# ADDITIONAL VIEWS OF COMMISSIONER DANIEL BLUMENTHAL

During its fact-finding trip to Asia in August 2008, Commissioners learned that the governments of Taiwan and South Korea place enormous importance on signing free trade agreements with the United States. The Commission has not taken a position on this critical issue.

In the case of South Korea, a free trade agreement is pending, the biggest one the United States has negotiated since the North American Free Trade Agreement (NAFTA). The agreement promises billions of dollars of new American exports into South Korea across every sector. In the case of Taiwan, the Bush Administration has failed to negotiate a free trade agreement for one reason alone: fear of angering China.

The United States cannot maintain its leadership position in Asia if it does not ratify free trade agreements that make eminent sense economically and strategically. China is signing countless trade agreements throughout the Asia Pacific. Leading the process of continued trade liberalization is one sure way America can check China's growing regional dominance.

# ADDITIONAL VIEWS OF COMMISSIONERS PATRICK A. MULLOY AND PETER VIDENIEKS

We are pleased to sign the Commission's unanimously adopted 2008 Report to the Congress. Members of the Commission, assisted by an able staff, worked in a very collegial and bipartisan manner to elucidate key aspects of the U.S.-China economic relationship and its implications for our nation's national security. It has been a privilege to participate in the effort.

One facet of the relationship which we wish to highlight is China's policy of underpricing its currency both to gain advantages in trade and attract foreign investment. Foreign-invested companies presently account for the majority of China's exports. The Chinese government has offered economic incentives, including an underpriced currency, to encourage foreign company participation in its economy. In its very first Report to Congress issued over six years ago in July 2002, this Commission stated that China's underpriced currency was an important contributing factor to our growing annual trade deficit with that nation, which was then about $90 billion; it is now three times that amount annually. In addition, the Commission stated that China maintained its underpriced currency by having its central bank make large official purchases of U.S. dollars and noted further that China's very large dollar reserves, accumulated as part of its exchange rate strategy, could in the future, if not stemmed, be used as an "economic weapon" against the United States. The Commission stated that China's policy of "currency manipulation," which contravenes China's International Monetary Fund (IMF) treaty obligations, needed to be addressed.

In each of our Reports issued since 2002, the Commission has pointed to the damage being done particularly to the manufacturing and industrial base of our economy by the strategies of China and other Asian nations that underprice their currencies against the dollar. We noted that our government needed to rectify this problem and that to persuade the Asian nations to take appropriate steps, it was necessary to get China to act first. The U.S. Treasury Department has a statutory charge from Congress in the 1988 Omnibus Trade Law to identify in annual reports to Congress nations that manipulate their currencies to gain trade advantages. Treasury further was charged by Congress to work with any countries so named to stop the IMF illegal practice. The Treasury Department has failed to carry out this Congressional mandate. In September 2005 when the Treasury's under secretary for International Affairs publicly criticized the IMF for failing to police its own charter provisions forbidding currency manipulation by China, the IMF's managing director retorted that the Treasury Department had not named China a currency manipulator in its own reports to the Congress. There was mutual finger-pointing.

While this shameful failure of responsibility by both the Treasury and the IMF has gone on, many more thousands of U.S. manufacturing jobs have been lost, and communities dependent on those jobs were decimated. Our nation's cumulative total bilateral trade deficits with China since 2001 have exceeded $1 trillion. China is now running a massive global current account surplus of over 10 percent of its gross domestic product. In order to maintain its underpriced currency in the face of trade surpluses of such a magnitude, the Chinese Central Bank has had to purchase ever larger amounts of foreign exchange, mostly dollars. In 2007, it purchased $430 billion and this year is projected to purchase $600 billion.

The Chinese government, in order to get a return on its now massive nearly $2 trillion of foreign exchange holdings acquired in part from its trade surpluses, has been investing huge sums into U.S. Treasury bonds and debt issued by U.S. government-affiliated agencies, such as Fannie Mae and Freddie Mac. China, in effect, has been lending us the money that enabled us to keep our interest rates low despite our large and growing domestic budget deficits. Many economists note that this surfeit of liquidity into U.S. capital markets encouraged irresponsible lending practices here and thus helped feed the real estate bubble. It also enabled Americans to continue to purchase Chinese imports by tapping into the equity in their once increasingly valuable homes to sustain standards of living they were not earning. The result for China is that it received a new stream of foreign earnings from interest paid on its debt holdings as well as increasing leverage over U.S. interest rates. This latter situation is what the Commission warned about in 2002.

Another offspring of China's increasing dollar holdings made possible, in part, by its exchange rate policy is its increasing investment in the United States by its government-owned sovereign wealth fund and other government-controlled funds and companies. Foreign governments are using the dollars we are paying to finance our trade deficits and other foreign borrowings to buy more of our economy. These matters and their policy implications are discussed in this Report.

