingly, China is becoming an aggressive and important player in such areas as trade, geopolitical issues in Asia, and the global war on terrorism. At the same time, internal social stability in the PRC has become more problematic, including greater labor unrest, growing misallocation of resources tied to managed industrial policies, and more assertive public dissatisfaction and discontent with official corruption and lack of basic freedoms. For this reason China's current policies, whether in trade and economics, human rights, or geopolitical ambitions, demand close scrutiny because they impact both U.S. national security policy and U.S. jobs.

Yesterday the United States and China held high level talks on trade, a critical issue with high stakes for American business and consumers alike. So, coming from a heavily agricultural state, I'm aware of how important trade is to our economy, especially trade with China. It's one of the world's fastest growing economies; China has a growing market for U.S. exports, including from my own state of Kansas. China is an important provider of imported products for U.S. manufacturers and consumers.

I want to note for Mr. Craner and those here—if we could get order in the back of the room we'd appreciate that—this last week I was traveling in Kansas and talking with a number of individuals about what's taking place in China, and the issue of outsourcing, the issue of lack of labor rights, the issue of religious freedom, the issue of China, China, China continues to come up on a very reg-

ular basis. You just look at the statistics and you understand why China's total worldwide exports were about \$438 billion in 2003. The percentage of that export which ended up in our market was about \$163 billion, or 37 percent, over a third of all their exports. By contrast, our exports from the U.S. were \$714 billion, but our percentage going to China was four percent. It's no wonder our trade deficit with China will likely top \$130 billion this year. It is a huge amount.

At the hearing later on today we will have the chief economist for the AFL-CIO testifying about their Section 301 case and the question of whether China is using labor in a trade disrupting, illegal fashion. We may want to, and I will try to express and we'll try to view the issue as well, of currency manipulation that's taking place in China and hear from other witnesses on that.

I welcome our two witnesses here today to testify about the important relationship and what's taking place between the United States and China. Our first witness is the Assistant Secretary of Democracy, Human Rights and Labor at U.S. Department of State, Mr. Lorne Craner.

Mr. Craner, before you begin I'd like to commend you for your efforts to pass a resolution condemning China's human rights practices and the U.N. Human Rights Commission. I think that sends an important signal, and it's a proper signal, that needs to be sent. That's not the easiest body to work within but your efforts have had a great impact and I appreciate that very much.

Our next witness will be Mr. Richard Lawless. He's the Deputy Assistant Secretary for the Department of Defense. We will go to him after Mr. Craner.

I want to welcome you to the committee, and I look forward to your testimony.

**STATEMENT OF LORNE W. CRANER, ASSISTANT SECRETARY OF STATE FOR DEMOCRACY, HUMAN RIGHTS AND LABOR**

Mr. CRANER. Thank you Senator, very much, for holding this important hearing. It's an excellent time to take a look at our complex relations with the People's Republic of China and I'm pleased to be here to answer your questions about human rights conditions and the prospect for democracy there.

As the committee took note when it convened this hearing, U.S.-China cooperation has improved steadily since early 2001. After September 11, the Chinese government became an ally in the global war on terror. It's been a key partner in discussions about North Korea. But even as we find common ground with China on these issues, we remain firm that there are areas on which we have different views, such as nonproliferation, and other areas such as Taiwan and Hong Kong that involve partly my areas of responsibility: freedom and human rights. We have not compromised when confronting China on and pursuing a resolution of these issues.

June 4, less than two months from now, is the 15th anniversary of the crackdown at Tiananmen Square. This will be a somber anniversary. Fifteen years ago Americans and others around the world watched in horror as the PLA fired on peaceful students and workers who had captured the world's attention. Certainly everyone who watched those events hoped that 15 years hence China

would be a very different place. But China's human rights record remains poor. In the 15 years since, the Chinese economy has continued to expand, and constraints on where one can live and what one can do for a living have been relaxed, but the freedom and rights that Tiananmen protestors asked for still have not been realized.

In my tenure as Assistant Secretary of State for Democracy, Human Rights and Labor we documented some progress in China in 2002, but we also documented backsliding on human rights in 2003. This backsliding prompted President Bush, as you noted Senator, to authorize the State Department to pursue a resolution criticizing China's human rights practices at the Commission on Human Rights. As you also know, the Chinese government was successful in getting a sufficient number of members to vote in favor of a no-action motion, preventing the commission from engaging in a healthy debate about the human rights situation in China. But our work in Geneva is not in vain. In pursuing a resolution at the commission during a time of backsliding, we made a strong statement about our unwavering concern over the human rights situation in China. Most important, those who fight courageously every day to have their voices heard know that the United States will not forsake them. We have an obligation to speak out against the lack of freedom and for protection of human rights in China because we see the people of China doing it for themselves. And I believe we have a responsibility to support these efforts and to try to expand the political and legal space inside China.

The State Department, and in particular my bureau, is currently administering \$27.5 million in fiscal year 2002-2003 in core funding to support democracy, human rights and the rule of law in China. At the end of the Clinton administration the State Department had begun to discuss the possibility of cooperating on legal reform projects in China. When President Bush came to office we decided to rethink that program and to craft a new approach to supporting freedom in China. Legal reform, while important, is too narrow a focus for a comprehensive China program. A U.S. program on China had to support liberty as well as law. Let me give you a few examples of the kind of things we're supporting.

Over the last five years, China's village elections, in which non-Communists can run and win local office, have received much publicity. We're supporting work to expand the availability of those elections and have gone beyond that to support those who want to see elections expanded to higher levels.

Legal reform in China is an area where we see meaningful change taking place. American NGOs continue to play an important role in catalyzing all kinds of legal development in China. The U.S. is supporting a wide array of efforts in this area, including programs that focus on drafting key pieces of legislation, a program to strengthen the use of evidence and witness testimony in trials, a program that works on helping villagers to challenge election fraud and abuse in the courts, and programs that hone the advocacy skills of criminal defense lawyers.

As the legal system has developed, the Chinese people are becoming increasingly aware of their rights under the law, and we're also supporting them. American NGOs are working with Chinese

sponsors to strengthen women's environmental and worker rights. Americans and Chinese are conducting awareness and public education campaigns so that average Chinese know whom to go to when they need legal assistance. We are also determining and monitoring compliance with international labor standards through such U.S.-sponsored activities as my bureau's partnership to eliminate sweatshops program, designed specifically to address unacceptable working conditions in manufacturing facilities producing for the U.S. market. And we're supporting the expansion of and encouraging new ways to think about the role of the media in China, as a provider of information and a watchdog.

These rights and freedoms are occurring with increasing frequency: Elections with independent candidates, activists challenging the government, reporters courageously reporting the truth—even at the risk of losing their jobs or going to prison. Every day now we see such steps being taken by Chinese in China. These steps give us reason to be optimistic but the events that I described in the first half of my testimony also make us realistic. We cannot sit back and assume that because its economy is developing China is on an unwavering path to democracy. If anything, the Chinese leadership has given no indication that it might consider seriously the prospect of following the path of South Korea, the Philippines, or Taiwan in pursuing gradual reform toward full freedom of speech and association, judicial independence, and free and fair elections.

With that in mind, we continue to monitor closely the situation in Hong Kong. We consistently urge Chinese and Hong Kong leaders to listen to the Hong Kong people and respond to their expressed aspirations for electoral reform and universal suffrage. After all, as Vice President Cheney pointed out in his remarks in China last week, China's actions in Hong Kong do not affect only Hong Kong. Many nations, the U.S. among them, have a significant investment in Hong Kong. The region's continued stability and prosperity is predicated on its continued rule of law and high degree of autonomy.

In sum, I am optimistically realistic, or realistically optimistic, about the prospects for freedom in China. I agree strongly with the President, the Vice President, and Secretary Powell, all of whom have spoken often about the importance of individual freedom and respect for human rights. With regard to China, I believe our best policy is to speak out against human rights abuses, as we did this month in Geneva, and to encourage the reforms that are making significant inroads there.

Mr. Chairman, I'm pleased to take your questions. Thank you.

[The prepared statement of Mr. Craner follows:]

PREPARED STATEMENT OF LORNE W. CRANER

I want to thank you, Senator Brownback, and the other members of the Senate Foreign Relations Committee for holding this important hearing. This is an excellent time to take a look at our complex relationship with the People's Republic of China and I am pleased to be here today to answer your questions about human rights conditions and the prospects for democracy in China. I am also glad to have this opportunity to share with you the Administration's assessment of these important issues and to tell you what we have been doing to confront the Chinese Government when it violates human rights in China and, as Vice President Cheney said

last week, to support the aspirations of all Chinese people for freedom and democracy.

As the committee took note when it convened this hearing, U.S.-China cooperation has improved steadily since the first months after President Bush came to office and we confronted each other over the mid-air collision of Chinese and American planes near Hainan Island. After September 11, the Chinese Government became an ally in the Global War on Terror. It has been a key partner in discussions about North Korea. But even as we find common ground with China on these important issues of national security, we remain firm that there are areas on where our views differ, such as Hong Kong, Taiwan, proliferation, and my area of responsibility: freedom and human rights. We have not compromised when confronting China on and pursuing resolution of these issues. As recently as last week, Vice President Cheney stood firm in talking to China about these areas of disagreement and reminded his counterparts in Beijing that “it would be a mistake for us to underestimate the extent of the differences” between us.

June 4—less than two months from now—is the 15th anniversary of the crackdown at Tiananmen Square. This will be a somber anniversary. It will be somber not just because of the hundreds, if not thousands, of lives lost in Beijing on the evening of June 3 and the morning of June 4. The June 4th anniversary is a somber one because there will be no public mourning in China for the lives lost there 15 years ago. The family members of the students and citizens who died in and around Tiananmen Square will not be able to gather there together to grieve their loss. There will be no candles lit, no memorial wreathes laid, no touching eulogies spoken. These mourners will receive no condolences from their government. The Chinese nation will not be able to come together in any public way to commemorate the lives that were lost on June 4. Even to discuss such a thing, as we have seen recently in the last few weeks, is to risk detention and imprisonment.

Fifteen years ago, Americans and others around the world watched in collective horror as the People’s Liberation Army fired on the peaceful students and workers who had captured the world’s attention for six weeks. Certainly, everyone who watched those events unfold hoped that 15 years hence China would be a different place. We hoped that China, 15 years after Tiananmen, might be a country that was free and open, a country where human rights are respected, a country where different points of view could be shared without any fear of reprisal, and a country where religious adherents of all faiths could pray openly in whatever temple, church or mosque they chose. Of course, China today is not such a country.

China’s human rights record remains poor. In the 15 years since 1989, the Chinese economy has continued to expand, and constraints on things like where one can live and what one can do for a living have been relaxed. But the freedoms and rights that the Tiananmen protestors asked for have still not been realized.

In fact, in my tenure as Assistant Secretary of State for Democracy, Human Rights and Labor, my office has documented some progress in 2002, but backsliding on human rights in 2003. The Chinese Government’s mistreatment of its citizens is manifest. Most recently, we have noted increased surveillance of the Internet and detention of those who express opinions about democracy. Democracy activists and some spiritual or religious adherents, including Tibetan Buddhists, Uighur Muslims, Falun Gong practitioners, underground Protestants, and Catholics loyal to the Vatican, continue to suffer harsh treatment. We have received reports of religious adherents being mistreated or beaten in prison. We have regularly raised the need for prison reform, the right of children to receive religious training, and our extreme disappointment over egregious abuses against religious groups. Mr. Chairman, this administration has repeatedly—and at the highest levels—expressed strong concern, publicly and privately, over the detention of persons for the peaceful expression of their faith or political views and over restrictions on religious freedom, and we will continue to do so. We also continue to raise individual cases of concern such as Uighur businesswoman Rebiya Kadeer, labor activists Yao Fuxin and Xiao Yunliang and Tibetan monk Jigme Gyatso.

These concerns were deepened by the Chinese Government’s failure to carry out commitments made to U.S. officials during the December 2002 Human Rights Dialogue to work with the UN Special Rapporteurs on torture and Religious Intolerance, the Working Group on Arbitrary Detention, and the U.S. Commission on International Religious Freedom.

This backsliding prompted President Bush to authorize the State Department to pursue a resolution criticizing China’s human rights practices at the meeting of the UN Human Rights Commission in Geneva this month. Our resolution was carefully considered. While acknowledging steps that China has taken that might result in improved respect for the rights of its people, we urged members of the commission to join us in expressing “concern about continuing reports of severe restrictions of

freedom of assembly, association, expression, conscience and religion, legal processes that continue to fall short of international norms of due process and transparency, and arrests and other severe sentences for those seeking to exercise their fundamental rights.”

As the committee is aware, the Chinese Government was successful in getting a sufficient number of members to vote in favor of a “no-action” motion, preventing the commission from engaging in a healthy debate about the sssshuman rights situation in China. But our work in Geneva was not in vain. The UN Special Rapporteur on Torture will indeed visit China at the end of June. And now the European Union is factoring China’s human rights situation more prominently in its calculus of whether to lift its arms embargo against China. In pursuing a resolution at the commission, we made a strong statement about our unwavering concern over the human rights situation in China. Other countries and the Chinese Government itself have been compelled to take notice of our concern. And those who fight courageously every day to have their voices heard know that the United States has not forsaken and will not forsake them.

We have an obligation to speak out against the lack of freedom and protection of human rights in China because we see the people of China doing this for themselves on a weekly basis. We see newspaper editors trying to push the boundaries for freedom of the press. We see democracy activists speaking out for constitutional protections and elections. We see lawyers who are fighting to make the legal system live up to its own laws. We see workers trying to come together to demand fair compensation. We see rural dwellers writing letters and gathering at government offices to demand that corrupt local officials step down. We see religious adherents risk their freedom to gather to pray in house churches. We see Tibetans who maintain their allegiance to the Dalai Lama and Catholics who maintains their allegiance to the Pope.

In other words, we see individual, ordinary Chinese doing the extraordinary week after week, month after month. And I believe that we have the responsibility to support these extraordinary efforts and try to expand the political and legal space so that individual Chinese can keep pushing the boundaries.

The State Department and, in particular my bureau, is currently administering \$27.5 million to support democracy, human rights and the rule of law in China. At the end of the Clinton administration, the State Department began to discuss the possibility of cooperating on legal reform projects in China. When President Bush came to office, the State Department and my bureau decided to rethink that program, and we crafted a new approach to supporting freedom in China. Legal reform, while important, was too narrow a focus for a comprehensive China program. A U.S. program on China had to support liberty as well as law.

Six years ago in 1998, when I was president of the International Republican Institute, I testified before the Asia and Pacific Subcommittee of the House International Relations Committee on the value of promoting democracy and the rule of law in China. At that time, the Congress was just considering democracy promotion as one policy option to address human rights concerns in China. In that testimony, I described to the committee the work that IRI had been doing since 1993 to promote electoral, legislative and legal reform in China. In five years of programming in China, IRI had seen rapid expansion of village elections in China and a strong commitment to developing sound, democratic procedures that allowed for open candidate selection and secret ballot voting. On the legal side, IRI had assisted the National People’s Congress in developing more sophisticated legislative drafting capabilities and had worked with China’s first legal aid service providers. I concluded:

I hope I have shown that electoral, legislative and legal reforms under way in China are meaningful and are accelerating, and organizations such as IRI can help catalyze them. Yet in the same period these reforms have taken place, so too have the Tienanamen verdict, and all the legal reforms to date haven’t gotten those dissidents out of jail.

I therefore come before you as an advocate, but not a zealot. I am an advocate of broader American efforts to catalyze Chinese reforms that are congruent with American values and interests. At the same time, only a zealot would claim to know how China will change. Democratic development in China may come through the kind of incremental reforms I have described today. It may also come more suddenly. Of one thing we can be certain: Given the stakes involved, we would be wise to encourage every possible source of change for China, including the potential for change from within China.

Six years later, I am proud to say that we are now encouraging “every possible source for change in China” through the State Department’s China Democracy program.

The reforms that were under way in 1998 have definitely accelerated and expanded. In 1998, American NGOs were addressing a fairly narrow range of issues related to democracy and legal reform in China. Elections at the village level were developing and taking root in a meaningful way. Training on legislative drafting showed promise as a means of strengthening China’s legislature so that could serve as a modest, but still effective check on central government power. Legal aid was just beginning in China. Today, these reform have significantly expanded and the State Department is supporting the organizations that continue to work on these issues. But we also support new organizations that are working to promote women’s rights, labor rights, media reform and host of other issues that show how the channels for promoting reform in China have grown exponentially over the last few years.

In the area of direct elections, for example, we are now no longer working to promote elections just at the village level. Since 1998, the pressure to expand elections to higher levels of government has increased significantly. In September 2003, a local official in Sichuan Province received international attention when he tried to organize a direct election for township magistrate despite a 2001 central government ban on such activities. Though his efforts were derailed, we believe that there are many other local officials who are willing to keep pushing the envelope to expand direct election in China, and we are able to support research and training that keep that mission alive.

Like elections, legal reform in China is another area where we see meaningful change taking place. American NGOs and universities continue to play an important role in catalyzing all kinds of legal developments in China. The United States is supporting a wide array of efforts in this area, including programs that focus on the drafting of key pieces of legislation, such as new administrative litigation laws that enable Chinese to sue the government, a program to strengthen the use of evidence and witness testimony in trials, a program that works on helping villagers to challenge election fraud and abuse in the courts, and programs that hone the advocacy skills of criminal defense lawyers and that help them think about ways to protect themselves from becoming targets of the government if they handle sensitive, politically-charged criminal cases.

As the legal system has developed, the Chinese people are becoming increasingly aware of their rights under the law, and the United States is supporting projects that increase this awareness. American NGOs are working with Chinese partners to strengthen women’s rights in China, environmental rights and workers’ rights. Americans and Chinese are working together to provide better legal services to abused women and workers who are injured on the job. They are working together to think about how to enforce China’s environmental protection laws in some of the nation’s and the world’s most polluted cities.

Americans and Chinese are conducting awareness and public education campaigns so that average Chinese citizens know whom to call when they need legal assistance. They are strategizing about how to use litigation and test cases to challenge the Chinese legal system to protect the rights that are on the books. And Americans and Chinese are determining and monitoring compliance with international labor standards, through such U.S.-sponsored activities as the Partnership to Eliminate Sweatshops Program, designed specifically to address unacceptable working conditions in manufacturing facilities that produce for the U.S. market. For example, one project in China is aimed at developing and testing an innovative model for worker-manager relations through which up to 3,000 workers will be trained in three to five factories in the toy and apparel industry; another focuses on working to promote labor rights awareness in the Chinese business community and Chinese business schools. I can’t announce to you today a final decision to deny or accept the AFL-CIO’s section 301 petition alleging that China’s systemic failure to protect workers’ human rights constitutes an “unreasonable” trade practice. But I can assure you that for our part, we are committed to continuing programs that actively support ongoing reform in China’s labor relations system, improve labor conditions and protect worker rights, and strengthen the capacity of the Chinese Government to develop laws and regulations to implement internationally-recognized workers’ rights and to promote greater awareness of labor law among Chinese workers and employers.

As these rights awareness programs indicate, civil society is growing in China. And the United States is supporting its expansion and encouraging new ways of thinking about the role of the media as a provider of information and a watchdog. Media reform was something that no one contemplated when I spoke before the

Congress in 1998 about democratic reform in China. Market competition is pushing the news media to hone their investigative skills and report on stories about which the public wants to read. The Nanfang media group, which is based in media-savvy Guangzhou and publishes Southern Metropolis Daily and Southern Weekend (China's most popular news weekly), has developed a reputation as China's most progressive media group for its reporting on corruption, HIV/AIDS and, most recently, SARS. Two editors of the paper were recently tried on embezzlement charges. Many believe that these cases are the result of the paper's aggressive reporting on sensitive topics, and in an unprecedented move, a group of reporters and legal scholars have filed an online petition asking the Government for a retrial.

This petition is one of several similar open documents that we have seen in recent months written by Chinese asking the Government to reconsider its policy on a particular issue. Last spring, three young Beijing law professors wrote a letter to the Government asking it to reconsider the use of "custody and repatriation" centers to hold people without residency permits, vagrants, and others. There followed the death of a young college graduate, Sun Zhigang, who was beaten by the police while being held in such a center. His death was widely reported by the media. The Government executed a staff member of the state facility and sentenced 17 others to long prison terms. At the same time, the Government also agreed to disband these centers, marking an important step for systemic reform of rights of the accused. Incidentally, one of the drafters of this letter, Xu Zhiyong, campaigned as an independent candidate for local People's Congress in Beijing's Haidian district. He won election in December.

