MAJOR INTERNAL CHALLENGES FACING THE CHINESE LEADERSHIP

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BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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WASHINGTON : March 2006

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CONTENTS

THURSDAY, FEBRUARY 2, 2006

MAJOR INTERNAL CHALLENGES FACING THE CHINESE LEADERSHIP

Opening statement of Acting Chairman Carolyn Bartholomew…… 1
Prepared statement…….. 2
Opening statement of Commissioner Larry M. Wortzel, Hearing Cochair…… 2
Prepared statement…… 4
Opening statement of Commissioner William A. Reinsch, Hearing Cochair…… 79
Prepared statement…… 80

PANEL I: ADMINISTRATION VIEWS:
What Keeps Chinese Leaders Awake at Night, and
What are U.S. Leaders Doing in Response?

Statement of James R. Keith, Senior Advisor, Bureau of East Asian and Pacific Affairs, Department of State…….. 5
Prepared statement……. 8
Statement of Jerry Clifford, Deputy Assistant Administrator, Office of International Affairs, U.S. Environmental Protection Agency…… 11
Prepared statement…… 15
Panel I: Discussion, Questions and Answers……. 20

PANEL II: MAJOR INTERNAL CHALLENGES FACING

Statement of Dr. Flynt Leverett, Senior Fellow, Saban Center for Middle East Policy, Brookings Institution…… 35
Prepared statement…… 39
Statement of Dr. Elizabeth C. Economy, C.V. Starr Senior Fellow and Director, Asia Studies, Council on Foreign Relations…….. 39
Prepared statement…… 42
Statement of Dr. Bates Gill, Freeman Chair in China Studies, Center for Strategic and International Studies…… 50
Prepared statement…… 54
Panel II: Discussion, Questions and Answers…… 61

PANEL III: CHINA'S INTERNAL UNREST:
Worker Demonstrations, Civil Disobedience, Riots and other Disorder, and the Prognosis for the Future

Statement of Dr. Albert Keidel, Senior Associate, Carnegie Endowment for International Peace……. 81
Prepared statement…… 83

PANEL III: continued

Statement of Dr. Joshua Muldavin, Professor of Geography and Asian Studies, Sarah Lawrence College…… 92
Prepared statement…….. 96
Statement of David Welker, Senior Project Coordinator, International Brotherhood of Teamsters…… 99
Prepared statement…… 103
Panel III: Discussion, Questions and Answers……. 106

FRIDAY, FEBRUARY 3, 2006

Opening statement of Commissioner William A. Reinsch, Hearing Cochair…… 128
Prepared statement…… 129

PANEL IV: CHINESE CONTROL MECHANISMS

Statement of Dr. Murray Scott Tanner, Senior Political Scientist, The Rand Corporation……. 129
Prepared statement…….. 132
Statement of Dr. Anne F. Thurston, Independent Researcher…….. 132
Prepared statement…….. 136
Panel IV: Discussion, Questions and Answers…… 141

ADDITIONAL MATERIAL FOR THE RECORD

Letter to Commissioner D'Amato from James R. Keith, Senior Advisor, Bureau of East Asian and Pacific Affairs, February 8, 2006 on the Status of HIV/AIDS in China (LINK LETTER)

Letter to Commissioner D'Amato from James R. Keith, Senior Advisor, Bureau of East Asian and Pacific Affairs, February 15, 2006, on a recent development about HIV/AIDS in China. (LINK LETTER)

MAJOR INTERNAL CHALLENGES FACING THE CHINESE LEADERSHIP

THURSDAY, FEBRUARY 2, 2006

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

The Commission met in Room 1310, Longworth House Office Building, Washington, D.C. at 9:03 a.m., Acting Chairman Carolyn Bartholomew and Commissioners William A. Reinsch and Larry M. Wortzel, (Hearing Cochairs), presiding.

OPENING STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW, ACTING CHAIRMAN

ACTING CHAIRMAN BARTHOLOMEW: I want to welcome all of you.

