



U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

Opening Remarks of Chairman Carolyn Bartholomew and Vice Chairman Larry Wortzel on the 2009 Annual Report

November 19, 2009

Good morning. Thank you for coming. My name is Carolyn Bartholomew. I am this year's Chairman of the U.S.-China Economic and Security Review Commission. Today we are releasing the Commission's Annual Report to Congress. This is the Commission's seventh major report since it was established in 2000. It is the work of our 12 member, bipartisan Commission, which was created to advise Congress on policy toward China. I am pleased to note that once again this report was adopted unanimously.

The Commission held eight hearings this year, including a field hearing in Rochester, New York, and conducted research relevant to the report and to our mandate from Congress to "monitor, investigate and report . . . on the national security implications of the bilateral trade and economic relationship" between the two countries. We also traveled to China and met with Chinese government and party officials, business leaders, and some of China's top scholars, and with American diplomats and business people in China. Commissioners also traveled to Hong Kong. Our findings from the trip are contained in the report.

In addition, the Commissioners attended six briefings in the Washington area with five major intelligence agencies. Our conclusions from those briefings will be contained in a separate, classified report available to those with the appropriate clearances. Finally, the Commission contracted with outside research firms for reports in specific areas, such as cyber security. Some of those reports have been posted on our website and others will be published there as they are completed.

The 2009 Annual Report reflects the Commission's concern that China is moving in the wrong direction in certain areas. The Commission notes a disturbing trend away from the development of a free market system and instead sees moves to greater government control of the economy. Contrary to its claim of being a market-oriented economy, Beijing continues to comprehensively plan, direct, support, and control its economy. As our report points out, many of China's economic reforms over the past 30 years are, in reality, a government-directed industrial policy that seeks to promote export-led growth. Key industries including auto parts, machine tools, information technology, optics, photonics, and clean renewable energy are targeted for government support. Such policies are having an adverse effect on U.S. industries.

The Chinese government continues to employ a wide range of subsidies to favored companies and industries within China and the government continues to unfairly control the value of its currency. It provides massive loans from state-owned banks to industries already producing over capacity. This approach gives China's exporters a substantial price advantage in international markets and disadvantages U.S. companies hoping to export to China.

China provides subsidized land, energy, and water to many foreign manufacturers who relocate their operations to China. By providing these benefits, along with a cheap labor force without the ability to bargain collectively or join independent unions, the Chinese government has created a low-cost haven for domestic and foreign manufacturers. China's subsidies have grown over the years and now include tax incentives and preferential loans, which further reduce the cost of investing in China.

China's industrial policy was a contributing factor to the imbalances that led to the global financial crisis, according to the Report. China's pursuit of export earnings has contributed to China's massive trade surplus and its accumulation of \$2.3 trillion in foreign exchange reserves.

Our report notes serious concerns about China's military growth, and its human and cyber espionage activities. The type of information being extracted by this espionage is assisting China's future industrial and military growth.

It is also important to note that China is attempting to tighten its control of information and news dissemination within China. Although the Internet has provided a freer venue for discussion of sensitive issues than the government-controlled news media, the Chinese government has employed new techniques for controlling flows of publicly available information over the Internet. The Chinese government also has taken steps to improve its ability to shape international perceptions of China through extensive use of propaganda and the dissemination of selective information.

The Chinese government seeks to shape opinion in elite U.S. policy-making circles by influencing the commentary about China. This takes the form of providing both positive rewards to "friendly" scholars—such as preferred access to interviews and documents—as well as taking punitive actions such as denying visas for academics in America who anger Beijing. These rewards and punishments offer the Chinese government leverage over the careers of foreign scholars and thereby encourage a culture of academic self-censorship.

The Commission makes 42 recommendations to Congress. Among them, the Commission urges steps that would press China to allow the renminbi to become flexible and responsive to market forces, thereby contributing to the correction of global economic imbalances. The Commission also recommends that Congress consider legislation that has the effect of offsetting the impact on the U.S. economy of China's currency manipulation. The Commission also urges stronger steps to implement an effective code of ethics and best practices by U.S. high-tech firms operating in China and

other authoritarian countries where Internet content and activity are controlled and monitored by the government.

Now I would like to introduce my colleague on the Commission, Dr. Larry Wortzel, who has served ably during this past year as the vice chairman.