Other petitions have also circulated recently. This winter, Chinese scholars and activists circulated an online petition to seek the release of democracy activists who posted their thoughts on the Internet. Also this past winter, another group of well-known scholars wrote a letter to the Government asking it to clarify standards of freedom of expression and what constitutes subversion under Chinese law. The Government frequently uses subversion accusations to silence democracy and human rights activists. Finally, in March, Dr. Jiang Yanyong, whose name became public last spring when he contacted Western news media to report that Beijing authorities were covering up the SARS epidemic in China's capital, wrote a letter to the legislature asking members to consider a review of the Tiananmen verdict.

These kinds of activities are taking place with increasingly frequency in China. Elections with independent candidates, activists who are challenging the Government to protect people's rights, reporters who are courageously reporting the truth, even at the risk of losing their job or going to prison—every day we are seeing these steps being taken in China.

These steps give us reason to be optimistic at the prospect for democracy in China. But the events that I described in the first half of my testimony also remind us to be realistic. We cannot sit back and assume that China is on an unwavering path toward democracy. If anything, the Chinese leadership has given no indication that it might consider seriously the prospect of following the path of South Korea, the Philippines or Taiwan in pursuing gradual reform toward full freedom of speech and association, religious freedom, judicial independence, and free and fair elections. With that in mind, we continue to watch the situation in Hong Kong. We consistently urge Chinese and Hong Kong leaders to listen to the Hong Kong people and respond to their expressed aspirations for electoral reform and universal suffrage. After all, as the Vice President pointed out in his remarks in China last week, China's actions in Hong Kong do not affect only Hong Kong. Many nations, the U.S. among them, have a significant investment of people and resources in Hong Kong. The region's continued stability and prosperity is predicted on its continued rule of law and high degree of autonomy.

In sum, I am optimistically realistic or realistically optimistic about the prospects for freedom in China. I agree strongly with the President, the Vice President, and Secretary Powell who have spoken often about the importance of individual freedom and respect for human rights for a strong polity and society. With regard to China, I believe our best policy is to speak out against human rights abuses, as we did this month in Geneva, and to encourage the reforms that are making such significant inroads there, as we are doing annually through the State Department's Democracy, Human Rights, and Rule of Law Program.

Mr. Chairman, members of the committee, I'm pleased to take your questions now.

Senator BROWNBACK. Thank you very much, Mr. Craner.  
We'll go to our next witness first before doing questions.

Mr. Richard Lawless is Deputy Assistant Secretary of the Department of Defense. And I appreciate very much you coming to the committee and we're happy to receive your testimony.

**STATEMENT OF RICHARD P. LAWLESS, DEPUTY UNDER SECRETARY OF DEFENSE, INTERNATIONAL SECURITY AFFAIRS-ASIA PACIFIC**

Mr. LAWLESS. Thank you indeed, Senator Brownback. It is indeed a pleasure to appear at this hearing and have the opportunity to address the important issue of PRC military reforms.

I have a prepared initial statement, largely drawn from our soon-to-be released Report to Congress on China's Military Power. I would then be glad to answer any questions you may have.

China's People's Liberation Army, the PLA, has embarked on an ambitious, long-term military modernization effort to develop capabilities to fight and win short duration, high intensity conflicts along its periphery. China's defense modernization encompasses the transformation of virtually all aspects of its military establishment, to include weapons systems, operational doctrine, institution building and personnel reforms. In recent years the PLA has accelerated reform and modernization so as to have at its disposal a variety of credible military options to deter moves by Taiwan toward permanent separation or, if required, to compel by force the integration of Taiwan under mainland authority. A second set of objectives though, no less important, includes capabilities to deter, delay or disrupt third party intervention in a cross-Strait military conflict.

The PLA has made progress in meeting these goals through acquiring and deploying new weapons systems, promulgating new doctrine for modern warfare, reforming institutions and improving training. The PLA's determined focus on preparing for conflict in the Taiwan Strait raises serious doubts over Beijing's declared policy of seeking peaceful reunification under the one country-two systems model. The growth of China's economy has allowed the PRC to sustain annual double-digit increases in its budget, with one exception, since 1990. The officially announced budget in 2004 is more than \$25 billion. However, when off-budget funding for foreign weapons systems procurement in particular is included, we estimate total defense-related expenditures this year would be between \$50 and \$70 billion, ranking China third in defense spending after the United States and Russia.

China's military reform has also benefited from observing U.S. operations; that is, combat operations. The PLA first observed the revolution in military affairs from the 1991 Operation Desert Storm and studied how a technologically inferior force could defend itself against a superior opponent during Operation Allied Force over Kosovo. The PLA has likewise studied operations Enduring Freedom and Iraqi Freedom. The PLA, we believe, likely learned lessons on the application of unmanned aerial vehicles for reconnaissance and strike operations, the role of modern, well-trained special forces in precision targeting and the importance of speed in modern warfare. There are several key areas of reform within the PLA which I'd like to emphasize today.

*Joint Operations:* PLA theorists and planners believe that future campaigns will be conducted simultaneously on land, at sea and in the air, space and electronic sphere. Therefore, the PLA is improving its joint operations capabilities by developing an integrated C<sup>4</sup>ISR network, a new command structure and a joint logistics system.

*Air Operations:* The PLA Air Force is transitioning from a defensive force to one with a modern offensive strike capability. China's forced modernization plan and acquisition strategy for its air forces have been aimed mainly at defeating regional air forces, defending against aircraft operating at long ranges from China's coast, denying U.S. Naval operations and striking regional targets such as air bases and air defense sites.

*Missile Operations:* In the area of conventional missile operations, Beijing's growing conventional missile force provides a strategic capability without the political and practical constraints associated with nuclear-armed missiles. The PLA's short-range ballistic missile, SRBM, force provides a survivable and effective conventional strike force and represents a real-time coercive option in the hands of the PRC military.

China continues to improve quantitatively and qualitatively the capabilities of its conventionally armed SRBM force. The deployed inventory number is between 500 and 550 SRBMs, all deployed opposite Taiwan. And this deployment is increasing at the rate of 75 missiles per year. The accuracy and lethality of this force also are expected to increase through the use of satellite-aided guidance systems.

*Naval Operations:* In the area of naval operations, Beijing realizes it must have forces available to respond rapidly to a range of regional contingencies, and it is seeking to build a balanced naval force for surface, anti-submarine, submarine, air defense, mine and amphibious warfare.

In the area of C<sup>4</sup>ISR, China requires a survivable, robust, reliable and sophisticated Command, Control, Communications, Computer, Intelligence, Surveillance and Reconnaissance, that is C<sup>4</sup>ISR, system. This will allow it to collect, collate, integrate, manage and share access across a network of all battle space information. The PLA is continuing to upgrade its communication capabilities, which will rival the most modern civil networks.

In the area of space, acquiring modern ISR systems remains critical to Beijing's military modernization program. And it supports the PLA's local war doctrine. Ongoing space-based systems, with potential military applications include two new remote sensing satellites, advanced imagery, reconnaissance and earth resource systems with military applications, as well as electronic intelligence, ELINT, or signals intelligence, SIGINT, reconnaissance satellites. China is conducting extensive studies and is seeking foreign assistance on small satellites and micro satellites weighing less than 100 kilograms, for missions that include remote sensing and networks of electro-optical and radar satellites.

In the area of counterspace developments, China is expected to continue to enhance its satellite tracking and identification network. According to press accounts, China can use probably low-energy lasers to blind sensors on low Earth-orbiting satellites, al-

though whether this claim extends to actual facilities at this point is unclear. China has reportedly begun testing an anti-satellite, that is an ASAT, system.

China's defense industrial base deserves special mention, I believe. And I would like to conclude with some remarks about that industry. China's defense industrial base, also known as the National Defense Science, Technology and Industry, is a redundant structure consisting of factories, institutes and academies subordinate to the organizations that represent the nuclear, aeronautics, electronics, ordnance, shipbuilding and astronautics industries. The production factors are represented, for export/import practices, by trading corporations, with well-known names such as China Aerospace Technology Import/Export Corporation (CATIC) and China North Industries Corporation (NORINCO).

The export/import corporations are entities which aggressively pursue contracts to sell PRC equipment overseas as well as involve foreign companies in joint ventures in China. The corporations are closely monitored by the State Department for proliferation concerns. For example, CATIC was recently sanctioned pursuant to the Iran Nonproliferation Act.

Mr. Chairman, this concludes my initial testimony, and I would be glad to answer any questions you may have.

Senator BROWNBACK. Thank you very much, Mr. Lawless. I'll have questions for both you gentlemen.

We have a vote that's on right now, and I've got about four minutes left in the vote. With your permission I'd like to put us in recess while I run over and vote and then come back, if you'd be willing to stay around for that period of time to answer some questions. I would appreciate that.

This committee will be in recess for probably about ten to 15 minutes and I'll be right back.

[Whereupon, at 2:42 p.m. the hearing was recessed.]

[RECESS]

[The hearing resumed at 2:55 p.m.]

Senator BROWNBACK. Gentlemen, thank you very much. Sorry for the inconvenience.

Mr. Craner, let me start with you if I could. In the next panel we'll have one of the chief economists for the AFL-CIO who's filed a Section 301 case based on labor practices in China and saying that those are an illegal trade advantage that is being expressed or used by China. The administration will have to make a decision whether or not to take this 301 case. Have you, can you articulate a position or where you are in the appraisal process of whether you will be making any recommendations regarding this 301 case?

Mr. CRANER. We're working with other agencies to come up with a recommendation. As you know, the office of the United States Trade Representative (USTR) has to announce a decision by April 30, and so the right response is under discussion between the State Department and other agencies. Clearly the petition itself refers numerous times to the human rights report that we put out. That report outlines that genuine freedom of association and collective bargaining do not exist. We all know that most workplaces have

substandard conditions and a high rate of accidents, and that wages, hours and safety laws and regulations are generally not enforced.

Senator BROWNBACk. When I first saw that suit was filed I looked at it, and I thought about it, and then I read about it again, and then I read about it again, and the more I read about it, it seemed as if a number of things that were being alleged were items that I'd been pushing on issues of human rights, on issues of a lack of any sort of democracy in the workplace, of any sort of rights in the workplace, and I thought that while this was a different angle than I would have taken at it, it seemed to me to be a very interesting angle, one that hit at much of the same issues that I've been running in against China for some period of time. I've been saying that China's economic system is rampant capitalism without a legitimate means for workers to be able to express themselves in a system without balance, without morality. So I was looking at that and that's why I was pleased to see that we'll have that on the next panel. I know the administration has to make a decision sometime soon; it will be a tough decision to make.

In addition, the currency case that the administration is bringing against China seems to me to be a clearer, perhaps easier, case to make. China's manipulating its currency, and by that impacting the global marketplace, impacting us, but more—it may have more of an impact on other countries that sell into this market (Mexico and Central American for example) than it does directly here. Because by the Chinese underpricing or devaluing their currency, a baseball cap that comes in here relative to Mexico appears to be cheaper. But that's not the issue that would be assessed by your agency or department. I would hope you could spend a great deal of time giving a lot of thought about how bringing this 301 case forward could have positive impacts in the field that you're concerned about, and have done a very good job.

Mr. CRANER. I can assure you myself and my staff and others at the State Department have been spending a great deal of time on this, including Secretary Powell. There's not a lot in the petition that I don't find factually accurate. I have a difference with one of the categories that they address, but as I said, a lot of it has been drawn from documents that we ourselves have put together. I think the issue is whether it meets the 301 test and what remedies could be applied through that process. We have been trying up to now, and we intended even before this came up, to try and intensify the kind of activities in China, both at the corporate level but also down at the factory level, to try and improve conditions in China. The Department of Labor has also been pursuing a pretty wide program. I met with Secretary Chao about it just a few weeks ago, especially in the area of mining safety, which clearly in China is way substandard from what you see in almost any other country in the world.

Senator BROWNBACk. Are there other routes or remedies—you brought cases in front of the U.N. Human Rights Commission, had difficulty there; are there other avenues or venues that we can pursue more aggressively, given the case we know that exists currently, against the Chinese? You mentioned that the 301 would be a bit of a novel way of putting this forward. There's a set of rem-

edies that are available there that is not available in other fields. Are there other fields we can pursue?

Mr. CRANER. Well, the areas I talked about in the last half of my testimony are essentially new. Those are things that we have been doing over the last two years and, though modest, at a total of \$27.5 million over three years, I would argue they're already having a good effect in terms of getting people in China to think a little more broadly. We encourage people in China to think a little more broadly about what kind of society they should live in, about their access to information, about whether or not they should be able to organize, at least at the factory level, about what their government ought to be doing for them, and ultimately about the possibilities of electing their own government. Those are all new questions that people in China are starting to ask, and they are very good questions to be asking. As a result of our doing the resolution, the Chinese threatened to, and did indeed, cut off our human rights dialogue, which was a formal, almost annual exercise that we had been through. I made clear to them that if we were going to have a dialogue it had to be based on results. In part because of the fact that we had not been seeing results from that dialogue, we hadn't had one in over a year. The President and the National Security Advisor, Secretary of State Colin Powell, Under Secretary Paula Dobriansky, and other officials in this government not traditionally concerned with human rights, they push these particular issues whenever they meet with the Chinese. And I think over time we're beginning to have an effect, partly because I think the Chinese are starting to understand that at least in a public way they need to be starting to get interested in these issues.

What do I mean by that? I mean that China, as you've heard, wants to be a great power. And in today's world you cannot be a great power without having an open society. It was fine 20 or 30 years ago to not have an open society and to try to be a great power. The Soviet Union managed to do it. But to be accepted as part of the club in today's world you cannot do that and be repressive with your people. And I think they are beginning to understand that.

Senator BROWNBACK. One final thought on this and then I would like to go to you, Mr. Lawless, if I could, is that, if China sets and gets away with a low bar on how it treats its own people in labor situations, in human rights situations—now particularly I'm thinking in labor situations now—it drives the rest of the world's bar down, and it has an impact on workers in Honduras, it has an impact on workers all over the world that are impacted having to compete with labor that's put in very difficult situations in China. So the degree that we can press on the Chinese aggressively here, and try to get more rights and more opportunities for them, I think it will have, I know it will have, a global impact. To the degree that we're not successful will have a global impact as well.

Mr. CRANER. I think you're right, and that's part of the reason we press it, especially as we get closer to 2005 and the end of quotas in places like a Bangladesh or a Guatemala or a Haiti that have been able to export goods into the U.S. under their quota.

When I talk to corporations that operate in Guatemala or Bangladesh or Honduras, and I say where are you going in 2005, they

all say China because that's where the cheap labor is going to be. But I would tell you one other thing that a lot of these corporations tell me, which is a little counter-intuitive, which is that they're looking for countries—remember, a lot of these corporations have been through scandals over the last five or ten years about the kind of places their clothing or sneakers or whatever are manufactured—and what they tell me is they're actually starting to look for places that want to make an issue out of better conditions for workers. Granted, these are name brand firms like Patagonia or Reebok. But they're actually looking for countries where the government is making an effort to jack the standards up because they don't want to get caught in a scandal two or three years from now about a rotten factory that they're making their goods in. That's a good thing, that these high end manufacturers are doing it. They are beginning to drag along some of the lower end manufacturers. But, a lot of no-name manufacturers, that doesn't really matter to them because it's not going to hurt their brand name. So, we can encourage better conditions in the factories, and we've also got to encourage corporations to understand that better factory conditions are good of their own name, because they don't want to go through the kind of boycotts that some of these firms have seen over the years because of the poor conditions in which they manufacture. Many of them are beginning to understand that.

Senator BROWNBACK. It's a good point.

Mr. Lawless, you point to a defense industry in China, doubling, I think you said, annual double-digit growth, and it's defense spending on an annual basis, all but one year over the last ten, I believe was your number, up to \$50 to \$70 billion in defense spending this year in China. Where are they going with all of this defense spending? And do you see it capping out any time soon?

Mr. LAWLESS. I guess really that is really the 64-thousand-dollar question, Mr. Chairman. I think that the credible breadth of the economic base that's being established there and the growth in GDP and its ability to develop and acquire and integrate advance technologies into this society and into this economy gives us great pause for a concern as to where they can take their industrial base for defense. So I don't know that we see a capping out. They have simply the potential to devote an increasingly greater amount of net resources to their defense spending. They've shown the ability to spend hard currency very aggressively when they want to acquire a given system or technology. I think the combination of their ability to spend hard currency in ever-increasing amounts, for example in their weapons shopping excursions, the Soviet Union and other sources of technology and weapons systems, coupled with the base that now exists, gives us great pause for concern in the future in what they're going to be able to do with that industrial base and that economic base.

Senator BROWNBACK. You were talking in your testimony about it being a regional offensive projection, no longer a defensive orientation, as I gather, but only a regional orientation. Do you believe that's where it stops? Is it a regional offensive projection or does it move on from that point? Or do we really even know?

Mr. LAWLESS. I don't think we know the answer to that. We do see clearly that the intention is to very rapidly, in most cases more

rapidly than we had originally projected, develop the ability to flesh out that regional capability and particularly the ability to project power offshore. The ability to evolve from an essentially defensive system that would wage a defensive war on one's own territory and the ability to project force out, even regionally, is a very big step that requires development of not only systems themselves but doctrine and, as I mentioned, ideals and concepts of jointness, ever increasing sophistication of the systems they bring to bear. So I think for the near-term, as we watch the development of this regional projection capability, that is in and of itself a pause for concern.

Senator BROWNBACk. If Chinese leadership does not change, if it remains held in the small Communist party over the foreseeable future, is China our most likely competitor militarily that we see growing in the world today, if it remains on the path that it's projecting today, with the doctrinal change, with the shift in investment, with the ability to integrate technology rapidly?

Mr. LAWLESS. It certainly would be working from the most robust base in the world to do that. And so, I think the combination of where they've grown their military today and the economic and industrial base which they'll have to grow it out in the future suggests that they would indeed become the main competitor, both regionally and possibly globally.

Senator BROWNBACk. So let's put the question another way. In other words, is there anybody else who has the same set of factors out there that would concern you as part of the Department of Defense here?

Mr. LAWLESS. Not really in terms of projecting into the future, no.

Senator BROWNBACk. They're it.

Mr. LAWLESS. Pardon me?

Senator BROWNBACk. They're it.

Mr. LAWLESS. Again, the combination of the growth of the economy, which is truly impressive, and the ability to integrate advanced technologies into that economy is something that we haven't seen perhaps in recent history. I'm not attempting to make a direct comparison to the former Soviet Union, but the fact remains that this is a very robust economy that is growing and establishing a very sophisticated industrial base. I'm not sure that the Soviet Union is working from the same basis at all. I think that's what gives folks most pause for concern.

Senator BROWNBACk. So that if they really wanted to turn it on and aggressively turn on, even more aggressively turn on this defense military—or this military industrial complex—they could really move it rapidly?

Mr. LAWLESS. I think it's a question of where they elect, where they decide to invest their resources. When you work from an economy of this size, with this growth rate, you perhaps don't need to invest as, say, a North Korea or another country would have to invest very high levels of GNP—GDP—to their defense budget. You can still grow your military at very strong rates over a period of ten or twenty years. So again, I concur with what you just said.

Senator BROWNBACk. I chair the Science, Space, Technology subcommittee and, you know, we're looking at adjustments in our

space program. One of the things that we're going to hold a hearing on in the future is other competitors in the space field, and China's the one that really steps forward, and there are others but China is a key one. What are they looking to do, can you determine from a defense or military perspective in the space program—other than what you were saying about imagery targeting—are there other designs that you've been able to determine from a military aspect of their space program?

Mr. LAWLESS. Well quite obviously they have a very aggressive manned space program. They've made no doubt about the fact that they intend to work and live in space. So I believe that the combination of the resources they're devoting right now, the fact that they're able to induce reasonably sophisticated technologies where they can't home grow them and the fact that they're devoting a lot of resources to development of space capabilities, suggests that they see space as an important area for security policy in the future.

Senator BROWNBACK. For me, this wouldn't be much of particular concern if it were a democracy, if it were an open society, you'd look at it and you'd go, great, here's a competitor and we will compete vigorously as well. It's when it comes from a leadership that's very narrow and self-selected and can move aggressively and—I don't want to say whimsically but cavalierly—easily, that's when, you know, as a policy maker I look at it and I just grow concerned. If it were a democratic society, if it were an open society, I'd say, fine, we'll compete. But this is what draws my greater concern.

Mr. LAWLESS. I would say in this year's China Military Power Report, which is in the final stages of preparation, and in fact I think we'll be able to deliver that in an early June time frame this year, some larger relative portion is devoted to the area of space and military use of space. And we make some judgements in there as to where we think the Chinese plan to take their programs, their security programs in space. So we've anticipated that and have addressed that in this year's report.