To help resolve the current global financial crisis and help reverse some of its most harmful beggar-thy-neighbor mercantilist trade practices, China needs to move toward a growth strategy led not by exports but by domestic consumption. Some of those dollars being pumped by the Chinese government into U.S. Treasury bonds, as part of China's strategy to maintain an underpriced currency, need to be used to grow the standard of living of the Chinese population. This transition has to be effected in a cooperative manner so as not to damage needlessly either our own or China's economy. The United States, in turn, also needs to adopt fiscal, economic, trade, infrastructure, education, and other policies that move us from our growing dependence on foreign money and foreign goods. If we continue to borrow more and more from China to support a standard of living we as a nation are no longer earning, we will hand over more of our independence of action on economic and financial matters to that nation. As Tennessee Williams depicted in his play *A Streetcar Named Desire*, it is not necessarily a wise policy to depend on the kindness of strangers.

# ADDITIONAL VIEWS OF COMMISSIONER WILLIAM A. REINSCH

This year's Report represents continued improvement over previous years, despite the Commission's determined effort to make its text as soporific as possible. If one is looking for a cure for insomnia, here it is. Substantively, however, the Report continues its slow march to responsibility. The rhetoric of past years has been reduced, and most—but not all—inflammatory recommendations have been omitted. In short, the Report is maturing, just like the U.S.-China relationship, and I am able to support it this year.

As in previous years, the Commission has continued its impressive record of thorough, balanced hearings with expert witnesses from the government and private sector. That body of work provides an in-depth set of studies on topics important to the bilateral relationship, and the hearing records contain significant amounts of data and other information of use to scholars and policymakers. Some of that is highlighted in this Report, but researchers would be advised to consult the full hearing records.

With respect to trade, the Report correctly notes some disturbing trends and our government's difficulty in dealing with them. China continues to pursue economic policies based primarily on export growth rather than on domestic consumption, leading to a persistent, large bilateral trade surplus and a rapidly growing global surplus. While the renminbi has appreciated significantly, China continues to make its value a function of China's economic policy rather than of market forces, thereby doing China a long-term disservice as well as distorting the global economy. Additionally, new policies on export tax rebates and potential restrictions on inward investment threaten to make the situation worse. While some of the Commission's recommendations are sensible, the Commission unfortunately also continues its enthusiasm for legislative remedies whose arbitrary nature is almost certain to make the remedies ineffective, and the Commission has largely failed to add value to the ongoing debate over exchange rates and trade policy, instead simply throwing back to Congress the same arguments that some of its Members already make.

One topic of increasing Commission focus is China's sovereign wealth fund. This is a complex area of inquiry because there are many hypothetical concerns with respect to which there is little or no present evidence that would justify taking action. On the other hand, waiting until it is too late is not a wise option either. While I have some reservations about the particular approach recommended, the idea of focusing on all sovereign wealth funds and not just China's, and on better transparency, is directionally the right approach.

One area where the Commission's recommendations continue to be thoughtful is with respect to energy and environment, where the Commission has consistently opted for a multilateral, cooperative approach. These areas have also been the focus of some of the Commission's most useful hearings, even though the topics lack the drama of exchange rates or Taiwan policy.

The Report correctly notes progress on China's nonproliferation policy. While there clearly are areas where our foreign policy interests and China's diverge and where China's conventional arms transfers conflict with our interests, China's proliferation controls—and attitude about WMD—appear to be improving.

Another constructive area of Commission emphasis has been on China's cyber activity. As military systems become more dependent on electronics and information technology, cyber intrusions and the potential for cyber attacks increase, and the damage they can do becomes more serious. While I believe our military is well aware of the problem, it is not clear they have been provided with adequate resources to address it. In addition, the Commission's recommendation that we attempt to deal with this problem multilaterally is a constructive one.

On the vexing issue of information technology (IT) companies attempting to operate in China, the Commission has improved its recommendations over previous years by taking note of the Global Network Initiative, an agreement by companies, human rights organizations, and others on guidelines, implementation commitments, and accountability procedures for dealing with governments' censorship efforts. This is probably the best approach—if it works—and the Commission is wise to acknowledge it, but the Commission's Report still leaves unexamined the question of whether the Chinese people's access to information and the U.S.' national security are better served by a growing U.S. IT presence in China, however limited, or whether the Chinese and we are better off with greater Chinese reliance on indigenous hardware and software. Here, as elsewhere, the morally and politically correct position, which the Commission has always been quick to take, may not be the one most in our or the Chinese people's interests.

In my comments in the last two Reports, I warned that China's becoming a responsible stakeholder does not simply mean that China must agree with us on all important issues. Each subsequent Report has reflected greater understanding of this point and the reality that we do best with China when we can explain to its leaders why a particular action is good for *them* rather than why it is good for us. America's challenge is patience and perspective. Progress will inevitably be as Lenin suggested—two steps forward and one step backward, and sometimes the reverse. The Commission could perform a real service to Congress by making that point from time to time and recommending a degree of patience at the same time that we press China to move more rapidly.

China, in turn, if it wishes to assume a global role commensurate with its size, potential, and aspirations, must understand and be prepared to assume the obligations of leadership, which often requires a degree of self-abnegation. China's leaders have demonstrated that they have a clear understanding of what is in their immediate interest. Their challenge will be to demonstrate they also understand what is in the larger interest of the global system of which they are a part, that the health of that system is inextricably tied with their own, and that they are prepared to act on that understanding.