[Begin Vice Chairman Wortzel's Opening Statement]

Thank you, Chairman Bartholomew, and good morning ladies and gentlemen. I would like to echo the Chairman in thanking you all for coming today. I will focus on a few broad themes in this year's Annual Report.

China's growing international economic interests are leading China to be more active on the international scene, especially in regards to energy and resource acquisition. China is acquiring energy and resource rights around the globe. Our Report also covered this issue in the context of China's strengthening relationships in the Central Asian states, and with Pakistan and Afghanistan. China is increasing its foothold in Central Asia through a concerted policy to acquire energy and resource deals. Yet Beijing remains conscious of Russian equities in the region, and does not seek to upset Moscow's interests. Beijing is also providing a modicum of support to U.S. and NATO efforts to stabilize Afghanistan and Pakistan. However, it primarily remains a free rider of the security that U.S. and coalition forces provide. Our report also questions the deliberations over China's acquisition of mining rights in Afghanistan. In addition, China is conducting an active and effective public diplomacy in ASEAN backed up by military engagement and an orchestrated perception management effort.

China's expanding international economic interests are driving its military to increase its international security presence. Nevertheless, it will remain essentially a regional military for the next decade. As demonstrated in this year's Report, the People's Liberation Army, or PLA, has begun to actively safeguard China's international economic interests, as evidenced by the PLA Navy's on-going escort operations off the coast of Somalia. Yet, while such operations benefit the global good, the PLA remains focused on national interests predominantly around China's periphery. And even when it does act on a broader scale, such as in the Gulf of Aden, its forces act independently of multilateral task forces. Key among China's interests is the desire to deter Taiwan's independence, protect China's regional economic stakes, and uphold China's disputed maritime territorial claims in the East and South China Seas. China's growing military capacity and its increasing focus on safeguarding economic interests have led it to act more assertively toward legal U.S. naval operations in China's exclusive economic zone, as demonstrated by the March 2009 harassment of U.S. Navy surveillance ships, the *Impeccable* and the *Victorious*. Such aggressive Chinese actions create the potential for unfortunate, incidents.

The PLA's defense budget has enjoyed double-digit percentage increases since at least 2000. These resources have allowed the military to greatly improve its capabilities

by developing or purchasing advanced platforms and weapon systems, some of which appear intended to counter U.S. military assets in East Asia. As the Commission points out, the PLA Navy since the mid 1990s has acquired at least 38 submarines, 13 destroyers, 16 frigates, and dozens of naval aircraft—as well as likely making progress on producing its first aircraft carrier. The Chinese navy has also vastly increased its arsenal of advanced weapons, particularly antiship and land attack cruise missiles, and advanced naval mines. Of particular importance for the United States is China’s attempt to develop antiship ballistic missiles, specifically planned with U.S. aircraft carriers in mind. In this way, China has improved its capacity to impede U.S. military access to the region in the event of a crisis. While the Commission recognizes that it is not in our mandate to address net assessments, my own view is that if current U.S. defense programs continue to produce 10 new Ford-class aircraft carriers by 2040, as well as a fleet of fifth generation F-35 fighters, the PLA will likely remain a regional impediment for U.S. forces.

Significant developments in cross-Strait relations have occurred over the past year. Economic and political interaction has become significantly more robust since Ma Ying-Jeou became president in March 2008. During our trip to China in the spring, we visited Xiamen, opposite Taiwan, and saw evidence of these initiatives. It looks as if Beijing and Taipei may sign a free trade agreement early next year. Despite these developments, Beijing has demonstrated no indication of drawing down its military forces, especially its ballistic missile forces, across the Taiwan Strait, and the military balance continues to tip in China’s favor.

Finally, China’s espionage activities against the United States are increasing greatly. These activities can be categorized into two types: traditional human espionage and cyber espionage. Although attribution is a difficult problem in cyber attacks, the scale and coordination of the attacks strongly indicates Chinese state involvement. In addition to harming U.S. interests, Chinese human and cyber espionage activities provide China with a method for leap-frogging forward in economic, technological, and military development.

I also want to acknowledge our excellent staff and thank them for their superb work in preparing this year’s Annual Report.

For those of you who wish to pursue these issues further, I urge you to read our Annual Report. It will be posted on the Commission’s website at www.USCC.gov. And with that, we will be happy to take your questions. Please identify yourselves as you ask your questions.

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