Senator BROWNBACK. As almost a final question, it's one that I want to put in the record, a *Business Week* article, March 26, 2004, and this is regarding the pending government contract to build Marine One. It's a helicopter for the White House. And according to the article, one of the company's that's vying for this contract had, as one of its development partners, a Chinese company that helped design and assemble some tail parts for its fleet of helicopters. That's no problem. But the problem is that the development partner, the China National Aerotechnology Import and Export Corporation, was indicted by the U.S. Government in 1999 for illegally buying and transferring machine tools to the Chinese military. Now, this company is also barred by the State Department for two years from any U.S. Government contract for technology sales to Iran. I've got questions about that, but I wonder, could you comment about the possibility of this group getting a U.S. Government contract while it's working with this Chinese company, or is this article inaccurate? If you could clarify that I would appreciate it.

Mr. LAWLESS. I'm quite familiar with the procurement itself. I'm not familiar with this aspect of it, and what I'd like to do is take

this under advisement and come back to you with a more detailed response.

Senator BROWNBACK. I would appreciate it if you would do that because it caught my eye that this was sitting out there. And again, you'd look at it one, I don't like it period, but it also seems to come on the heel of several instances where we've had trouble with technology transfers getting to China. And, you know, we hope no scenario that's a military one ever develops, but you just hate to see this continued violation in technology transfer happening, particularly if we're involved in funding any of it; we don't want to see that. So if you could get back to me on that in more detail I would appreciate that.

Mr. LAWLESS. I would do that, and if I could make one final comment on this, I do agree with you in that technology leakage and technology transfer becomes exponentially more dangerous to us in the Chinese context when you do have an industry, particularly a microtechnology industry and other aspects of this commercial industry which are growing apace and are able to induce and use this cream skimming technology, if you will. So it's a very important problem for us and I think it's one we're paying increasing attention to.

Senator BROWNBACK. Thank you.

Gentlemen, thank you very much for joining me today. And I appreciate very much your insights.

We have a second panel I'd like to call forward. Dr. Arthur Waldron, Lauder Professor of International Relations, University of Pennsylvania out of Philadelphia. Thea Lee, Chief International Economist for the AFL-CIO. Mr. Pieter Bottelier, Adjunct Professor of China Studies at Johns Hopkins. And Mr. Roger W. Robinson, Jr., Chairman, U.S.-China Economic and Security Review Commission out of Washington. He will be accompanied by Mr. C. Richard D'Amato, Vice Chairman, U.S.-China Economic and Security Review Commission.

I want to thank you all for joining us today. And I appreciate very much you staying in here while the hour's gotten late. Mr. Robinson, let's start off with you as Chairman of the U.S.-China Economic and Security Review Commission, if you wouldn't mind. We will put your complete statements in the record, so you can summarize if you would choose to, that would be just fine; then we'll have some questions afterwards.

Mr. Robinson.

**STATEMENT OF ROGER W. ROBINSON, JR., CHAIRMAN, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION; ACCOMPANIED BY C. RICHARD D'AMATO, VICE CHAIRMAN, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION**

Mr. ROBINSON. Thank you very much, Mr. Chairman. We appreciate this opportunity to testify on the work of the commission and our assessment for the Congress of the priority areas in U.S.-China relations. I'm joined at the table by commission Vice Chairman Richard D'Amato, demonstrating the strongly bipartisan nature of our views and the work of the commission. I should also note at the outset that the views expressed in this testimony are those of the commission's Chairman and Vice Chairman and, except where

specifically stated, do not necessarily reflect the views of other commissioners. The commission will be delivering its 2004 report to Congress next month, which will present the full commission's consensus, findings, and recommendations in fulfillment of our legislative mandate.

Today we want to highlight for the committee our preliminary assessment of the priority areas of concern in U.S.-China relations, those requiring the most immediate attention of the Congress, and reinforce some of the recommendations we've made to Congress on these topics over the past year. We see the priority areas as follows: (1) effective management of U.S.-China trade and investment; (2) the changing dynamics of the cross-Strait relationship; (3) holding China to its commitments on Hong Kong; and (4) China's pivotal role in the North Korean nuclear crisis.

Before we address these specific areas, we would like to offer our summary assessment of the current direction of U.S.-China relations, at least with regard to the broad areas covered by our mandate. In short, we believe that a number of the current trends in U.S.-China relations have potential negative implications for our long-term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections. We believe that the time is ripe for putting the U.S.-China relationship on a more solid, sustainable footing from the perspective of long-term U.S. interests. The U.S.-China relationship is still in the relatively early stages of its development and is marked by a fluid, rather than a static, environment. The United States has played and continues to plan an enormous role in the economic and technological development of China. As we've documented through our hearings and reports, U.S. trade investment and technology flows have been the critical factor in China's rise as an economic power. We need to employ the substantial leverage this provides to develop an architecture that advances both country's long-term interests. We have leverage now, and perhaps for the next decade, but this may not always be the case. Within this framework, let me turn to a discussion of the key near-term areas of concern and our thinking on possible U.S. policy responses.

I'd like to begin with effective management of U.S.-China trade and investment. First, our trade and investment relationship with China, with current trends continuing and the deficit expanding, is not just a trade issue for the United States but a matter of our long-term economic health and national security. Beyond these immediate challenges are the implications for globalization writ large. The commission believes that the U.S.-China economic relation is of such large dimension that the future trends of globalization will depend to a substantial degree on how we manage our economic relations with China and shape the rules of the road, if you will, for broader global trade relations. Our written testimony contains numerous specific recommendations the commission has made to the Congress on actions to right the imbalance in U.S.-China trade. We meet today during the same week that a high level trade dialogue took place in Washington between U.S. and Chinese officials. As we understand, the Chinese side made commitments to significantly improve their poor record of protecting intellectual property rights and not to move forward with a restrictive standard that would

have been a barrier to U.S. wireless goods. Time will tell whether these commitments will be fulfilled. We've often seen China's trade promises, particularly on IPR, be worth no more than the paper they're written on. We also are concerned—

Senator BROWNBACK. Sir, I've got to jump in. I think this is the third or fourth time around I've heard them commit to protecting intellectual property rights more. I was in Bush I of the trade rep's field; they promised then. I was here during the Clinton years; they promised then. They're promising now. You know what? At some point in time, you know, and that's what you're saying but this is personally, for me, seeing this song over a decade period of time and nothing has happened yet. Please proceed.

Mr. ROBINSON. I don't disagree. We're also concerned that several vital issues in U.S.-China trade, including China's currency and subsidies policies were not on the table during these talks.

Second, the changing dynamics of the cross-Strait relationship. The committee's well aware of the significant events in the Taiwan Strait over the past few months and the growing tensions between the two sides, particularly following President Chen's re-election last month. The state of cross-Strait relations appears to be entering a new era, one that will require new thinking by the administration and the Congress. The Taiwan Relations Act has served U.S. interests well over its 25-year history, and we as a government and nation need to remain faithful to it, especially now when the cross-Strait situation is as complex as it's ever been. In sum, given the current economic and political trends in the Strait that we've identified in our written testimony, developments that call into question the status quo in cross-Strait relations, we believe there's an immediate need for Congress and the administration to review our policies toward Taiwan and cross-Strait relations, and to determine an appropriate role for the United States in reinvigorating the cross-Strait dialogue.

Third, holding China to its commitments on Hong Kong. The recent events in Hong Kong point to troubling signs of an erosion of the autonomy promised Hong Kong by the mainland under the One Country, Two Systems formula. These events have no doubt played into developments in Taiwan, where such a formula for any eventual unification has become a non-starter. We know this committee is deeply concerned, as is the commission, about the maintenance of Hong Kong's basic freedoms. We urge the Congress and Administration to let the Chinese leadership know that Beijing's moves to limit Hong Kong's autonomy and democratic aspirations are not in any party's long-term interest, and that U.S.-China relations will be adversely affected by a continuation of Beijing's current course.

And fourth, China's pivotal role in the North Korean nuclear crisis. In the post-9/11 world there can be no doubt that stemming the tide of the proliferation of weapons of mass destruction and ballistic missiles is the highest national priority for the United States. The commission's charge to examine China's role in WMD proliferation is part of this effort. North Korea is heavily dependent on Chinese assistance in the form of fuel, financial aid, military-to-military ties, and food. These facts clearly indicate that the considerable leverage Beijing could exert over Pyongyang is evident, if it chooses to use it. To date, however, China has been playing more

of a host than intermediary role in the Six-Party Talks and does not appear to be pressing for its expeditious resolution. Time is not on our side in confronting this crisis. As the Six-Party Talks drag on, North Korea's nuclear weapons and ballistic missile programs keep moving apace. As these capabilities are attained, the prospects for achieving a complete, verifiable and irreversible dismantlement by North Korea are dimming substantially. In our view, the U.S. government must make clear to China that its efforts in this crisis are a key, if not the key, test of the U.S.-China relationship. China's efforts in getting the Six-Party Talks underway must be followed up by the active use of its substantial leverage. In the event of continued stalemate and lack of Chinese success in persuading North Korea to accept these requirements, we believe the United States must develop other policy options with our partners in the region to resolve this highly critical situation in the near-term.

Mr. Chairman, we thank you for this opportunity to testify. Through an appropriate mix of U.S. policies we're optimistic that this complex relationship can be managed in such a way as to minimize the downside risks and enhance the prospects of moving China toward a more democratic and market-oriented society to the benefit of both of our economic and national security interests. Vice Chairman D'Amato and I will be pleased to take your questions. Thank you.

[The joint statement of Mr. Robinson and Mr. D'Amato follows:]

PREPARED STATEMENT OF ROGER W. ROBINSON, JR., CHAIRMAN; AND C. RICHARD D'AMATO, VICE CHAIRMAN, U.S.-CHINA ECONOMIC & SECURITY REVIEW COMMISSION

Mr. Chairman and members of the committee:

Thank you for this opportunity to testify on the work of the commission and our assessment for the Congress of the priority areas in U.S.-China relations. We are submitting this as a joint statement by the Chairman and Vice Chairman of the commission, as an expression of the bipartisan nature of our views and the work of the commission.<sup>1</sup>

The commission was established in the Fall of 2000 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 (PRC)." We were, to a large extent, a result of the decision by Congress earlier that year to grant Permanent Normal Trade Relations (PNTR) to China. The annual NTR debate in Congress had been the forum by which Congress took stock of year-to-year developments in U.S.-China relations, and ventilated concerns regarding areas where the relationship might be off track. With the approval of PNTR, the House and Senate properly recognized the importance of continuing Congress' annual assessment of key areas of U.S.-China relations, given the growing stature of this bilateral relationship.

Following the commission's first Report to Congress in July 2002, Congress revised the commission's charter to focus our work on the following areas: China's proliferation practices, China's economic reforms and U.S. economic transfers to China, China's escalating energy needs, Chinese firms' listing or trading in the U.S. capital markets, U.S. investments into China, the regional economic and security impacts of China's growing economic, military, and political clout, U.S.-China bilateral programs on science and technology cooperation and agreements on intellectual property rights and prison labor imports, China's record of compliance with its World Trade Organization (WTO) commitments, and the Chinese Government's efforts to control the media and, through that, perceptions of the United States within China. This extensive mandate reflects the complexity of U.S.-China relations, and high-

<sup>1</sup>The views expressed in this testimony are those of the commission's Chairman and Vice Chairman and, except where specifically stated, do not necessarily reflect the views of other commissioners.

lights the continuing need for the United States to carefully manage this relationship.

The commission will deliver its 2004 report to Congress next month, which will present its findings and recommendations in the issue areas specified by Congress. We will also be answering the central theme of our mandate to provide Congress with an overall assessment of “the national security implications of the bilateral trade and economic relationship.” We hope this analysis will prove useful for the committee’s and Congress’s important deliberations on U.S.-China policy. We would be pleased to come back to the committee to present the full findings and recommendations of our report once it is complete.

Today, we want to highlight for the committee our preliminary assessment of the priority areas of concern in U.S.-China relations—those requiring the most immediate attention of the Congress—and reinforce some of the recommendations we have made to Congress on these topics over the past year.

In sum, we see the priority areas as the following:

- Effective management of U.S.-China trade and investment
- The changing dynamics of the cross-Strait relationship
- Holding China to its commitments on Hong Kong
- China’s pivotal role in the North Korean nuclear crisis

Before we address our specific concerns and recommendations in these areas, we would like to offer our assessment of the current direction of U.S.-China relations, at least with regard to the broad areas covered by our mandate. In sum, we believe that a number of the current trends in U.S.-China relations have potential negative implications for our long-term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections.

This assessment is somewhat counter to much of the conventional wisdom in the United States today that characterizes U.S.-China relations as having reached a positive new echelon in light of the apparent cooperation between the two countries on anti-terrorism initiatives and, in particular, confronting the North Korea nuclear crisis. We recognize the importance of these developments and do not dismiss their significance. Rather, we believe that there are long-term trends in the relationship that give us cause for concern, but which can be corrected given timely and sustained U.S. attention and effort.

In light of this assessment, we believe that the time is ripe for putting the U.S.-China relationship on a more solid, sustainable footing from the perspective of long-term U.S. interests. The U.S.-China relationship is still in the relatively early stages of its development and is marked by a fluid rather than static environment. To use an analogy—the relationship is like a building where not only has the paint not dried in any room, but the architectural plans are still being revised. The United States has played—and continues to play—an enormous role in the economic and technological development of China. As we have documented through our hearings and reports, U.S. trade, investment, and technology flows have been the critical factor in China’s rise as an economic power. We need to use the substantial leverage this provides us to develop an architecture that advances both countries’ long-term interests. We have the leverage now and perhaps for the next decade, but this may not always be the case.

When the Congress approved PNTR for China, the guiding premise was that it would expand market access for U.S. goods and services and, more fundamentally, would lead to economic reform in China and, eventually, political reform. In this context, it was characterized as in our “national security interest” to support China’s accession to the WTO. Having taken this significant step, the United States cannot lose sight of these important assumptions, and we must configure our policies toward China to help make these assumptions materialize—from expanded trade opportunities for U.S. exporters and a mutually beneficial trade relationship that sets global standards for fair trade, to an open, more democratic society that can be an important partner in addressing global security challenges, including weapons proliferation, terrorism, and, of course, a peaceful resolution of the cross-Strait situation.

If we falter in the use of our economic and political influence now to effect positive change in China, we will have squandered an historic opportunity. We believe China demonstrated a willingness to move in a positive direction, and to take substantial risks to do so, when it entered the global economy. And there has been substantial market liberalization in China as well as new laws improving property rights for citizens. But China will likely not initiate the decisive measures toward more mean-

ingful economic and political reform without substantial and sustained pressure from a United States willing to utilize its tools of leverage and persuasion.

The Congress gave our commission an important and unique task—to identify the scope of problems and shortcomings in key areas of the U.S.-China relationship, and to make recommendations to Congress concerning how to address these concerns. In this pursuit, the commission can serve as an effective early warning mechanism to surface economic and national security concerns before they become unmanageable, and to recommend policy changes that can affect mid-course corrections in U.S. policy where necessary.

Within this framework, we will now turn to a more detailed discussion of the key areas of concern we see at the present time in U.S.-China relations, and our thinking on possible U.S. policy responses.

#### EFFECTIVE MANAGEMENT OF U.S.-CHINA TRADE AND INVESTMENT

Trade and investment flows constitute the core of U.S.-China economic relations. Bringing these flows into proper balance will significantly determine the benefits to the United States of this important relationship. The challenge facing U.S. policy-makers operates at two levels. On one level there are the immediate problems associated with the enormous trade deficit that the United States has with China and the resulting consequences for the U.S. economy, particularly the manufacturing sector. This requires attention to the issues of exchange rates and currency manipulation, and addressing China's mercantilist trade and industrial policies through vigorous enforcement of WTO and U.S. trade laws.

But beyond these immediate challenges are the implications associated with "globalization." The commission believes that the U.S.-China economic relationship is of such large dimensions that the future trends of globalization will depend to a substantial degree on how we manage our economic relations with China. It is reasonable to believe that U.S.-China economic relations will shape "the rules of the road" for broader global trade relations. If current failings are remedied and the relationship is developed so as to provide broad-based benefits for both sides, globalization will likely be affected in a positive manner on a worldwide scale. If trade commitments and the rule of law are honored, and trade is conducted with respect for labor rights and environmental protection, the direction of globalization will probably take a turn for the better worldwide. If not, the opposite will likely eventuate.

The dominant feature of U.S.-China economic relations is the U.S. goods trade deficit, which rose by more than 20 percent in 2003 to a record \$124 billion. The deficit with China now constitutes 23 percent of the total U.S. goods trade deficit, and China is by far the largest country component of the deficit. Moreover, U.S. trade with China—with \$28 billion in exports to China in 2003 as compared with \$152 billion in imports—is by far the United States' most lopsided trade relationship as measured by the ratio of imports to exports. This trade deficit is of major concern because (i) it has contributed to the erosion of manufacturing jobs and the current jobless recovery in the United States, and (ii) manufacturing is critical for the nation's economic and national security.

Therefore, our trade and investment relationship with China—with current trends continuing and the deficit expanding—is not just a trade issue for the United States, but a matter of our long-term economic health, and national security.

A key factor contributing to the deficit is the undervaluation of the Chinese yuan against the U.S. dollar. This gives Chinese producers a competitive advantage by making Chinese imports relatively less expensive, and U.S. exports relatively more expensive. It also undermines the profitability of U.S. manufacturers, thereby reducing their investment spending while also giving them an incentive to shift production to China. Economic fundamentals suggest that the Chinese yuan is undervalued, with a growing consensus of economists estimating the level of undervaluation to be anywhere from 15 to 40 percent. However, China persistently intervenes in the foreign exchange market to maintain the de facto peg of 8.28 yuan per dollar.

The 1988 Omnibus Trade and Competitiveness Act requires the Secretary of the Treasury to report to the Senate Banking Committee twice each year with an assessment of currency manipulation by trading partners. The commission is greatly concerned that the Treasury Department has repeatedly sidestepped a finding that China is manipulating its currency, despite the mounting evidence to the contrary.

To address this, the commission has recommended to Congress that if the Treasury Department's efforts to effect an upward revaluation of China's currency prove ineffective, Congress should use its legislative powers to force action by the U.S. and Chinese Governments to address this unfair and mercantilist trade practice. For the near future, continued vigorous development of such legislative initiatives as were

outlined by members of Congress during our hearing, linking China's performance on its exchange rate policies to its continued full access to the U.S. market, appears essential to ensure the appropriate level of effort by both governments to this matter.

A second factor contributing to imbalances in U.S.-China trade are China's mercantilist industrial and foreign direct investment policies, the purpose of which appears to be to enhance the power of the Chinese state. China has pursued industrial policies that involve a wide range of measures including technology transfer requirements, government subsidies, discriminatory tax relief, and limitations on market access for foreign companies. The Chinese Government is currently targeting the high tech, auto, and auto parts industries. The textile sector is another industry of great concern as the ending of the multi-fiber agreement (MFA) on January 1, 2005 promises to spur a massive shift of textile production to China, which will likely decimate what remains of the U.S. textile industry (which still employs 630,000 people), as well as textile industries from Mexico to Bangladesh.

To counter these practices, the commission has recommended to Congress that:

- The United States Trade Representative and Department of Commerce immediately undertake a comprehensive investigation of China's system of government subsidies for manufacturing, including tax incentives, preferential access to credit and capital, subsidized utilities, and investment conditions requiring technology transfers. USTR and Commerce should provide the results of this investigation in a report that lays out specific steps the U.S. Government can take to address these practices through U.S. trade laws, WTO rights, and by utilizing special safeguards China agreed to as part of its WTO accession commitments.
- The U.S. tax code be restructured to eliminate incentives for U.S. business, particularly manufacturing, but also services and high technology companies, to shift production, services, research and technology off-shore.
- Congress amend U.S. countervailing duty laws to make them applicable to non-market economies, such as China.
- The U.S. Government work with other interested WTO members to convene an emergency session of the WTO to extend the Multi-fiber Arrangement at least through 2008.

An essential part of our mandate—as well as U.S.-China trade relations—is to assess China's progress in meeting its commitments as a member of the WTO. China joined the WTO in December 2001. Its accession agreement is extremely complex, reflecting the need for special arrangements to address the fact that China joined the WTO without having met the requirements of a market economy. To protect against trade distortions and unfair trade practices resulting from China's non-market status, China's WTO agreement includes a special review mechanism to monitor China's compliance and special safeguard provisions giving WTO members the right to protect themselves against sudden surges of Chinese imports. It is critical that these agreements be properly and vigorously implemented and enforced.

China has made progress in reducing tariffs and otherwise formally meeting a large number of its WTO accession commitments, but significant compliance shortfalls persist in a number of areas of key importance to U.S. trade. In particular, China continues to provide direct and indirect subsidies to Chinese producers, there is rampant abuse and lax enforcement of intellectual property rights, foreign firms face discriminatory tax treatment, there is poor transparency in the adoption and application of regulations, and China uses unjustified technical and safety standards to exclude foreign products.

We are also particularly dismayed with China's level of cooperation with the WTO's Transitional Review Mechanism (TRM) for reviewing China's WTO progress. As part of its accession agreement, China agreed to be subject to this multilateral annual review of its compliance record for the first eight years of its WTO membership, with a final review after the tenth year. The TRM was an important provision of China's accession agreement—one that U.S. negotiators strenuously pressed for—because it was seen as a robust mechanism for both monitoring China's compliance progress and for applying multilateral pressure on China to correct deficiencies. Instead, however, China has undermined the TRM during its first two years by refusing to fully cooperate with and address WTO member questions and other efforts to engage China in a dialogue on compliance shortfalls. It has simply not served as the intended robust mechanism for combating China's compliance shortfalls.

Therefore, the commission has recommended to Congress that USTR and other appropriate U.S. Government officials undertake strenuous efforts to reform the TRM process into a meaningful multilateral review and measurement of China's compliance with its WTO commitments. If this is unsuccessful, the U.S. Government

should initiate a parallel process with the EU, Japan, and other major trading partners to produce a unified annual report by which to measure and record China's progress toward compliance, which report should be provided to Congress as part of USTR's annual report to Congress on this matter.

Though aware of these failings and problems, the U.S. Government has not been sufficiently vigorous in enforcing U.S. trading rights under either U.S. law or through the WTO. This is exemplified by the administration's failure to use the China-specific safeguards available to WTO members that protect against market disruptions by Chinese imports. The International Trade Commission has conducted five Section 421 safeguard investigations against Chinese products, and in three cases it found for the plaintiffs. Yet, in all three cases the President refused to take action. These developments risk undermining the Section 421 process, as companies may cease filing legitimate petitions if, given the significant legal costs, they come to believe the administration will not act. Moreover, the administration was slow in implementing procedures for U.S. use of the WTO China-specific textile safeguard, and first imposed the safeguard in December 2003 on a select few categories of textiles, despite the enormous detrimental impact of imports from China on the U.S. textile industry.

Overall, we are troubled by what we see as a general hesitancy among WTO members with substantial trade relations with China to raise legitimate trade disputes with China for fear of economic retaliation. The United States finally broke the ice by bringing the first WTO trade dispute against China on its preferential value-added tax (VAT) treatment for domestically designed and produced semi-conductors. We hope this will open the door to other WTO members exercising their rights under the WTO to address unfair Chinese trade practices. In fact, the United States should be actively coordinating with its major trading partners on areas of mutual concern regarding China's trade practices.

In light of the above, the commission has recommended to Congress that:

- The Congress should press the administration to use the WTO dispute settlement mechanism and/or U.S. trade laws, including Section 301 provisions, to seek redress for China's practices in the areas of exchange rate manipulation, denial of trading and distribution rights, massive violations of intellectual property rights (IPR) that have cost U.S. firms billions of dollars, and government subsidies to export industries that harm the competitiveness of U.S.-based manufacturing firms.
- The U.S. Government should make optimum use of the special Section 421 and textile safeguards negotiated as part of China's WTO accession agreement. These important safeguards were designed to prevent our domestic industries from being injured by surges of Chinese exports.

We note that the commission has reported on the scope of intellectual property rights abuses in China and the lack of improvement in Chinese enforcement of IPR protections for the past two years, and recommended WTO action. We strongly reiterate the need for the U.S. Government to take more aggressive action in addressing this vital trade issue.

In addition to addressing the problems of China's exchange rate manipulation and its mercantilist trade and investment policies, U.S. policymakers must turn their attention to China's impact on globalization. In our eagerness to expand trade and investment, too little attention has been given to this critical matter.

Trade and investment are not the ends of policy, but rather the means by which we enhance our national well-being. It is not the size per se of these flows that matters, but rather their impact. Just as intellectual property rights are not self-organizing, it is time to recognize that trade and investment rules must be placed in a framework designed to deliver maximum well-being. Trade must be standards based, and trade agreements with China and other countries must incorporate labor rights and environmental standards. We note that the U.S. Trade Representative, Ambassador Zoellick, vigorously embraced these concepts in a recent editorial in the *Washington Post* (April 19, 2004).

Economic action must conform to the fundamental values that guide us as a nation. To date, our policy toward globalization has tilted toward letting the market determine our values, rather than having the market conform to our standards and values.

We take note of the high-level trade dialogue taking place in Washington this week between U.S. and Chinese officials, and are hopeful it may result in a breakthrough. We are concerned, however, that certain key issues—including China's currency and subsidies policies—appear not to be on the table.

## THE CHANGING DYNAMICS OF THE CROSS-STRAIT RELATIONSHIP

The committee is well aware of the significant events in the Taiwan Strait over the past few months, and the growing tensions between the two sides. Beginning with Taiwan President Chen Shui-bian's announcement late last year that Taiwan would hold a national referendum as part of its March 2004 presidential balloting, and culminating in the dramatic reelection of President Chen last month, the state of cross-Strait relations appears to be entering a new era, one that will require new thinking by the administration and the Congress.

This past December and February we held public hearings that explored both the economic and security aspects of cross-Strait relations and China's military modernization efforts. Members of our commission traveled to the region last month and had a chance to talk with high-level observers of the cross-Strait situation in Tokyo, Hong Kong and Taipei. We also commissioned a study of China's acquisition and integration of foreign weapons systems, which is published on our website. The annual Department of Defense report on the cross-Strait military balance, the 2003 Council on Foreign Relations Study of China's Military Capabilities, and published reports of the U.S. Naval War College on China's growing submarine warfare capability offer additional useful perspectives.

China's modern arsenal includes a small but increasingly sophisticated missile force that is of direct strategic concern. In the Western Pacific theater, it is estimated that China has deployed some five hundred short-range ballistic missiles that directly threaten Taiwan and longer-range conventional missiles that could threaten Japan and our forces deployed in the region. China's advanced naval and air weapons systems—including surface ships, submarines, anti-ship missiles, and advanced fighter aircraft—have been significantly enhanced by infusions of foreign military technology, co-production assistance and direct purchases, mainly from Russia. China's military capabilities increasingly appear to be shaped to fit a Taiwan conflict scenario and to target U.S. air and naval forces that could become involved.

We conclude that China is steadily building its capacity to deter Taiwan from taking steps that the PRC deems unacceptable movements toward independence or consolidation of Taiwan's separate existence, to coerce Taiwan into an accommodation, and, ultimately, to have a viable option to settle the Taiwan issue by force of arms if necessary. A significant component of its military modernization strategy is to develop sufficient capabilities to deter U.S. military involvement in any cross-Strait conflict.

The United States cannot wish away this capacity. We cannot assume China will stay its hand because it has too much at stake economically to risk military conflict over Taiwan. In our view, we should not think of the 2008 Beijing Olympics as an insurance policy against Chinese coercion of Taiwan.

We can certainly hope that the economic benefits China gains from Taiwan investment and trade; the growing production and supply linkages among China, Japan, other Asian economies and the United States; the significant value to China of strong economic relations with the United States; and China's own desire to be seen by the world as a power that is "peacefully rising" will constrain China from using military force. Hopes, or even reasonable expectations, do not, however, provide a defense of vital U.S. interests. This is why it is more important now than ever before for the United States to uphold its key obligations under the Taiwan Relations Act (TRA) [22 USC 48], notably "to maintain the capacity to resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people on Taiwan."

Under the TRA, the additional U.S. responsibility to assist Taiwan's military preparedness is set out clearly. The law requires the United States to "make available to Taiwan such defense articles and defense services in such quantity as may be necessary to enable Taiwan to maintain a sufficient self-defense capability." Notably, it further requires that both "[t]he President and the Congress shall determine the nature and quantity of such defense articles and services based solely upon their judgment of the needs of Taiwan." Thus, the TRA sets out a unique joint role in the formulation of Taiwan policy for the Congress and administration, including on arms transfers decisions, demonstrating Congress' deep and abiding concerns regarding U.S. policy in this area.

Despite the TRA's provisions, we believe that the Congress and administration are not adequately coordinating in this area and that there are other operational impediments to the United States' ability to fulfill its important obligations to Taiwan.

In addition to providing vital defense support for Taiwan against PRC military threats, the TRA further requires U.S. policy to support the "social" and "economic"

system of Taiwan. This is an area of commitment the United States needs to be more alert to given current developments.

There are a number of key trends developing across the Strait that call for a re-evaluation of how we implement our Taiwan policy. First, there are two paradoxical trends: on the one hand, indirect cross-Strait economic ties continue to grow with large flows of investment in the mainland by Taiwan businesses and a stream of exports from Taiwan to feed production platforms. On the other hand we see a deterioration in the cross-Strait political situation, with both Beijing and Taipei hardening in their positions.

There is also the PRC's coordinated campaign to continue to "marginalize" Taiwan in the region, both politically and economically. Taiwan is being shut out of regional groupings such as the ASEAN Plus One or ASEAN Plus Three (China-Japan-South Korea) forums and unable to participate in regional trade arrangements like the Bangkok Agreement or the China-ASEAN framework agreement on a free trade area. Further, Taiwan has been unable to find regional economies willing to engage in bilateral free trade arrangements, due largely to PRC political pressure.

Moreover, there has been a gradual de-coupling of Taiwan's large and growing investments in China from Taiwan, due to the lack of direct transportation links across the Strait. Investors' interests are more concentrated in the mainland and less in Taiwan—to the point where some observers are asking whether Taiwan is becoming a "portfolio economy" instead of a "production economy." This has proven true for foreign corporations in Taiwan as well as native Taiwan firms. We have learned that in recent years the number of U.S. regional operational headquarters in Taiwan has declined and offices downgraded to local units.

The key political trend in Taiwan over the past 15 years has been the development of a vibrant democracy with new institutional bases. This is a valuable product of steady U.S. support for Taiwan, giving it the space it needed to develop its social and economic system without coercion from the PRC. The proof of the fundamental strength of that democratic development was last month's Presidential election in Taiwan, which we were privileged to monitor as part of our trip to the region. The system was sorely tested but appears to have emerged intact and resilient. Should Chen Shui-bian's narrow victory—one in which he nevertheless received an absolute majority of the votes cast in an election with heavy voter turnout—withstand its legal challenge, it will appear to be vindication for Chen's campaign that stressed Taiwan's separate identity and a mandate for his plans for constitutional reform.

While the United States should be proud of its role in helping to develop strong democratic institutions in Taiwan, Beijing appears threatened by these developments. The State Council Taiwan Affairs Office (TAO) has issued stern warnings that the path Chen Shui-bian is laying out for constitutional reform—a referendum in 2006 and a new or amended constitution in 2008—is tantamount to a "timetable for Taiwan independence." The TAO reiterated that no progress on cross-Strait issues could be achieved unless and until Taiwan accepted Beijing's "One China Principle."<sup>2</sup> The prospects for China letting up on its strategy of isolating Taiwan—by, for example, allowing Taiwan observer status in the World Health Organization, where Taiwan's active participation is clearly in the greater interest of China and the East Asian region—are dim.

The lack of trust across the Strait is palpable, and it goes both ways. Aside from its campaign of isolating Taiwan, China's heavy-handed interference in the political process in Hong Kong—discussed later in this testimony—has only reinforced Chen Shui-bian's argument that the "one country, two systems" formula Beijing employed in Hong Kong and has proposed for cross-Strait unification is totally unacceptable for Taiwan. Chen said in his first inaugural speech in 2000 that he is willing to talk with Beijing about a "future one China." Beijing has steadfastly rejected the implied premise of Chen's approach, taking the position that it will only accept cross-Strait talks if Chen agrees as a precondition that there is only "one China" now and that Taiwan is part of it.

Mr. Chairman, in the face of these current difficulties in the Taiwan Strait, we believe the U.S. "One China Policy"—based on the three Sino-U.S. communiqués and the Taiwan Relations Act—is the historic framework for conducting our official relations with Beijing and our unofficial relations with Taiwan. We must remember that this policy is U.S. policy, not Taiwan's, not China's. Our policy is emphatically not the same thing as the PRC's "One China Principle." The United States has not taken a position on the legal status of Taiwan. The United States acknowledges Beijing's formulation but does not necessarily embrace—or reject—the PRC's concept

<sup>2</sup> FBIS Translation of "Text of Taiwan Affairs Office News Conference on Taiwan Election, More," CPP20040414000027 Beijing CCTV-4, in Mandarin, 14 April 2004.

that “there is but one China in the world and Taiwan is part of China.” It is also true that the United States has stated it does not support Taiwan independence, or two Chinas, or one China-one Taiwan—as President Clinton reiterated in Shanghai during his visit there in 1998.

The Taiwan Relations Act has served U.S. interests well over its 25-year history, and we as a government and nation need to remain faithful to it, especially now, when the cross-Strait situation is as complex as it has ever been. The fundamentals must be remembered: our decision to establish diplomatic relations with the PRC “rests upon the expectation that the future of Taiwan will be determined by peaceful means.” This expectation must be declared at every turn.

Given the current economic and political trends in the Strait that we have outlined above—developments that call into question the state of the “status quo” in cross-Strait relations—we believe there is an immediate need for Congress and the Administration to review our policies toward Taiwan and cross-Strait relations and to determine an appropriate role for the United States in reinvigorating cross-Strait dialogue.

Accordingly, we have recommended that Congress enhance its oversight role in the implementation of the TRA. Executive Branch officials should be invited to consult on intentions and report on actions taken to implement the TRA through the regular committee hearing process of the Congress, thereby allowing for appropriate public debate on these important matters. This should include, at a minimum, an annual report on Taiwan’s request for any military aid and a review of U.S.-Taiwan policy in light of the growing importance of this issue in U.S.-China relations.

We believe Congress should consider conducting a fresh assessment of existing U.S. policy toward Taiwan, with particular attention to whether all elements of the TRA are being effectively pursued. This should include the coordination of our defense assistance to Taiwan, how U.S. policy can better support Taiwan breaking out of the international isolation the PRC seeks to impose on it, and examine what steps can be taken to help ameliorate Taiwan’s marginalization in the Asian regional economy.

Further, we suggest that Congress consult with the administration on whether the United States should become more directly engaged in facilitating talks across the Taiwan Strait that could lead to direct trade and transport links and/or other cross-Strait confidence building measures. We will be providing more detailed recommendations on this to Congress in our upcoming report.

#### HOLDING CHINA TO ITS COMMITMENTS ON HONG KONG

Mr. Chairman, more than 50,000 American citizens live and work in Hong Kong. Over 1,100 American firms operate there, and the United States has more than \$38.5 billion in investments in the city. These direct interests alone demand that the U.S. Government keep a close eye on developments in Hong Kong; but there is much more at stake.

How Beijing lives up to the promise of the Sino-British Joint Declaration of 1984 and the Hong Kong Basic Law of 1990 tells us much about China’s direction. We need to look at Hong Kong to gauge whether China is evolving into the more open and tolerant power that China’s leadership would like us to believe is unfolding. Alternatively, are China’s leaders bent on “nipping in the bud” any domestic call for democratic change—even in highly autonomous Hong Kong where such change is anticipated under China’s own laws—that is not of their own making.

In response to popular calls for direct elections in 2007 for the Chief Executive and 2008 for all of the Legislative Council, as allowed under the Basic Law, the PRC’s National People’s Congress Standing Committee has made some telling and worrisome moves in recent weeks. First, on March 26, the Standing Committee decided on its own to intervene in the question of whether and how changes to the methods of selecting the Hong Kong Chief Executive and forming the Legislative Council could be made. The decision of the Standing Committee to self-initiate an interpretation of the Basic Law was itself a blow to Hong Kong’s separate legal and political systems.

The interpretation issued on April 6 was an additional setback for Hong Kong democratic aspirations. It reinforced the message that no changes would be made without the central authorities’ approval, at the beginning and the end of the process. A report by the Chief Executive to the Standing Committee would have to start any process of change, and the Standing Committee would then give direction as to whether and how changes should be made. No initiative would be allowed to rest in the hands of Hong Kong’s legislature, which was ruled ineligible to present any draft bill, even on implementing changes decided by Beijing.

The Chief Executive's immediate action to submit a report to the Standing Committee, on April 15, stating there is indeed a need for change, has not been taken as a sign of progress among advocates of greater democracy in Hong Kong. Rather, the principles laid down in the report—reiterating the absolute authority of the Standing Committee in all decisions relating to Hong Kong's Basic Law and elections; emphasizing the need for a strong "executive-led" government—suggest that the fix is in.

We hope we are wrong. We hope Beijing will recognize that its own reputation as a modernizing power is at stake in Hong Kong; that not just a handful of local democratic activists and "troublemakers" care about what happens, but that the United States cares, and is paying attention.

Under the Hong Kong Policy Act of 1992 [22 USC 66], the U.S. Government has an obligation to assess whether Hong Kong's "high degree of autonomy" and the solemn promise by Beijing to respect Hong Kong's governing under the "one country, two systems" formula is genuine or a charade. Hong Kong's future autonomy was set out in an international agreement, the Sino-British Joint Declaration; granted by China's National People's Congress; and legislated in the Basic Law. It may be true that what the PRC Government giveth, they may taketh away. But when Hong Kong's autonomy is diminished by the direct action of the central authorities, the United States is obliged to take notice and consider its policy options.

Directly invoking provisions of the Hong Kong Policy Act to suspend certain aspects of U.S.-Hong Kong bilateral relations is an option which may be considered. If the United States were to end its special treatment of Hong Kong in some important areas—such as air services, customs treatment, immigration quotas, visa issuance, export controls—the principal pain would be felt in Hong Kong, however, not in Beijing.

The Congress and administration should continue to let the Chinese leadership know that Beijing's moves to limit Hong Kong's autonomy and democratic aspirations are not in any party's long-term interest. And that U.S.-China relations will be adversely affected.

#### CHINA'S PIVOTAL ROLE IN THE NORTH KOREAN NUCLEAR CRISIS

The commission's charter calls on us to "analyze and assess the Chinese role in the proliferation of weapons of mass destruction (WMD) and other weapons (including dual use technologies) to terrorist-sponsoring states, and suggest possible steps which the United States might take, including economic sanctions, to encourage the Chinese to stop such practices." In the post-9/11 world, there can be no doubt that stemming the tide of WMD proliferation is of the highest national priority for the United States. The commission's charge to examine China's role in WMD proliferation is part of this effort.

China has a checkered record at best on controlling its own transfers of WMD-related technologies to states of proliferation concern, including Iran, North Korea, and Pakistan, something we will document in detail in our 2004 Report to Congress. But this past year has been marked by a proliferation crisis in which China is now playing the role of an intermediary—the North Korea nuclear crisis. Given the gravity of the events unfolding in North Korea, the commission felt it imperative to examine closely China's participation in efforts to resolve this crisis. The key focus of our examination has been: What are the U.S. goals for resolving this impasse? What leverage can China wield to help bring about that outcome? Can we reasonably expect China to be an effective partner? For the commission, the role China plays in this crisis is a key, if not the key, test of the U.S.-China relationship and pivotal to the future of global non-proliferation policies.

The United States has clearly articulated that it seeks the complete, verifiable, and irreversible dismantlement of North Korea's nuclear programs. To achieve this proper outcome will require that the parties to the Six Party Talks underway with North Korea—the United States, Russia, Japan, South Korea, and China—present a strong and unified position that this is the only acceptable outcome to ensure the region's stability. But it is also necessary that China, North Korea's principal ally and financial supporter, demonstrate a willingness to exert its considerable leverage over North Korea to bring about this outcome. At the present time, we have not witnessed the appropriate level of effort from China that the situation warrants.

North Korea is heavily dependent on Chinese assistance in the form of food and fuel. Our research indicates that China provides upwards of 90 percent of North Korea's oil and 40 percent of its food. Since 1996, China has allocated somewhere between 25 to 33 percent of its foreign assistance outlays to North Korea. Moreover, the North Korean and Chinese militaries have long maintained close ties. These

facts clearly indicate the considerable leverage Beijing could exert over Pyongyang, were it to choose to do so.

To date, however, China has been playing more of a host and intermediary role in the Six Party Talks, and does not appear to be pressing for its expeditious resolution. We certainly recognize the key role China has played in getting the talks started, and U.S. officials have on many occasions lauded China for this accomplishment. At the same time, it has become increasingly evident that the current impasse may not be broken without a considerably more forceful posture by the Chinese.

To date, China has been opposed to sanctions in this case, and to bringing the North Korea nuclear issue to the United Nations. Moreover, China issued a cautionary statement regarding any decisive moves by the United States and its allies in the context of the U.S.-led Proliferation Security Initiative (PSI) that might provoke Pyongyang's ire. In a telling statement, the Chinese Foreign Ministry has indicated that China "does not approve of sanctions, blockages and other measures which are aimed at putting pressure on (North Korea) . . . Doing so will not only be useless to solve the problem, but will escalate antagonism and tension."<sup>3</sup>

Time is not on our side in confronting this crisis. As the Six Party Talks drag on, North Korea's nuclear weapons and ballistic missile programs keep moving apace. While we cannot be sure just how far North Korea has progressed, there seems to be a growing consensus that it already poses significant capabilities in this regard and will advance considerably further within a matter of months. As these capabilities are attained, the prospects for achieving a complete, verifiable, and irreversible dismantlement by North Korea are dimming substantially. The Six Party Talks must move forward with renewed urgency, and with China playing a far more significant role—including demonstrating a willingness to exert its considerable leverage with North Korea—in obtaining an acceptable outcome.

The key question is not only whether China will be willing to exert leverage in a meaningful way on North Korea, but whether China is prepared to press the North Koreans to accept a robust and intrusive dismantlement verification regime, an essential component of a complete, verifiable, and irreversible dismantlement scenario. North Korea's failure to comply with the 1994 Agreed Framework underscores the absolute requirement for on-site inspections and verification. Given China's posture to date on the PSI, not to mention its own continuing proliferation problems, it is certainly a questionable proposition. In fact, recent news reports indicate that Chinese officials, following a meeting between the Chinese foreign minister and North Korean leader Kim Jong Il, informed a U.S. envoy that the onus was on the United States to show more flexibility in resolving the crisis.

In our view, the U.S. Government must make clear to China that its efforts in this crisis are a key, if not the key, test of the U.S.-China relationship. China's efforts in getting the Six Party Talks underway must be followed up by the active use of its substantial leverage to persuade North Korea to freeze its reprocessing efforts and verifiably dismantle its nuclear weapons and ballistic missile programs, and to accommodate an intrusive international verification regime, to ensure effective implementation of any agreement that is ultimately reached. In the event of continued stalemate and lack of Chinese success in persuading North Korea to accept these requirements, we believe the United States must develop other policy options with our partners in the region to resolve this highly critical situation.

#### CONCLUSION

Mr. Chairman and members of the committee, thank you again for this opportunity to testify. It is now commonplace to assert that the U.S.-China relationship will be our most significant bilateral relationship during the 21st century. Our trade relations with China already have an enormous impact on the U.S. economy, and the security challenges before us are of the highest order. Through an appropriate mix of U.S. policies, this complex relationship can be managed in such a way as to minimize the downside risks, and enhance the prospects of moving China toward a more democratic and market-oriented society, to the benefit of both our economic and national security interests. If mismanaged, bilateral tensions and the potential for conflict will surely grow.

As we stated at the outset, we have concluded that a number of the current trends in U.S.-China relations are presently moving in a troublesome direction. With a renewed and candid focus on the relationship by the Congress, we are optimistic that U.S. policy toward China can be put on a more solid, productive footing to tackle the long-term challenges that lie ahead.

<sup>3</sup>Catherine Armitage, "China condemns intercept plan," *The Weekend Australian*, 12 July 2003, sec. LOCAL, 6.

Senator BROWNBACK. Well, I think you put your finger on the right button on the right set of issues. Now, whether we will see progress made is yet to be determined.

Mr. ROBINSON. You bet.

Senator BROWNBACK. Let's see, let's go back up to the top of the list. Dr. Waldron, delighted to have you here today. Thank you for being here to testify. We'll run the clock at about six minutes, that'll give you an idea, and if we can kind of keep close to around that that will give us the chance to have more active questions.

**STATEMENT OF ARTHUR WALDRON, LAUDER PROFESSOR OF INTERNATIONAL RELATIONS, DEPARTMENT OF HISTORY, UNIVERSITY OF PENNSYLVANIA**

Mr. WALDRON. Mr. Chairman, I will do my best. I prepared these remarks yesterday; this morning I learned of the testimony of Assistant Secretary of State James Kelly, one of our best diplomats, to the House International Relations Committee yesterday, and I wanted to quickly, and I have inserted my additional remarks into my printed testimony and on the disk, just say a things about this; this is specifically about Taiwan.

In connection to what Mr. Robinson mentioned—the growing desire of the people of Taiwan to assert their own identity—Assistant Secretary Kelly said that this must be stopped; these were his strong words. On the other hand, when it came to the Chinese threats of use of force against the island, he stated only that we strongly disagree with this approach. He did not say that it must be stopped. And let me just quickly make a few points.

The first is that under international law the United States has never recognized Chinese sovereignty over Taiwan. That continues to be our position, which is that the status of Taiwan under international law remains to be determined. Therefore, the question of independence seems rather odd. If we don't recognize that it's part of China, what is it becoming independent of?

The second point is that we have always insisted on only a peaceful resolution of the issue. Period. And I would say, from my background as a professor of strategy, that we must be absolutely crystal clear on that point, there must be no wiggle room.

The third point is that we must never allow Beijing to believe that they are intimidating or manipulating us. My own sense is that there is some intimidation going on. I would note that I have learned informally that members of our American Institute in Taiwan have privately been telling people that there's going to be a war next year in the Taiwan Strait unless President Chen is somehow reigned in, which I think is unprofessional and probably inaccurate.

Fourth, I think the origin of this problem goes back to some faulty diplomacy. Mr. Robinson mentioned the need to re-examine the 1979 to 1982 framework, and I think that that is correct. We've had a policy that expected one thing to happen: We expected Taiwan to join China shortly after we broke relations. She didn't do that; she democratized instead, and we have a series of institutions that are simply incapable of dealing with the current reality. Or, another way of putting that would be to say that all we have now

is a military policy, and, oddly enough, we don't have a political policy with respect to the island.

Now, having spoken about that very specifically—I felt I couldn't let this pass without commenting on it—let me say a little bit about the situation in China today. I think it's more volatile than most people understand. Your chosen title was "Reform." Well frankly, I don't think reform is the word to apply. I think something more like "major change in several dimensions but without any goal specified," or "unplanned change," is more appropriate. Clearly, all sorts of dynamic forces have been released in China: intellectual, political, economic, travel, all of these things. Yet if you ask a Chinese, where are these going to lead, what is the end state that we're trying to achieve, there's absolutely no clarity about that at all. Are we aiming for a private, free enterprise economy or not? Are we aiming for democratization or not? There's complete, sort of agnosticism about the future, even as the future is being created by these forces that are unleashed.

Now, let me speak briefly about political reform. Here I think it's important to point out that one lesson of the end of the Cold War is that regime type is critical. It's not the case that it doesn't matter whether a country is a dictatorship or not and that one can somehow deal with them economically and militarily regardless of whether their people participate in politics. The reason that we are no longer aiming thousands of warheads at the Soviet Union and they not aiming them at us, it doesn't have to do with SALT treaties, it doesn't have to do with summits, it doesn't have to do with people-to-people exchanges, although all of those things were important. The reason is that the Soviet Union gave up communism, allowed people to vote, made its currency convertible, established a parliament, freed the press, and allowed political parties to form. It transformed itself. And the result of that was peace in a Eurasian continent which had previously been threatened by massive destruction.

Now, China continues to be an extremely repressive regime. And let me just mention one fact, which is the assistance that American companies have given to the Chinese secret police in creating a very, very sophisticated network for monitoring the Internet, tracking individual users, blocking web sites; they can even monitor cell phone conversations and text messaging, store this material, search it with high-speed computers and obtain profiles of what individuals do. Now, not all Chinese are happy with this. According to Radio Free Asia there were some 10 million people who participated in demonstrations, thousands of demonstrations, at various places in China last year. So my own feeling is that politically the situation is rather challenging and that an enlightened government would, at this point, have begun to make changes. But they have not done that which implies that the change will come in a rather surprising way.

Let me now turn quickly to the economy. First of all, it's not a market economy, despite what the administration said yesterday within their economic negotiations. There's no way that China is a market economy. It's growing fast, but the growth is based on exports, foreign investment, and massive borrowing. In my written testimony I go into some detail about the unsustainable levels of

borrowing and debt that are being created. I think that it is the consensus of experts on the Chinese economy that it's headed for some kind of landing, hard or soft. A crunch is going to come.

Now let me briefly say something about the military buildup. I thought Mr. Lawless's testimony was excellent, although, as he said to me in the break, it's just the tip of the iceberg. The military is now the king-maker in China. Politicians, those who want to advance, lavish money on the military, create generals and so forth. The Chinese buildup is substantial, and it does not affect just, for instance, say Taiwan; it directly affects Japan, Korea, India, Indonesia, you name it, even Russia. I always wonder why the Russians are selling all of this stuff to China; they are, but it makes no sense. And if this military rearmament were to continue without some kind of countervailing rebalancing, we would have a very, very serious situation in East Asia. Two specific points on this: First, Americans should understand that the Chinese military is the only one in the world that is being developed specifically to fight the United States. If you look at, for instance, the purchases of missiles from the former Soviet Union, many of these have only one use, and that is to destroy aircraft carriers, which they can do; we have no defense against these supersonic missiles. Now, you might say that their target was the aircraft carrier Charles de Gaulle, but I don't think so. I think that they have the great American carrier battle groups in mind, and, as I say, we have no defense against this. This is certainly not a cause for complacency.

The second point, and I thought your questioning of Mr. Lawless brought this out, is that although many people will say that China seeks only minimal deterrence and has no great power ambitions, my own view is that there is no objective reason that if the present regime stays in power—this is why regime change is so important, or change of regime type—there's no reason that China should not become every bit as strong and threatening as the Soviet Union was at its height. Because, as Mr. Lawless pointed out, the conditions that constrained the Soviet Union, economic conditions and so forth, don't apply in the case of China.

To conclude, received opinion in Washington troubles me a bit because the opinion seems to be that, in spite of all of these worrying indicators, change is going on, and the democratization is eventually, she's going to come right in the end and we'll all be friends. Let's say that I hope that happens. However, the only way that China can be a positive player in the region and in the world and be a real friend to the United States is for her to abandon the Communist dictatorship, as the USSR and the former satellites did, introduce freedom and democracy, and redirect spending away from things like the military and prestige projects and toward the needs of the people. I would point out that as of September of last year the average Chinese farmer had an income somewhere between \$300 and \$400 U.S. per year—that's very, very low; the average urban resident about \$700 or \$800.

Now, let's hope that these changes will occur. There's much that we could do to help them occur, and we should. But we must not stake our policy on the idea that they will occur. Things could go well or they could go very wrong. And what we need is a China policy that can deal with either outcome.

Thank you very much.

[The prepared statement of Mr. Waldron follows:]

PREPARED STATEMENT OF ARTHUR WALDRON

A NOTE ABOUT TAIWAN

In light of Assistant Secretary of State James Kelly's remarks yesterday to the House International Relations Committee, I would like to preface my testimony with a few words that are not found in the printed handout, but are on the disk.

First, it is important to realize that the United States has never recognized Chinese sovereignty over Taiwan, whether that sovereignty was claimed by Chiang Kai-shek's Republic of China government, which we nevertheless recognized until 1979 as the legitimate government of China, or by the People's Republic of China, whose claims to Taiwan we only "acknowledge" but do not accept, as is clear in the transcripts of Mr. Kissinger's discussions, and was reiterated by the Clinton administration, when Press Secretary Mike McCurry was forced to correct remarks to the contrary. Our consistent position is that the status of Taiwan under international law "remains to be determined."

Therefore the phrase "one China policy" does not mean that we recognize Taiwan as part of China: we do not. Rather, it means that while we did recognize both East and West Germany, and could well recognize both North and South Korea, in the case of China we have decided that we can recognize only one government. That was a problem only when Taipei presented itself as the government of all of China. This it no longer does.

Yesterday Mr. Kelly, one of our finest diplomats, revealed the growing confusion about our China and Taiwan policies when he stated flatly that efforts by Taiwan to assert its own independent national identity "must be stopped"—strong words—while saying of China's threats to use force against the island only that "we strongly disagree with the approach." He did not say that it "must be stopped."

Clearly we are in a bind here. On the one hand we have never recognized that Taiwan is part of China. Yet we are deeply concerned lest it declare "independence." Independence from what? Unless it is a part of China, which we do not accept, it is already independent.

Briefly we have three problems here:

First, by responding as it has to democratic developments in Taiwan, Washington risks bringing its commitment to democracy into question.

Second, I have no doubt that the current concern in the administration arises from China's increasing military strength and growing talk about using it against Taiwan. To be frank, we are appearing to be intimidated, something no great power should ever allow. Of course we want cooperation from Taiwan on avoiding conflict, but whom should we insist "be stopped?" Not so much Taiwan, as China—for it is China that has the immense military and China that is making the threats of war. It is not enough to "strongly disagree" with China's menacing approach. We must make clear that we reject it, period.

Third, I think we have a lesson here in diplomatic plans gone awry. When President Carter severed all relations with Taiwan in 1979, his assumption, I think, was that the island, then ruled autocratically, would become part of China through an agreement over the heads of the people of Taiwan, between Taipei's unelected leaders, and the unelected leaders in Beijing.

We did not consider the possibility that Taiwan would reform and liberalize and democratize. So not only did we fail to plan for such a possibility, we gave away all sorts of things that would have helped us to deal with that situation, for instance by failing to insist that Taipei remain in the UN General Assembly.

Thinking we were stabilizing the situation, we unwittingly created deep instability in the Taiwan Strait under the Carter administration. Historical development took off in a direction we had scarcely considered and for which we were unprepared. The answer today is not to try to put things back the way they were—like King Canute, proverbially lashing the incoming tide to force it to retreat—but rather to begin to rethink our whole approach, dealing with the current reality and not the failed expectations of thirty years ago.

## INTRODUCTION

The situation in China today is more volatile than most observers understand. “Reform” is not quite the word to apply to what is happening there; something like “unplanned but major change in several dimensions” would be more appropriate. For although economic, political, and social forces have been released over the past quarter century that will certainly take China somewhere, no one in China can specify exactly to where that will be. No plan or roadmap exists. So when change does come, as it most certainly will, most likely it will be unexpected and discontinuous, which means that it will have the potential to affect not only China, but also her neighbors, the world economy, and direct interests of the United States and its friends and allies.

## NO PROGRESS ON POLITICAL REFORM

Politically, the Communist Party seems intent on maintaining its slipping hold on power. No signs of progress are visible in areas such as the establishment of real law and impartial courts, the freeing of speech and political and religious activity, or the constitution of legitimate government by voting at local and national levels. Quite the opposite: political repression is, if anything, increasing. With the help of American companies, China has created a highly sophisticated system for monitoring the internet, tracking individual users, blocking access to web sites. Thanks to powerful new computers and technology, China’s secret police even has the ability to monitor cell phone conversations and text messaging, and to store and screen messages in detail. This monitoring ability extends to an increasingly well developed Chinese secret police network in the United States, operated out of the Chinese embassy and consulates, and now so deeply rooted on our university campuses that a Chinese dissident can be monitored by Beijing almost as easily here as in China.

More conventionally, the freedom even of the Party-run press has, if anything, been curtailed in the past year, with a number of editors being fired, and some publications closed. Even respected academic specialists in such areas as economics often find it impossible to publish their opinions in the Chinese press, while nothing remotely resembling dissent—or even *USA Today* style of editorials, one pro and one con, is to be found.

This situation cannot last, for as Chinese sages taught thousands of years ago, imposing dictatorship depends upon keeping the people ignorant and tied to the land, as they were in the Qin dynasty (221–206 B.C.E.) and again under Mao Zedong (1949–1976). Since Mao’s death new forces have been unleashed, not least of which are intellectual and political. China’s educational institutions have begun to regain some of their pre-Communist distinction. The number of highly educated people has grown, and so has the number of those who have traveled or lived abroad. In addition, Chinese people are beginning to own their own dwellings, have a bit of money, and feel a stake in society. Put simply, the system has begun to turn out citizens, or rather potential citizens—for at the moment these educated and thoughtful people (like the farmers, who also have a certain wisdom) are denied any meaningful influence on how they are governed. Officials are appointed, not elected—even mayors. At the top, no transition of rule has ever occurred in the PRC that actually followed the Constitution or even the rules of the Communist Party. The current ruler, Hu Jintao, was simply designated by the late strong-man Deng Xiaoping, at the time of the Tiananmen massacre, to succeed Jiang Zemin, who was installed in power immediately—and quite illegally—while Premier Zhao Ziyang was placed under house arrest (which continues). This lack of even a defined system for choosing a leader is a powerful contrast to India (where even a series of assassinations never disrupted constitutional rule), Japan, South Korea, Taiwan, and numerous other countries. Politically the Chinese system remains rather primitive and lacking in legitimacy.

It also quite evidently lacks any feeling of the urgency of reform. One reason for this is that the leadership is deeply divided, and things work best in the short term if everyone is allowed to do more or less as they want. But that approach will work only in the short term. As economic development makes China more complex, the need for objective mechanisms, for choosing leaders responsive to popular needs and wishes, and for resolving disputes objectively, will become inescapable. Doing those things will require that the Communist Party give up power.

If the Party does not move on its own, it will probably face increasing internal division and popular turbulence, which may effect the sort of change it is unwilling to carry out itself. That sort of chaotic shift is worrying enough. But even more worrying is the possibility that the Party will somehow retain control, and develop China into a state having a dictatorial government having unfulfilled territorial as-

pirations (*see below*), a sizeable treasury and military, and no internal checks and balances.

The unwillingness of the Party to consider change is clear in its approach to Hong Kong, to which it promised democracy in 1984. In the past year or so, as the people of Hong Kong began to call for real progress towards actually electing their government, Beijing seems to have panicked and, in effect, torn up all its promises in favor of rule from the center, intermediated by carefully selected pro-Beijing locals. To some extent Beijing must be bluffing, for she lacks the capacity to coerce Hong Kong (as she did her own capital in 1989) without destroying the hub of her most advanced economic region. Yet so strong is the instinct for control that the central government has adopted quite astonishingly hard line talk and methods.

The same unwillingness is demonstrated in Beijing's policy toward Taiwan, now a democracy, and a state having a national character and identity quite different to that of the People's Republic. Taiwan would like to coexist with China and enjoy the benefits such coexistence would bring to both sides. For more than a dozen years the government in Taipei has been offering to negotiate with China, but after a brief start in 1993 in Singapore, Beijing has refused all offers to meet. Instead, she has adopted a strategy of pressuring Washington, somehow, to force Taiwan to do what she says—which is of course both impossible and dangerous.

So, much as we may all hope for political reform leading to freedom and democracy in China, and however much we may be heartened by the occasional liberal straw in the wind, it is essential that we recognize clearly the complete lack of progress in this area at least since 1989. We should talk to the Chinese about this; we should never be bashful about listing prisoners or condemning abuses—but we must not comfort ourselves with the illusion that the present leaders are “reformers.” They are not. They are dictators, having aspirations to a sort of totalitarianism they cannot achieve (this is evident in their approach to religion), improvising expedients to stay in power, whatever it takes—arrests, propaganda, whipping up xenophobia, even perhaps a “Splendid Little War.” These leaders are to be treated with great care and caution, even as we are mindful of the precariousness of their power.

#### A PRECARIOUS ECONOMY

Economically, China is in the midst of an unsustainable boom and headed for a hard or a soft landing, depending upon policy. China's astronomical growth rates are not entirely credible, and, to the extent they are real, they do not represent healthy growth. By and large they are the product of three factors: (1) exports, which as we know, are soaring; (2) foreign investment, which is fine so long as it does not substitute for the development of Chinese entrepreneurship. Sadly, a good half of China's exports are accounted for by firms having foreign participation, and in some key sectors foreign ownership is greater than Chinese (in Information Technology, for example, Taiwanese investors own roughly 70% of China's capacity), and (3) massive state investment, based on government-directed borrowing from the state-owned banks (the only place Chinese can put their savings)—such borrowing goes heavily to support loss-making state enterprises, rather than to genuinely profitable uses. Chinese growth, in other words, is not being created by increased productivity and efficiency, the proverbial “assignment of goods to their highest paid uses,” but rather by a torrent of capital investment, both foreign and state, much of which is misallocated and thus wasted.

To be more specific, last year in 2003 non-farm investment increased at three times the rate of GDP. So far this year that rate has doubled again. Year on year it is up 53% in the first two months of 2004. Investment by state enterprises is up 55% with investment in industry up an astonishing 79%. Purchases of building materials in the first two months of this year grew at an annualized rate of 137%. Chinese demand for oil—a commodity of which the globe has only a limited supply—has now passed that of Japan, to stand second to our own country, which consumes roughly four times as much. Not surprisingly world commodity prices are beginning to rise in response.

But this is artificial demand, driven above all by state directed loans to state enterprises. It is not the product, as some would have us believe, of dynamic “free enterprise” or “entrepreneurship” in China. If anything, the entrepreneurial class, is being squeezed out and denied capital of which it could make good use, by extravagant state lending (only 1% of which goes to the private sector) and by foreign investment, which often receives preferential treatment.

The result of all this is of course insolvency in the banking system (experts disagree about the exact percentage of bad loans, but an estimate of one third would be conservative) and growing government debt. Local currency loans through February of this year alone rose by 20.7% year to year, to \$1.98 trillion. New loans in

the past year alone amount to one quarter of GDP. Total government debt, including unfunded liabilities for unemployment, for medical care, and retirement for state workers, is of course far larger.

Although plans are regularly announced to reduce the rate of growth of debt, purge the banks of non-performing loans, rein in over-investment, and so forth, so far these have little to show. China is of course not the only country where fiscal irresponsibility may be politically expedient. But in today's world she is nearly unique in the all-important role that governments, central and local, play in deciding, not always very rationally, what will be invested and where. So even though countries such as the United States and Japan also face massive fiscal and debt problems, in both of them the economy as a whole is sound and productive. Both are host to dozens and dozens of world-class global companies, and have been for many years. If we count twenty-eight years from the creation of the Ministry of International Trade and Industry in Japan in 1949, we reach 1977, by which time Japan already boasted such players as Honda, Fujitsu, Kyocera, NEC, and others. By contrast, count the same number of years from Mao's death in 1976, when so-called "reform" began, and you reach the present—and the worrying realization that even after all that time, China has yet to produce a genuinely world-class competitive company, whether private or state owned.

Most worrying, perhaps, is the rapid growth in regional and personal inequalities of income owed to state misallocation of resources, and to massive corruption. In September of last year rural incomes in China averaged \$217 U.S., while urban incomes were at \$766 U.S. Hundreds of millions of farmers remain dirt poor and deprived of all political rights as well. Tens of millions of unemployed rural workers roam the urban areas, sleeping on streets, working at construction and other hard labor, or trading, without any provision for health, education, or even wages. (Official estimates of unemployment are now touching 14%). Nor is the typical Chinese urbanite the fashionable young woman one reads of so often, stopping in at a fashionable Shanghai boutique to spend \$400 on a pair of the latest shoes. Urban life has a much more uniformly early industrial revolution shade of gray about it than we often realize.

So we have a vicious circle. Population and unemployment are rising, which pose an obvious threat to order in China. Unwilling to unleash the private sector, which already accounts for half to two thirds of new jobs in some areas, the state insists on taking the precious savings of the impoverished Chinese people and pouring them into make-work projects that may absorb some labor for a while, but are unlikely ever to be profitable, which is to say, provide real long-term jobs. The money thus wasted cannot be recovered: it is a vast, wasted, opportunity cost. Nor does China have the resources to continue to waste money at such a rate.

As one economist at the Chinese State Development Bank recently put it, "All the characteristics of China's financial industry today are similar to those found in Thailand before the Asian financial crisis [of 1997]. The probability of a crisis erupting in China is rising." This comment, by a well qualified Chinese economist, deserves careful note.

Sooner or later a crunch will come, with the ordinary people being the chief victims—as the perpetrators will mostly have expatriated first their money and then themselves ahead of time. We can only guess about the consequences for the rest of the world, and for the Chinese regime.

#### MILITARY BUILDUP

Finally, and perhaps most importantly, China is engaged in a massive military buildup, to which both Washington and China's neighbors unaccountably pay far from adequate attention.

Ever since the sack of Beijing by the People's Liberation Army in June of 1989, that army has been dissatisfied and ashamed of what it did. I have been told as much personally by a very senior Chinese military commander. Chinese join the army to protect their country, not to kill their fellow citizens. Furthermore, ever since Mao died in 1976, and his chosen successors were swept away by a coup d'état of the 8341 unit, or capital bodyguard division, the military has been the ultimate kingmaker in China. Put these two facts together, and it becomes clear why over the past dozen years or so members of the Chinese Communist ruling elite who lack military ties have been so eager to create them.

Since the Tiananmen massacre, the PLA has been given immense budget increases, difficult to estimate but obvious when one considers new military hardware, the space program (which has strong military dimension), and huge increases in research and development and military production capability. Jiang Zemin, China's former president who retains a great deal of power today as Chairman of the Mili-

tary Commission, created numerous field and flag level officers in a bid to win loyalty. Now, evidently, Jiang's ostensible successor, Hu Jintao has also established his own military headquarters, in the Western Hills, in an attempt to counterbalance Jiang's continuing influence over the military and security apparatus.

At the same time the military has been given a new mission: not so much national defense (as no country seems to have any desire to attack China) but rather national expansion, or as it would be put in China, "recovery" of lost national territories—to most of which Beijing holds only the most tenuous of claims. Hence we have seen repeated Chinese probes into the Japanese Senkaku Island chain (Diaoyutai in Chinese) which have deeply irritated Tokyo and, along with the acquisition of nuclear weapons by North Korea, evidently set Japan on a course toward military self-sufficiency: very bad news for Beijing. We have seen "archaeological" research carried out that reassigns the ancient Korean kingdom of Koguryo to the "Chinese" world, which would mean that Korea almost to the 38th parallel would be Chinese. This is a difficult move to judge, but it is hard to resist the conclusion that it prepares the way for possible intervention to prevent Korean unification. On the Indian border, China has proved most unforthcoming about territories occupied in the 1962 war—and some territory given to China by Pakistan. As with Japan, Beijing's condescending and ham-fisted approach to India has led to terrible strategic consequences, in the form of a nuclear armed India alert to its national interests. Without Chinese assistance, the Pakistani nuclear program would have been little more than blackboards and some smart physicists. In the South China Sea, China is asserting sovereignty over various reefs and islands, some seized from Vietnam, another from the Philippines, probably with a view to declaring the entire area territorial waters. And of course there is Taiwan, against which China is carrying out an unprecedented military buildup. She will soon possess more advanced fighter aircraft than Taiwan does; her submarine and surface fleets are growing, and she has roughly 500 missiles—one for every 45,000 Taiwanese—aimed at the island. Russia seems not yet to have grasped fully the potential threat to her interests that this newly well-armed China poses (Moscow, after all, is a major source of weapons and technology), but that realization may come soon. Added together, all of this portends increasing tension and danger in Asia, as China attempts to shift the military balance decisively in her favor—an action, however, more likely to elicit a balancing coalition than lead to success.

Most importantly, however, Americans should understand that the new Chinese military is the only one being developed anywhere in the world today that is specifically configured to fight the United States of America. Thus China has gone to great lengths to acquire supersonic missiles from Russia that were originally designed by the USSR to destroy American aircraft carriers. Her researchers are deeply involved in identifying potential weaknesses in the American military. She is working hard on counter-stealth technologies, lasers, cruise missiles, space surveillance, and weapons that target our vulnerable communications and other links. Many argue that China seeks only minimal deterrence and a certain degree of influence in Asia. But that does not account for the vast scale of, for instance, her ICBM and space programs, nor for her development of specific systems to target American forces. My own view is that no objective reason exists why China, if she stays on her present course, should not eventually pose an even greater threat to the United States and its friends and allies than did the Soviet Union.

#### CONCLUSION

Received opinion in Washington appears to be, overwhelmingly, that in spite of the worrying indicators I have mentioned, China is in a process of change and democratization that will make her eventually into our close friend, rather than competitor or adversary. Most people remain highly bullish about the Chinese economy, despite the warning lights I have mentioned. American business has made itself increasingly dependent upon China, regularly provides technologies it should not (e.g. for internet surveillance) and increasingly lobbies for Chinese wishes in Washington. Many also believe that U.S. policy mistakes (support for Taiwan, for example) rather than Chinese political competition and strategic debates, explain whatever difficulties or menaces may seem to appear. The result is an extraordinary degree of complacency in the face of potentially real threats.

Those threats may never become real, but if they do not, the reason is likely to be more than just good luck. It will be the result of serious American and allied action to cut off Chinese access to advanced military technology, enhance the defensive and deterrent abilities of the free countries in Asia that are our real friends, and straight talk with the Chinese government.

In the longer run, the only assurance of our interests and those of our Asian friends and allies will be for China to abandon Communist dictatorship, as the USSR and its former satellite states did, introduce freedom and democracy, and redirect spending away from prestige projects (such as the Olympics and extravagant new buildings in Beijing and Shanghai) and toward the still-pressing needs of her people.

This may occur. The U.S. can do much to help it to occur, and should. But we must not count on its occurring. Things could go very well, or they could go very wrong. We need a China policy that can deal with either outcome.

Senator BROWNBACK. Thank you very much for those insightful comments.

Ms. Lee, good to see you again. I look forward to your testimony. I don't know if you caught the earlier panel, but we've already spoken some about the case that's been put forward. I look forward to hearing your specifics about that case.

**STATEMENT OF THEA M. LEE, CHIEF INTERNATIONAL ECONOMIST, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS**

Ms. LEE. Thank you so much, Mr. Chairman, for the invitation to come today and testify on behalf of the AFL-CIO. We appreciate that. And I also appreciate your personal interest and concern in the issues that we've raised with respect to workers' rights and human rights.

I want to talk today about a crucial issue in the U.S.-China economic relationship that we believe has not received the attention it deserves from this or previous administrations, and that is, as you've said, the brutal repression of workers' rights by the Chinese Government and the impact of that repression on American workers. This is particularly important this week, as Mr. Robinson noted, since we've just concluded a very high level annual meeting, the Joint Commission on Commerce and Trade. From all the press reports, it appears that workers' rights was not even on the agenda, from the point of view of the Bush administration, while other issues, such as intellectual property rights protections and some sectoral market access issues were discussed. Another issue that did not appear to be on the agenda was the Chinese Government's manipulation and undervaluation of its currency. These two issues together, the currency undervaluation and the workers' rights repression, to us are the two key economic problems in the U.S.-China relationship that account together for many of the hundreds of thousands of U.S. jobs that are lost due to this economic relationship. We are disappointed that the administration chose not to put a priority on these important issues in these high level talks.

As you know, on March 16 the AFL-CIO filed a Section 301 petition with the U.S. Trade Representative, alleging that China's violation of workers' rights is an unfair trade practice under U.S. trade law. This is the first time that Section 301 has ever been used in that way. We think this is a really important innovation and an important message, both to our own Government and to the Chinese Government, that the unfair cost advantage that comes from repressing the human rights of workers is contributing to the \$124 billion trade deficit the United States has with China, the highest bilateral trade deficit between any two countries in the history of the world. This unfair cost advantage contributes to the

hundreds of thousands of U.S. jobs lost. We think we've clearly met the standard of Section 301, that this is a burden and restriction on U.S. commerce and that there's a persistent pattern of violation of workers' rights on the part of the Chinese government.

If we don't address the systematic, egregious and institutionalized repression of workers' rights in China, we'll continue to lose hundreds of thousands of good jobs here. We're creating conditions of desperation and exploitation in China and fundamentally altering the nature of global labor competition in the rest of the world. Workers in developing countries, that I think Mr. Craner mentioned earlier, are impacted by the kinds of competition that we will or won't tolerate with respect to China, and I know you mentioned that as well. So our petition seeks to ensure that our Government will give this issue the priority it deserves in its economic dialogue with the Chinese Government.

Chinese Vice Premier Wu Yi said this week to *The New York Times* that the allegations in our petition are groundless and she invited the AFL-CIO to come to China to see for ourselves what the conditions are. In response to her charge that the allegations are groundless, as you know, the documentation in the petition is quite extensive and credible and, as Mr. Craner said, relies heavily on extremely credible sources, such as the U.S. State Department, the International Labor Organization, the International Confederation of Free Trade Unions, *The New York Times*, *The Washington Post*, and so on. We're very confident that the evidence that we've put together will stand up to scrutiny. We also would be very interested in being able to go to China and further investigate some of the allegations that were made. We've always said in the past to the Chinese Government that if we are to go to China we want to be able to have access to Chinese labor dissidents who are in jail, as well as the official union representatives. We want to be able to meet with workers on our own terms without any kind of government supervision or restriction and to bring our own translators and so on. So if we can meet all those conditions we would be very happy to go to China and investigate further.

As you know, the allegations have to do with the denial of freedom of association, the right to bargain collectively; Chinese workers simply don't have the right to organize an independent union. They are limited to the government-controlled body, the All China Federation of Trade Unions. Workers who attempt to strike or organize unions independent of that body have been arrested, imprisoned, beaten and tortured. Even speaking out at the workplace has been often grounds for severe reprisals and arrest.

We've very concerned about the conditions of forced labor, essentially, that exist for many migrant workers. As we've discussed, the migrant workers in China work under a system where they're disempowered and vulnerable, often caught between unscrupulous employers and an indifferent government.

The Chinese Government has simply failed to enforce its own labor laws with respect to minimum wage, maximum hours of work, and health and safety. The results are that workers are left really defenseless at the workplace, and this is simply an unacceptable situation.

We don't challenge the fact of low wages in China. We understand that a developing country with an excess supply of poorly educated rural workers will have low wages. We understand that even if China were to fully enforce workers' rights we wouldn't completely close the wage gap between Chinese and American workers. But we think it would surely narrow. And what the AFL-CIO petition challenges is the incremental cost advantage that comes from the brutal and undemocratic repression of workers' human rights. That incremental advantage is illegitimate under universal norms of human rights and it's illegitimate under U.S. trade laws.

The AFL-CIO petition shows what the economic burden is on the United States, that there's a cost advantage of between 10 and 77 percent that comes specifically from the repression of workers' rights. We ask the President to take trade measures that will offset this illegitimate advantage, to negotiate an agreement with the Chinese Government to meet concrete benchmarks of compliance with workers' rights. As those benchmarks are met, the tariff can be gradually reduced.

And third, we ask the President not to enter into new WTO agreements until the WTO incorporates enforceable workers' rights as a condition of WTO membership, so that we can have protection for workers' rights throughout the trading system through multilateral rules. Global rules should fairly enforce basic workers' rights to ensure that competition does not reward and encourage repression of human rights at the workplace.

I thank you very much for your attention, and I look forward to your questions.

[The prepared statement of Ms. Lee follows:]

PREPARED STATEMENT OF THEA M. LEE

Mr. Chairman, members of the subcommittee, I want to thank you for the opportunity to testify today on a crucial issue in the U.S.-China economic relationship that has not received the attention it deserves—from this or previous administrations: the brutal repression of workers' rights by the Chinese government and the impact of that repression on American workers.

This is particularly important now, as the U.S. and Chinese governments conclude a high-level annual meeting, the Joint Commission on Commerce and Trade. From early press reports, it does not appear that workers' rights are on the agenda, while other issues, such as intellectual property rights protection and market access were scheduled to be discussed. Another key issue that does not appear to be on the agenda is the Chinese government's manipulation and undervaluation of its currency, which we believe is also adversely affecting American workers, producers, and jobs.

On March 16th, the AFL-CIO filed an unprecedented petition with the United States Trade Representative under Section 301 of the Trade Act of 1974, asking the Trade Representative to take action to end the Chinese government's repression of the human rights of its factory workers.

This marks the first time in the history of Section 301 that a petition has invoked the violation of workers' rights as an unfair trade practice, although it is quite common for corporations or the government to use Section 301 to challenge commercial unfair trade practices, such as illegal subsidies or violations of intellectual property rights.

The petition shows, first, that the Chinese government engages in a "persistent pattern" of denying the fundamental rights of its factory workers.<sup>1</sup> Second, it dem-

<sup>1</sup>The internationally recognized workers' rights enumerated under Section 301 include freedom of association and the right to organize and bargain collectively, prohibitions on child and forced labor, and acceptable conditions with respect to minimum wages, hours of work, and health and safety.

onstrates that China's violation of workers' rights artificially reduces wages and production costs in China and, as a result, displaces hundreds of thousands of manufacturing jobs in the United States. This unfair cost advantage has contributed to the stunning bilateral trade deficit with China, which hit \$124 billion in 2003—the highest bilateral trade deficit between any two countries in the history of the world. Under the terms of Section 301, we argue that this clearly “burdens and restricts” U.S. commerce.

China's brutal repression of workers' rights is, in our view, the most important issue in the U.S.–China trade relationship. Failure to address the systematic, egregious, and institutionalized repression of workers' rights in China costs hundreds of thousands of good jobs here, creates conditions of desperation and exploitation in China, and fundamentally alters the nature of global labor competition in the rest of the world. The AFL-CIO's 301 petition seeks to ensure that our government will give this issue the priority it deserves in its economic dialogue with the Chinese government.

#### CHINA DENIES WORKERS' RIGHTS

There is overwhelming evidence that the Chinese Government denies the workers' rights covered by Section 301. The petition amasses evidence from the U.S. State Department, the International Labor Organization (ILO), labor unions, academics, newspaper accounts, and human rights groups.

China denies freedom of association and the right to bargain collectively. The Chinese Government relentlessly represses attempts to organize unions that are independent of the government-controlled All-China Federation of Trade Unions (ACFTU). The ACFTU is officially and legally subservient to the Communist Party and to local officials who profit from export enterprises. Workers who attempt to strike or organize unions independent of the ACFTU have been arrested, imprisoned, beaten, and tortured. Even workers who have spoken out against corrupt managers or who have attempted to publicize workplace problems have been subject to severe reprisals and arrest.

Conditions of forced labor are widespread. Many of the workers in China's export sector are temporary migrants from the countryside, who work under a system of internal passports that is similar to the pass system in apartheid-era South Africa. Factory workers are permanently registered to live in their rural villages, and have few civil or political rights when they work temporarily in factory towns and cities. Upon arrival to the factories, migrant workers become heavily indebted in order to pay large “deposits” and other fees to their employers. They lose their deposit if they quit without the employer's consent. They are thereby essentially turned into bonded laborers who cannot leave their employment without incurring large and disproportionate penalties. The wages, conditions of work, and hours often turn out to be quite inferior to what is promised upon arrival, meaning that workers have clearly not entered into a free labor market, with fairly enforced rules.

China does not enforce its own laws with respect to minimum wages, maximum hours, and workplace safety and health. Many manufacturers in China, including multinational corporations, pay their workers much less than the minimum wage standards set by the central and provincial governments. It is apparently common for companies to keep double and triple sets of books, to hide this practice. Workplace safety and health practices are atrocious, and China has the highest rate of industrial deaths and accidents in the world. Government officials simply do not enforce their own laws on wages, hours, and safety and health.

The AFL-CIO's petition does not challenge China's right to compete in the global economy on the basis of low wages. It is natural for a developing country with an excess supply of poorly educated rural workers to have low wages. We fully understand that even if China fully enforced its workers' rights, the wage gap between Chinese and American workers would not disappear. But it would surely narrow. The AFL-CIO challenge is specifically to the incremental cost advantage that comes from the brutal and undemocratic repression of workers' human rights. That increment is an illegitimate advantage under universal norms of human rights. And it is illegitimate under U.S. trade law as well.

#### THE BURDEN ON U.S. COMMERCE

U.S. workers today have to compete with factory workers who are forced to work under lawless working conditions. And it is taking a toll. The manufacturing sector in the U.S. has been losing jobs for 43 straight months. The U.S. has lost a staggering 2.8 million manufacturing jobs since early 2001.

The AFL-CIO petition shows that China's violations of workers' rights gives Chinese manufacturers a cost advantage ranging between 10 percent and 77 percent

of overall production costs. We estimate that the illegitimate cost advantage displaces approximately 727,000 jobs in the United States.

These are very conservative estimates. We used the most conservative assumptions to estimate the wage reduction that results from the Chinese government's repression of independent unions and its failure to enforce its own minimum wage laws. Then we applied the trade model used by the U.S. International Trade Commission to translate that figure into an impact on U.S. output, prices, and jobs.

And the burden on U.S. workers goes far beyond the number of jobs lost. Twenty-five percent of displaced workers in the U.S. are still without a job six months after losing their jobs. Many of those who are fortunate enough to find new jobs suffer big losses of income, with two-thirds earning less on their new jobs. And these figures on lost wages are from the years before the bottom fell out of the labor market in the last three years, when it has become even more difficult to transition into decent-paying jobs.

#### CHINA'S MANUFACTURING CAPACITY

While U.S. manufacturing workers have faced catastrophic losses, China's manufacturing output, exports, and productive capacity have grown at unprecedented, accelerating rates—and are poised to grow even more explosively in the next five years. It is much easier to keep jobs from leaving than it is to bring them back once they are gone. For this reason, the USTR should act now to prevent the imminent, irreversible loss of U.S. jobs due to China's illegitimate exploitation of its factory workers.

Even though China is still in a relatively early stage of industrialization, it is already the second leading exporter to the United States, surpassed only by Canada. China's exports to the United States now exceed the exports of such industrial powerhouses as Japan, Germany, and the United Kingdom, and may soon surpass even Canada's. China's exports to the United States also exceed those of Mexico, the low-wage export platform immediately across our border.

Unlike Mexico and other emerging export platforms, China has made "the crucial leap" from assembly of electronic and other consumer goods for global and domestic markets, to manufacturing the components for those goods, including the fabrication of computer chips. Guangdong Province encompasses the largest such production base for electronics in the world.

China now leads the world in the production of televisions, refrigerators, cameras, bicycles, motorbikes, desktop computers, computer cables and other components, microwave ovens, DVD players, cell phones, cigarette lighters, cotton textiles, and countless other manufactured products—and China's lead is growing at an accelerating pace.

China's exports of textile and apparel goods have increased 320 percent in the last two years, while U.S. employment in those sectors has fallen by 323,000. In the first eleven months of 2003, China's production of computers grew by 105.5%. Its production of micro-computers grew by 84.9%, power-generating equipment by 72.5%, optical communication equipment by 54.3%, air conditioners by 43.2%, semiconductor integrated circuits by 38.6%, metal-cutting machine tools by 34.1%, motor vehicles by 33%, chemical equipment by 30.5%, fax machines by 30.2%, household refrigerators by 27.3%, household washing machines by 27%, cell phones by 24.5%, electric motors by 26.8% electric-driven tools by 26.2%, steel products by 21.5%, and plastic products by 17%. China's output of many manufactured products showed accelerating growth in the later months of 2003. China has now become an export powerhouse in high-tech computers and electronics and machine parts, not just low-tech toys and garments.

But even while productivity rose rapidly in China in the last decade, the real wages of China's factory workers stagnated. The manufacturing boom in China has not been a train carrying China's workers into the middle class. China's workers can't bargain for higher wages because they lack basic workers' rights.

#### THE U.S. MUST ACT

The President had 45 days from the date when the AFL-CIO filed its petition, March 16th, to decide whether to accept the petition and launch an investigation. If he denies the petition, he must state his reasons. He must declare either that China does not violate its workers' rights, or that China's violation of its workers' rights has no adverse effect on U.S. workers. Either declaration would contradict the overwhelming evidence presented in the AFL-CIO petition. Indeed, the President had authority under Section 301 to take action on his own initiative even without the AFL-CIO petition, but he has chosen not to do so. The only Section 301 case

initiated by this Administration to date has been on intellectual property rights violations in the Ukraine.

Section 301 authorizes the President to take any actions within his Constitutional powers to enforce fair competition and protect workers' rights overseas. The AFL-CIO petition asks that the President take three actions to remedy China's persistent denial of workers' rights:

First, the President should impose trade measures against China that are sufficiently large to induce China to enforce workers' rights and to offset the unfair competition caused by China's violations. The AFL-CIO is not asking for protectionist barriers. If China enforces the basic workers' rights agreed by the international community, then it can enjoy normal access to U.S. markets, and it can create jobs that don't assault human dignity.

Second, in that non-protectionist spirit, the AFL-CIO asks that the President negotiate an agreement with China to phase out the trade measures in incremental steps, as China comes into compliance with concrete workers' rights benchmarks—benchmarks that are specific and verifiable by the ILO, the United Nations agency responsible for promulgating and monitoring international labor rights.

Third, the AFL-CIO asks that the President enter into no new WTO agreements until the WTO incorporates enforceable core workers' rights as a condition of WTO membership. It is essential that workers' rights be protected throughout the trading system, ideally through multilateral rules.

Global rules should fairly enforce basic workers' rights—to ensure that global competition does not reward and encourage repression of fundamental human rights at the workplace. I thank you for your attention, and I look forward to your questions.

Senator BROWNBACK. Thank you very much, Ms. Lee, for bring this forward and addressing an issue that I care about a great deal in a different form and in a novel way.

Mr. Bottelier, thank you very much for being here, welcome. And I look forward to your statement.

**STATEMENT OF PIETER BOTTELIER,  
JOHNS HOPKINS UNIVERSITY (SAIS)**

Mr. BOTTELIER. Thank you, Mr. Chairman, and thank you for inviting me to participate in this panel. I will limit my comments to the specifics in the AFL-CIO petition, and I have not addressed the currency manipulation issue that you are interested in. Should you wish to address questions to me on that subject I'm ready to respond.

Senator BROWNBACK. Okay.

Mr. BOTTELIER. Let me preface my comments by saying that I believe job losses to plant relocation and outsourcing certainly due to unfair trade practices are an extremely serious issue for the U.S. And I also believe that we cannot take it for granted that every job lost will be automatically replaced, even in a growing economy. However, blaming U.S. job losses to any significant degree on China's alleged repression of workers' rights is not going to get us very far. I do not believe that the repression of workers' rights in China—and I certainly do not deny all the facts in the AFL-CIO report—is a significant source of unfair cost advantage to many producers in China.

The petition's conclusions on the measurement of job losses in the U.S. hinges critically on the estimate of the margin by which China's alleged persistent repression of workers' rights depresses Chinese wages below the level that would otherwise prevail. The petition estimates that Chinese wages would rise by 90 to 595 per-

cent if there were no repression of workers' rights in China. I have at least three serious problems with that.

First, the estimate of the underpayment, 90 to 595 percent. One absurd implication of this estimate is that if it were true, probably the majority of Chinese enterprises engaged in exports or even in local trade would have to disappear. These are margins so big they far exceed the profit margins of Chinese firms, which are typically very low. The implication of this allegation is that somehow these Chinese workers that would then not be employed would be better off in other circumstances.

The second objection I have, Mr. Chairman, is that the petition assumes, without even raising the issue, that all these alleged cost advantages generated by the suppression of workers's rights are automatically passed on to the buyer; the buyer in the U.S. or the buyer elsewhere. That's an assumption that flies in the face, I would say, of logic. To the extent employers can succeed in pocketing that rent that they create that way, themselves, they would certainly do so. There is no reason to assume that automatically all cost advantages would be passed on to the buyer. And that's the basis of the case.

The third point I wish to bring to your attention, Mr. Chairman, is that a share of Chinese exports to the U.S. is generated by U.S. companies located in China. There are no statistics on that. I personally estimate that somewhere between 12 and 15 percent of Chinese exports to the U.S. originate from U.S.-owned plants in China. Now, the petition doesn't mention that, but if the petition were to recognize that fact, it implies that the suppression of workers' rights is equally conducted by U.S.-owned plants in China, and that the U.S. would somehow need the cooperation of the Chinese Government to get U.S. companies in China to stop the suppression of those rights. That seems to be a rather absurd implication of the way the petition has been formulated.

Finally, and perhaps somewhat philosophically, if I may, the petition does not really take into account that China is in a relatively early stage of development, sometimes in economics called the "Lewis Phase of Industrialization." During that phase a vast number of rural workers remain outside the modern economy. In this respect China's current stage of labor market development is comparable to that of Britain in the Industrial Revolution and the U.S. in the 19th century. There were few, if any workers' rights in either country in those days. There's no reason to believe that free labor unions and the right to strike would improve average industrial wages in China today. The petition employs assumptions about the effect of independent unions and strike threats on wage levels that are not consistent with the realities in China.

Finally, the estimates of the degree to which people are receiving less than they should in China are somewhat shaky and contradict, I think, other indicators. We know from many statements and statistics that the average standard of living in China, including rural people but more particularly urban people, is rising fast. The world has never seen a population increasing living standards on such a vast scale, so fast. This also leads to massive transfers of worker savings from the urban areas to the rural areas. Last year, according to the Chinese banking statistics, almost \$40 billion of savings

was transferred by urban migrant workers to their families in rural areas, almost nine percent more than the year before. Clearly, that is a significant source of income that could not have been transferred if urban wages are suppressed to a pure survival level.

Another fact is that, according to my information, whereas all cities have different standards for minimum wages—and these are not laws, these are standards—they are enforced to varying degrees. In some areas, for example in Shanghai, the minimum standard is 570 RMB per month. My contacts in Shanghai, and these include private companies, tell me that Shanghai is pretty effective in enforcing the standards there.

Another dimension I would like to mention, if you give me a second, is the suggestion that the underpayment of Chinese workers is somehow supported or condoned or at least abetted by the Chinese Government. This, I think, is a misstatement of the facts. It's clear that there are problems in China, particularly with regard to those migrants who enter the urban labor market for the first time; they have no negotiating power, but the average wages in China are, in fact, rising very rapidly. The abuses that do occur are recognized by the present government, both Prime Minister Wen Jiabo and President Hu Jintao have repeatedly stated that they want to end these practices and have invested a lot of political capital in trying to redress some of the problems.

One final very brief comment on the so-called bondage of Chinese laborers through the hukou system, that is, the internal passport system. I believe that the report is seriously out of date. It quotes sources of many years ago. The hukou system in China is, in fact, on its way out; there is an official committee that is studying how it should be modified or abolished and in some areas of China it has officially been abolished already on an experimental basis.

I'd like to leave it at that, Mr. Chairman. I'm ready to take your questions.

[The prepared statement of Mr. Bottelier follows:]

PREPARED STATEMENT OF PIETER BOTTELIER

COMMENTS ON THE AFL-CIO SECTION 301 PETITION AGAINST CHINA DATED 3/16/04

*Conclusions:*

1. The economic analysis underlying the calculation of job losses in the U.S. due to China's alleged "Persistent Suppression of Workers Rights" is defective and deceptive.

2. The suggestion that China's Government knowingly supports or at least abets the suppression of workers rights, so as to allow Chinese industries to gain unfair competitive advantage, is not adequately substantiated; there are important indications that China's Government, led by President Hu Jintao and PM Wen Jiabao is making serious efforts to combat such abuses of workers rights as do occur (other than the ban on strikes and the prohibition of independent unions).

3. China's Government does indeed prohibit independent labor unions and generally does not permit labor strikes. These factors were known and understood at the time the U.S. negotiated the terms of China's entry into the WTO and the U.S. Congress passed the PNTR legislation in 2001. If the U.S. had wanted to accuse China of unfair competition due to a "Persistent Suppression of Workers Rights" under section 301 of the 1974 Trade Law, it should have done so much earlier. If anything, labor conditions in China, though still very poor in many respects, particularly with regard to unskilled or semi-skilled rural migrant labor, are generally improving and in many industries better today than they were at the time China

entered the WTO. The low pay of migrant labor is only one of many factors that keep production costs low in many manufacturing and service industries in China.

4. The relentlessly negative picture of labor conditions in China presented in the petition is based on a selective use of data and sources; moreover, much of the information used is out of date.

5. It would be more important and more productive for the U.S. to focus on other violations by China of fair trade rules and to approach the issue of job losses in the U.S. due to globalization in a different, more strategic way. There are many things the U.S. can do internally to make the economy more efficient and to lower production costs.

*1. The economic analysis is defective and deceptive.*

1. The petition's conclusions on job losses in the U.S. hinge critically on the estimate of the margin by which China's alleged "persistent repression of workers' rights" depresses Chinese wages below the level that would prevail in the absence of such repression. The petition estimates that local wages would rise by 90 to 595 percent if there were no repression. There are at least three problems with this:

(a) The estimate of "under-payment" is not credible—most Chinese manufacturing industries/exports would not be able to survive if they had to pay their workers 90–595 percent more than they are paying now. One absurd implication of this is that the bulk of China's enterprises ought not to exist and that Chinese workers, whose rights are being repressed, would somehow be better off if these enterprises didn't exist.

(b) The petition assumes, without questioning or substantiation, that all of the production cost advantages resulting from labor repression—estimated at 10–77 percent—are always fully passed on to the customer (local or foreign). Why would the seller do this if he can keep at least part of the "rent" for himself, as must be possible in some cases? If all or part of the unfair cost advantages are pocketed by the Chinese firm or its owner (often a local Government), the petition's central argument is seriously undermined.

(c) The petition makes no allowance for the fact that U.S. companies operating in China account for an estimated 12–15 percent of China's exports to the U.S. Are those companies also violating Chinese workers' rights? If they don't, the petition's calculations of unfair cost advantages and associated job losses in the U.S. need to be adjusted. If they do, another absurd implication of the petition is that the U.S. Government requires punitive duties on all Chinese exports to the U.S. (and cooperation from China's Government) to get U.S. companies in China to stop suppressing Chinese workers' rights.

2. The petition does not take into account that China is at a relatively early stage (sometimes called the "Lewis phase") of industrialization. During this stage a vast number of rural surplus workers remain outside the "modern" economy. In this respect, China's current stage of labor market development is comparable to that of Britain during its industrial revolution and the U.S. in the 19th century. There were few if any "workers' rights" in either country in those days. There is no reason to believe that free labor unions and the right to strike would improve average industrial wages in China today. The petition employs assumptions about the effect of independent unions and strike threats on wage levels that are not consistent with present labor market conditions in China.<sup>1</sup>

<sup>1</sup>To illustrate this point two quotes from Upton Sinclair's, *The Jungle* (1906) describing the terrible conditions in Chicago's meatpacking industry and the ineffectiveness of labor unions at that time: "She was in another canning factory and her work was to trim the meat of those diseased cattle that Jurgis had been told about not long before. She was shut up in one of the rooms where the people seldom saw the daylight; beneath her were the chilling rooms, where the meat was frozen, and above her were the cooking rooms; and so she stood on an ice-cold floor, while her head was often so hot that she could scarcely breathe. Trimming beef off the bones by the hundred-weight, while standing up from early morning till late at night, with heavy boots on and the floor always damp and full of puddles, liable to be thrown out of work indefinitely because of a slackening in the trade, liable again to be kept overtime in rush season, and be worked till she trembled in every nerve and lost her grip on her slimy knife, and gave herself a poisoned wound." "Of course she stopped paying her dues to the union. She lost all interest in the union, and cursed herself for a fool that she had ever been dragged into one."

3. The petition's estimates of unfair cost advantages in China due to the alleged non-observance of minimum wage standards are shaky. Nobody seriously disputes that average real incomes and living standards in China, especially in urban areas, have improved dramatically over the past 20 years and continue to rise at a rate that the world has rarely seen anywhere, any time. How do we reconcile the petition's picture of utter misery and Government-sanctioned bondage and deprivation in China's factories with this? How do we explain the RMB 374 billion that was transferred by urban migrant workers to their families in rural villages in 2003 (8.7 percent more than in 2002) according to China's banking statistics? Most Chinese researchers agree that real wages at the very bottom of China's urban labor market—the point where most urban migrants enter—have risen only very slowly or stagnated at around RMB 500–600 p.m. for many years. No serious researchers (Chinese or foreign) dispute, however, that average real wages (and living conditions) for skilled and experienced workers are improving, sometimes rapidly, in most urban areas, and not only in factories owned by foreigners. The current standard minimum wage in Shanghai (excluding overtime and benefits such as lunch and transportation subsidy) is RMB 570 p.m. According to my sources, the minimum wage standard is reasonably well enforced in Shanghai and in other big cities. There are, moreover, many known and documented cases of Chinese firms improving labor conditions for their workers in order to be able to retain them or to attract better qualified people.

*2. Is China's Government condoning the repression of workers' rights?*

1. The petition either states or implies that China's Government supports, condones or at least abets the repression of workers' rights for economic advantage. This is a misrepresentation of the facts. It is true that migrant workers in China, especially those who are just entering the market, are often subjected to abuse and discriminatory practices. (Is the situation in the U.S. with regard immigrant labor from Latin America any better?) It is probably also true that local Governments in China are often aware of labor abuses when they occur, but chose not to intervene, either because they benefit from the situation, or because they are unable to correct the problem. However, this is not Government policy. President Hu Jintao and PM Wen Jiabao have both stated repeatedly that the Government wishes to eliminate labor abuses and there is ample evidence of efforts in this regard.

2. The petition's characterization of China's "internal passport" (hukou) system is out of date. Rather than using the system for labor repression (bondage) as stated in the petition, the Chinese Government is actively working to reform the system. There is an official Government study group charged with recommending policies how best to modify or abolish the system (which, as the petition points out, dates back to the Mao years). In several parts of Zhejiang (currently the Province with the most advanced private enterprise development in China) the hukou system was abolished on an experimental basis last year. Many cities have begun to use the hukou system as a fiscal revenue instrument instead of a labor control instrument. The entire hukou system is likely to disappear in the coming years and be replaced by a national ID card system. The ID card system is already in use in some parts of China.

3. Ironically, the petition asserts that the hukou system artificially depresses wages in China. The opposite is more likely to be the case. If the hukou system works the way the petition describes it, namely by restricting the flow of rural surplus labor to the cities, abolishing the system would probably increase the supply of migrant labor and thus depress urban wages.

*3. China's policy on independent labor unions and labor strikes.*

1. The petition has the facts right, but the interpretation wrong. China is afraid that free labor unions could undermine the (constitutional) power monopoly of the CCP (as happened in Poland under Walesa's Solidarity movement in the 1980s) and thus become a threat to social stability. However despicable or deplorable one may find this Chinese perspective on the risk of independent labor unions, it is China's reality today and the U.S. knew all about this when it negotiated the terms for China's entry into the WTO and when Congress passed the PNTR legislation. The fundamentals of China's political system may not change dramatically any time soon, but the dynamics of the ongoing social and economic change processes, will undoubtedly contribute to further improvements in average living standards and in widening freedoms for the vast majority of its population. Foreign enterprises operating in China account some 50%

of China's exports. Many of these enterprises contribute actively to the improvement of labor conditions in China.

2. The petition's assumption that independent labor unions and the right to strike would significantly improve wages and other labor conditions in China (and thus reduce unfair costs advantages) is not realistic as long as there are massive numbers of rural surplus labor and urban unemployed (see footnote 1).

4. *The petition's unqualified and relentlessly negative picture of labor conditions in China.*

1. I am sure that there are quite a few factories in China that retain some or all of the terrible conditions for workers as described in the petition. But, by not acknowledging or even hinting, that the situation is highly variable between industries and areas—and in any event changing, generally for the better—the petition undermines its own credibility. The petition presents evidence and data in a highly selective way. Only the most ardent China critics—often people with little or no real knowledge of the country—will accept the petition's description of labor conditions in China without question.

2. On some less important points, the petition is just plain wrong. For example, on page 64 it states that "Chinese citizens have no alternative to depositing their savings in the state-owned banks". That was probably substantially true until about ten years ago. Today Chinese citizens can and do own stock, cars, houses, etc. and if they any savings left, they can buy insurance or deposit them in many different banks. From December 2006 they can also deposit their savings in foreign banks in China if they wish, under WTO conditions. Chinese citizens can also obtain passports for personal travel abroad and take out foreign exchange for that purpose. The limits on what may be taken out of the country for personal travel have recently been increased significantly.

5. *Comments on China's unfair trade practices and job losses in the U.S.*

1. The "repression of workers' rights" in China is almost certainly not a significant source of unfair cost advantage for many producers in China. More important in my opinion are China's lax enforcement of IPR and the pervasive counterfeiting of both foreign and domestic products. Another way in which some Chinese state-owned enterprises may gain unfair advantage is through quasi-fiscal loans from state banks. Banking reform has still not progressed to the point where all state enterprises face genuinely hard budget constraints, like non-state enterprises. Completion of China's banking system reform will probably take several more years. It is still possible for some state enterprises in some situations to offload some or all of their losses on state banks, thereby adding to the NPL problem. To the extent they succeed in doing so, they may be in a position to under-price their competitors unfairly. I think that it would be more important and more productive for the U.S. and other trading partners of China to focus on compliance with WTO commitments that China has made regarding IPR protection, legal system development and banking reform.

2. Job losses due to globalization in general are undoubtedly a serious issue for the U.S. and other rich countries—we cannot take it for granted that every job lost will automatically be replaced by another one elsewhere in the economy. Blaming U.S. job losses to any significant degree on China's alleged repression of workers' rights, however, is not going to get us very far. Opponents of the AFL-CIO Petition could argue that U.S. production costs are unduly high, because of excessive CEO compensation, enormous waste in energy use and in the country's health care system, serious problems in public education, etc. Addressing U.S. unemployment problems is going to require a more strategic approach than what the AFL-CIO is proposing in its Petition.

3. I fully support efforts to improve occupational safety and health standards (OSH) in all factories around the world, through the WTO or otherwise. Unfortunately, after citing many OSH horror stories in Chinese factories, the petition drops the OSH issue in its final analysis on the ground that there is empirical evidence to suggest that improved OSH standards may be cost-neutral or even contribute to cost reductions over time. If the AFL-CIO has the interests of Chinese workers at heart, it should press the OSH standards issue, not drop it. The petition is also silent on cost advantages that some Chinese producers may enjoy as a result of inadequate environmental controls. Again, I would support efforts by the U.S. and by China's other trading partners to improve environmental standards in China and their enforcement, even if that in some cases leads to cost increases.

Senator BROWNBACk. Thank you very much for the very thoughtful comments that you put forward. The whole panel has been very good on an area that I've had a lot of questions about, so I appreciate the tutorial from each of you.

Mr. Robinson, let me start with you on this. Do we know, or do you know what percent of total foreign investment going to developing countries goes to China? In other words, of the whole global Foreign Direct Investment (FDI), or maybe Dr. Waldron, if you know this number, how much of it's pouring into China versus going to Honduras, other developing countries? Do we know that number?

Mr. WALDRON. I don't know the number but I do seem to recall a news item a while ago saying that China had overtaken the United States as the most-favored destination for investment. We can get that number, certainly.

Mr. BOTTELIER. I don't know it, Mr. Chairman, precisely, but let me answer by saying, the number varies from year to year. China has come on extraordinarily strong as a recipient of FDI in the last few years and, as Mr. Robinson mentioned, received more FDI than the United States last year, and this year, probably. My guess is that the total amount of FDI flowing to developing countries—we have to distinguish between Europe, United States, Japan—that China would probably receive about a quarter, at least a quarter at the present time.

Ms. LEE. A lot more than that.

Senator BROWNBACk. I want to focus in on the developing countries because here's the thought that I'm working with on this, is that you've got a global economy that's clearly integrating very, very rapidly. I mean, it moves and it moves rapidly and capital moves. But China has become such a great suction for Foreign Direct Investment that it has significant impacts on that score throughout the developing world in quite a profound way.

Mr. D'AMATO. There's no question, Mr. Chairman, that China is exceeding the net in-flow from developing countries because, for example, we're worried about Mexico ceding its textile advantage to the Chinese because of China's lower labor costs coming up, that if the multi-fiber agreement does end on time, this year, that the chances of most of the countries of Asia losing textile share to China will be apparent. So it looks like the in-flow of FDI into China is exceeding, you know, most of that that's going to the rest of the developing world.

Mr. ROBINSON. I would just chime in, Mr. Chairman, that the number's about \$50 billion, and that sucking sound you hear in your mind is real. This is the largest flow of Foreign Direct Investment on the globe, I believe. Now, what percentage it is of the developing world, we'll take a look at that and be back to you on it. But leave it to say that this has got to be having a deleterious affect on some of these other emerging market economies that I think you're getting to.

Senator BROWNBACk. I'm getting to that and plus, this is about two years ago, I did a trip through India and China, and I was just comparing those two countries' Foreign Direct Investment, and India was a paltry amount relative to what China was. Now, I think India's has been growing substantially the last couple of

years, but it still has not been in comparison to China. And then, I started to hear now from Central American countries saying this thesis: Look, we engaged democracy and open societies ten, 15 years ago, and we aren't living any better today than we were ten or 15 years ago. Why? What's happening here? Well, it appears as if, you know, while we were saying yes, you should do that and you've got to open the society and create systems where you can grow, but that China is pulling so much of that in that we're just not seeing that spread much anywhere around the world.

Mr. WALDRON. Could I just add, I think one of the things that troubles me the most about this is that China has what is euphemistically described as a disciplined workforce. And she is competing with lots of countries, new democracies, where workers actually have rights. Now, the sad fact is that most investors are quite happy to have a disciplined workforce. They don't want strikes. They're quite happy if the secret police takes away somebody who's making trouble. They will supply all sorts of rationalizations, but the real point is that it's much easier to do business in a certain type of dictatorship than it is in a democracy. Yet it's overwhelmingly in the interest of the United States that we should support other democracies with trade, with investment, and so forth. And I think the administration and the government should think very, very seriously about how to do this.

One of my colleagues at Penn, who is a law professor, said that he expects, within ten or 15 years, that the issue of workers' rights will become an integral part of international trade law. And if that should happen then this very, very worrying issue would begin to be addressed. But I do think, as an American, that it is terrible to see countries that have made the sacrifices and taken the risks to become democratic and to give their workers rights then lose out in the competition for foreign capital to countries having these workforces which are basically under police supervision.

Senator BROWNBACK. Mr. Bottelier, respond to that thought. I would ask, what are your thoughts about that?

Mr. BOTTELIER. Okay. May I preface that, Mr. Chairman, by just one more comment on these FDI numbers? I think it's important. China is indeed a huge absorber of FDI. Number one comment that I would like to make, that China now has also become a large source of outgoing FDI. It's the largest amongst developing countries of outgoing FDI, that few people have focused on. Secondly, in the 80s and the early 90s, 60 to 70 percent of all the FDI going in China came from overseas Chinese, mainly Hong Kong, Taiwan, Thailand, Indonesia. Even today, about half of the FDI going into China is from overseas Chinese. Furthermore, to qualify the numbers, it is estimated that perhaps 20 to 30 percent of the total FDI going into China is in fact Chinese money that is being recycled through Hong Kong or the United States in order to take advantage of certain privileges extended to foreign investment rather than domestic investment.

Senator BROWNBACK. Good, good, excellent point.

Mr. BOTTELIER. The number is a bit more. And finally, perhaps the most important point, a lot of FDI goes to China because the domestic financial intermediation in that country is still so undeveloped that bank loans tend to be not easily available to private

enterprises or non-state enterprises. Most of them still go to state enterprises and now increasingly mortgages. Once the domestic banking system and the stock exchanges and the bond markets develop, then you will see that there is much less need for foreign investment money to sustain the same level of investments. The FDI record levels partly reflect defective domestic financial intermediation.

Senator BROWNBACk. Mr. Bottelier, though, respond to the comment that China's disciplined workforce is one that gives it an advantage over a democratized Central or South American workforce?

Mr. BOTTELIER. Well, I think the discipline to which Mr. Robinson referred is probably an element but less and less so. The Chinese labor force is, by Asian standards, East Asian standards and South Asian standards, a disciplined labor force in the sense that the people are well trained, Chinese workers are generally very literate, have relatively high health standard; this is a long tradition, their life expectancy is higher than in most Asian countries and the Chinese are extraordinarily industrious people.

Ms. LEE. Oh, please.

Mr. BOTTELIER. And entrepreneurial people. I'm not an advocate for China here, but we should realize that there's more to China than cheap labor. Another factor which is now beginning to play a significant role is the relationship between all these foreign investments located in China. It is the intra-China supply lines that allow newcomers to reduce their costs, not only because labor is good and cheap but because everybody else is there. So intra-China supply lines between manufacturing industries allow cost advantages that other developing countries, with far less foreign investments, don't have.

Senator BROWNBACk. Ms. Lee?

Ms. LEE. If I may just say, I think it's really an insult to talk about workers in China as industrious and hard working as opposed to oppressed. Of course they're industrious and hard working and of course they're good workers and they're smart and so on, but the reason that foreign investment floods to China is a combination of many factors, including other kinds of commercial advantages, a large marketplace, and so on, but I think you cannot underplay the level of oppression in China. You said you don't challenge the facts that are in the petition that the State Department has documented. I just think it's really appalling to talk about the advantages of Chinese labor in terms of level of hard work. Workers in China are denied their basic human rights. They're not allowed to form unions. They're not allowed to even advocate for unions. They're not allowed, in some cases, to even ask for the wages that they're due, and they're treated abominably both by their employers and by their own government. And I challenge many of the arguments you make. I'm surprised, Mr. Bottelier, to hear your critique, and I guess I'm wondering what the implication is, whether you're saying that there's no wage advantage whatsoever that comes from the denial of workers' right of freedom of association, the failure to enforce minimum wage and hours of work and health and safety laws, or are you saying that the particular estimate that we have is too high? We can talk about what the particular estimate is, but to say that there's no advantage whatso-

ever, there's no cost advantage, I think threatens credibility because then you have to ask the question, why is it that companies don't pay decent wages? Why is it that the Chinese government by law prohibits unions from forming, prohibits workers from exercising their rights? And is there no economic advantage whatsoever to doing that? I find that very, very hard to believe, and I'd be surprised if that's really the argument that you're making.

Mr. WALDRON. Could I just second what Ms. Lee has said? I'm really ashamed to hear American spokesmen or business spokesmen gloss over the fact that China is now one of the most repressive countries in the world and their labor force is certainly under very close observation and supervision. And my own view is that we need something like the Sullivan Principles that we applied to South Africa to regulate the activities of American business there with respect to the treatment of labor. And I would add, of course, on another point that the activities of American business in facilitating the development of the Chinese military industrial complex have also been a very serious problem. But to run through a list of how hard working, industrious, healthy and so forth the Chinese workers are while suggesting that somehow they have no awareness they are oppressed is simply wrong. We all know any number of union leaders who have been arrested. We know that there is strong labor awareness, and we also know that the Chinese secret police cracks down on this very, very hard.

Senator BROWNBACK. It's a tough topic. Ms. Lee, let me ask you a question that I had a gentleman pose to me this morning, if the administration agrees with proceeding forward with the 301 case, and hearing it, that we will not get support internationally in the developing world because many people in the developing countries will say, well, that may be China now, but we're going to be next, and it will be about our not having the same worker wages or rights in our area as they do in the United States so we're not going to support you on step one because we think we're step two or three down the road. How do you respond to that?

Ms. LEE. Well, that's a really interesting question. I don't know the answer at the moment because we haven't had official conversations with governments in developing countries on this specific issue. What we have had is conversations with unions in developing countries around this issue, and with the International Confederation of Free Trade Unions (ICFTU), which is the international labor body which we belong to. ICFTU represents about 150 million workers worldwide, about two-thirds of whom are in developing countries, and it has been very supportive of our workers' rights petition. Most of what we hear from unions in developing countries is that they are terrified competing with China. They're very supportive of an action that would, in fact, challenge China to be more democratic, to respect basic ILO core labor standards, to bring its laws into compliance with international standards. So certainly workers in developing countries have a keen understanding of the same exact kind of challenges that American workers are facing. They're losing their jobs to China because China's not a democracy, because China violates human rights. We'd like to see some of their governments, we certainly will be in contact, more specific contact with our union counterparts in devel-

oping countries and also in industrialized countries to see if we can get them to lobby their governments to support the petition.

Senator BROWNBACK. Have any come forward yet to support, in any developing countries?

Ms. LEE. We haven't had that specific conversation yet at this time. But we expect that there will be some support internationally because even in Cancun, at the last WTO ministerial meeting, many trade union representatives, including myself, met with some developing country governments, most of whom were fixated on the problem, the challenge of competing with China, particularly in 2005 when the textile and apparel quotas are scheduled to be lifted. And there were governments in Africa and the Caribbean that were very, very concerned what the competitive impact on them would be, and they were more interested in talking to us about workers' rights provisions in the WTO than they've ever been in the past.

Senator BROWNBACK. I haven't been a fan, historically, of labor agreements as part of trade agreements. I've always felt like these are things that should be separated. Yet what I'm seeing develop is a constellation of issues, particularly focused on China, that just makes me increasingly concerned with it, so that I'm looking aghast and saying what else? How else should we address this set of issues? And maybe it all works through. I'm hoping for that, that it all works on through, but I'm been hoping for that for a number of years now, and I haven't seen anything. And so that's why I'm wondering if we're going to have to take other actions that maybe previously had not been thought of for the issues of addressing China, but also for addressing equality and democratization issues around the world that we're running into our own rhetoric in places where we ought to be able to stand up and say, you do this and life does improve.

Mr. Bottelier, you present some very sound, I think, arguments on some of these things, as well. I mean, like once you get a concentration in China it tends to grow; when if you don't have that same concentration in other places, it would have less ability to attract the capital, and so I respect the thought and the fundamental economic forces. There are a set of very big issues here that are circling around China, and much of it, I think, could be resolved if they would embrace democratization, if they would embrace human rights. And then, you know, guys like me would let up and say if that's the way the market's going to compete, it will compete, and we're all going to compete fairly in it. It just doesn't seem like that's what's taking place. And then the product of our policy decisions, or lack of policy decisions, then grows and its importance and our options lessen as the years move forward. I think Mr. Robinson was saying we may have about ten years to really influence China and its direction and pass that. The engine has enough fuel on its own to do what it chooses to do at that point in time.

I want to thank you all for being here and for hanging in through this. I would invite each of you, if you have particular policy thoughts that you think we should be putting forward to implement some of the ideas that you're putting forward, to get them to us.

Dr. Waldron, you mentioned the Sullivan Principles. Mr. Robinson, I thought you really put your finger on the issues. I didn't hear with the same clarity okay, do this, this and this afterwards.

I think, Ms. Lee, I understand clearly your point of view is certify the case, would be it.

And Mr. Bottelier, if you see items that we should move forward with, let us know as well.

This is an area of growing concern, policy-wise. It's a growing concern politically across the country. The nation knows that we are heavily dependent upon China, and we're getting cheap goods from there, but they don't like it. They don't particularly like that set up.

And while the outsourcing issue is getting a lot of play as well, as it should, I think it needs some real good economic examination as to the actual outsourcing/insourcing issue. It still reflects more of an internal, deeper feeling, like we're just too dependent upon a place that's just not structurally the way we think it should be. And not stable structurally, when you're ruled by a small party elite that has the ability to move rapidly in unpredictable fashions, and that's a discomforting thing to many, many of us.

Mr. D'Amato.

Mr. D'AMATO. I just wanted to say, Mr. Chairman, the commission will have its report for you in about a month, and it will have a lot of very specific recommendations and things we think the Congress ought to be doing to take a look at these issues and to move to the Executive Branch as well, down the road. Because we do think that leverage is important here. The Chinese do respond to leverage but leverage has got to be strong, sustained.

Senator BROWNBAC. And real.

Mr. D'AMATO. And real, absolutely. And that's what's going to have to make the difference. But those are the recommendations that we will be providing for you.

Senator BROWNBAC. Yes, it's not a jawboning process. This is playing with real dollars here and real lives, and we have to make it substantial and direct and felt for action to occur.

Mr. D'AMATO. Right.

Senator BROWNBAC. Thank you. Thank you all very much for attending.

The hearing is adjourned.

[Whereupon, at 4:19 p.m. the hearing was adjourned.]

## APPENDIX

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RESPONSES TO QUESTIONS FOR THE RECORD SUBMITTED TO ASSISTANT SECRETARY  
LORNE W. CRANER BY SENATOR RUSSELL FEINGOLD

*Question.* The Congressional Executive Commission on China stated in their 2003 annual report that “working conditions and respect for worker rights in China were frequently in violation of China’s own laws, especially those governing wages and overtime pay, work hours and overtime hours, and workplace health and safety.” What are the obstacles to the enforcement of China’s own laws? What steps are you taking to encourage China to both enforce its existing labor laws and expand worker protection?

*Answer.* The 2003 annual human rights report noted “widespread official corruption and efforts by local officials to attract and keep taxpaying, job-producing enterprises that might otherwise locate elsewhere undercut enforcement of the minimum wage provisions.” There are national laws governing working hours, but these laws are often not enforced, particularly in private enterprises that can rely on a vast supply of low-skilled migrant labor. A Work Safety Act was enacted in 2002 and nearly 70 field offices of the State Administration for Work Safety exist throughout the country, but enforcement is the responsibility of lower-level governments and is weak. The absence of genuinely representative trade unions exacerbates this state of affairs by depriving workers of a powerful voice that could defend their rights in the workplace.

The U.S. Departments of State and Labor are funding projects in China totaling approximately \$10 million to improve labor laws, strengthen their enforcement, raise labor awareness, provide legal aid to workers, and improve mine safety and health.

*Question.* It has been reported that much of the labor abuse occurs in foreign-owned factories in China’s coastal provinces. News reports discuss how factory managers hold two accounting books—one reflecting the reality of the factory and one book, which distorts the hours and workplace conditions to show their foreign clients. What should be done to pressure the Chinese government and foreign companies to monitor their factories more closely to ensure that labor codes of conduct are being followed? Can more be done to encourage companies operating in China to prioritize labor conditions?

*Answer.* The U.S. Government is committed to supporting socially responsible business practices and encouraging good labor practices in China. The U.S. Departments of State and Labor are funding projects in China totaling approximately \$10 million to improve labor laws, strengthen their enforcement, raise labor awareness, provide legal aid to workers, and improve mine safety and health. Projects to foster socially acceptable practices are being carried out by organizations selected through open competition.

In March, representatives of major international buyers in the footwear and apparel industry met with our Ambassador in Beijing to discuss ways to improve enforcement of labor law in their Chinese supply chains. The Ambassador said he would raise their concerns in his own meetings with Chinese government officials. We are exploring holding a national conference on socially responsible practices in China in the near future.

*Question.* According to recent news reports, the People’s Republic of China continues to assert that they will set the pace of reform in Hong Kong on their own schedule. Democracy activists believe that Beijing is gradually renegeing on their guarantee of broad autonomy and that their demands for direct elections are being

dismissed. What leverage will you use to pressure the Chinese government to respect the political rights of the people of Hong Kong?

Answer. It is longstanding United States Government (USG) policy that the Hong Kong Government should move toward greater democratization, through electoral reform and universal suffrage, as provided for in the Basic Law. We were deeply disappointed by the recent National People's Congress decision that effectively ruled out the possibility of universal suffrage for the Chief Executive in 2007 and the Legislative Council in 2008. This decision does not adequately reflect the strongly expressed wishes of the Hong Kong people for universal suffrage and democratization and threatens to undermine the high degree of autonomy guaranteed to Hong Kong in the Basic Law.

We will continue to support electoral reform and universal suffrage in Hong Kong, in keeping with the Basic Law's own goals. Hong Kong Consul General James Keith, Ambassador Clark Randt and other senior USG officials regularly express our views on this issue, stressing that international confidence in Hong Kong is predicated on its rule of law and high degree of autonomy. Vice President Cheney made this point to his counterparts during his April trip to China. In the months ahead, the United States will continue to monitor the situation in Hong Kong with the goal of supporting Hong Kong's democratization process.

*Question.* China has recently suspended its human rights dialogue with the United States following a proposed UN resolution by the Bush Administration that criticized China's human rights practices. How can we continue to make progress on these issues despite this Chinese action?

Answer. Since the defeat of China's no-action motion in 1995 and a close vote on the resolution itself, the Chinese have equated sponsorship of a China resolution at the United Nations Commission on Human Rights with "confrontation" and suspended the U.S.-China Human Rights Dialogue in retaliation. We were not surprised that they did so this year, but felt that China's backsliding on human rights in 2003 fully warranted bringing up China's human rights record before the world's preeminent human rights forum.

Key human rights issues are being raised in channels other than the Human Rights Dialogue by senior officials. For example, Vice President Cheney raised human rights concerns during his April trip to Beijing.

We have already begun to press China to resume the dialogue, pointing out that it is China's own strongly held and often expressed view that dialogue, not "confrontation," is the most effective way to resolve differences on human rights. We are hopeful that China will agree to resume the dialogue sometime later this year. We are also making the point to Chinese officials that only progress made as a result of dialogue will enable us to forego an resolution next year and that resuming the dialogue is in both of our interests.

## PREPARED STATEMENT OF SENATOR RUSSELL D. FEINGOLD

I would like to thank Senator Brownback for convening this important hearing on the status of reforms in China.

Sadly, evidence of positive human rights reforms is sparse. Despite U.S. pressure on the Chinese government, it appears that the human rights situation continues to deteriorate. Refusing to distinguish between peaceful and violent dissent, the Chinese government punishes those who dare to speak out for political and civil rights, and works to silence those demanding basic labor rights.

A flurry of press reports have documented China's labor conditions, and revealed a persistent and widespread suppression of labor rights in China. China's labor activists continue to be accused of "subversion of the state" and to be imprisoned, tortured and beaten by authorities. Too many Chinese workers suffer from inhumane working conditions, confronting gas explosions, mine flooding, and toxic fumes at work, and laboring at machinery without proper safeguards in their workplaces. They have no national minimum wage or overtime pay, nor do they have the ability to seek recourse for these injustices. While the Chinese Constitution ostensibly provides for freedom of association, Chinese workers in practice are not free to organize or bargain collectively.

Wisconsin alone has lost approximately 80,000 manufacturing jobs since 2002, many of which have moved to China. There is a growing consensus in my state that abysmal labor conditions in China are creating an impossible playing field, one where U.S. workers cannot compete, and should not compete. The Chinese government's unwillingness to check these labor abuses appear to be undermining our own manufacturing base in Wisconsin.

In addition to problems with labor rights, the People's Republic of China continues to violate the political and civil rights of its citizens. The state refuses to allow the people of Hong Kong to elect their own representatives despite the overwhelming support for direct elections, and continues to persecute the ethnic Uighurs and Tibetans, repressing all political, religious and cultural expression.

When it comes to these fundamental human rights issues, where is the reform? Where is the progress? What more can Congress do? I look forward to the panelists' insights on how the U.S. government can play a greater role in encouraging reforms in China.