I'm Carolyn Bartholomew, the Acting Chairman of the U.S.-China Economic and Security Review Commission, and I am pleased to welcome you all today to our first hearing in the 2006 reporting cycle. We're very honored also to announce the appointment and the swearing in of our newest commissioner, Kerri Houston. She will be joining us today for the first time. I'd like to recognize Ambassador Jim Lilly, who is in the audience today who served as a member of this commission, and obviously is one of the leading China scholars, China hands and former ambassador to China. Welcome.

Our hearing today is on the major internal challenges facing the Chinese leadership. This important hearing is being cochaired by Commissioner Bill Reinsch, who is presently testifying before the Senate Foreign Relations Committee, and Commissioner Larry Wortzel, who will take over for the morning panel.

I will just begin by saying that the U.S.-China relationship is one of great importance is an understatement. Our economies are intertwined for better or worse and there is a growing interdependence between China's economy and the economy of U.S. allies, both in the Pacific and in Europe.

During the past 25 years, since China began to implement economic reforms and open its economy, the world has witnessed a phenomenal surge in China's economic growth, ranging between eight to ten percent annually for most of that period.

Yet despite this tremendous progress, China's modernization is neither complete nor assured. Though the recent pace of China's modernization has been both rapid and steady, it has also been uneven, leaving wide swaths of the Chinese society and rural areas in particular far behind.

For the past 25 years, China's leadership and local officials have often favored economic growth and development over environmental and other social concerns.

Chinese leaders now confront the many difficult challenges that were set aside while they focused on economic growth. Economic upheavals, constrained natural resources, environmental degradation, migrant labor problems, worker dissatisfaction and unfunded social needs are contributing factors to China's growing social unrest.

At today's hearing, we will have an opportunity to explore the breadth and scope of China's internal challenges, examine the steps the Chinese are taking to address these challenges, and consider the implications for the United States if China is unable to adequately meet its challenges.

I will now turn the microphone over to Hearing Cochair, Commissioner Larry Wortzel.

[The statement follows:]

Prepared Statement of Commissioner Carolyn Bartholomew, Acting Chairman

Good morning and welcome to the U.S.-China Economic and Security Review Commission's hearing on Major Internal Challenges Facing the Chinese Leadership. This important hearing is being co-chaired by Commissioners Bill Reinsch, who is presently testifying before the Senate Foreign Relations Committee, and Larry Wortzel who will chair this morning's panels.

To say that the U.S.-China relationship is one of great importance is an understatement. Our economies are intertwined, for better or worse, and there is a growing interdependence between China's economy and the economies of U.S. allies, both in the Pacific and in Europe. During the past 25 years, since China began to implement economic reforms and open its economy, the world has witnessed a phenomenal surge in China's economic growth—ranging between 8 to 10 annually percent for most of that period. Yet despite this tremendous progress, China's modernization is neither complete nor assured. Though the recent pace of China's modernization has been both rapid and steady, it has also been uneven, leaving wide swaths of the Chinese society—and rural areas in particular—far behind.

For the past 25 years China's leadership and local officials have often favored economic growth and development over environmental and other social concerns. Chinese leaders now confront the many difficult challenges that were set aside while they focused on economic growth. Economic upheavals, constrained natural resources and environmental degradation, migrant labor problems, worker dissatisfaction, and unfunded social needs are contributing factors to China's growing social unrest.

At today's hearing we will have an opportunity to explore the breadth and scope of China's internal challenges, examine the steps the Chinese are taking to address these challenges, and consider the implications for the United States if China is unable to adequately meet its challenges. I will now turn the microphone over to Hearing Cochair, Commissioner Larry Wortzel.

OPENING STATEMENT OF COMMISSIONER LARRY M. WORTZEL, HEARING COCHAIR

HEARING COCHAIR WORTZEL: Thank you, Madam Chairman. Good morning. I want to join Chairman Bartholomew in welcoming our distinguished guests and witnesses and welcome also to Commissioner Houston.

China has achieved a really remarkable economic expansion with strong annual growth and that surge in growth among other things has facilitated the modernization of China's military and it's encouraged a

Chinese leadership that's really a lot more confident and assertive in foreign affairs.

When China's Communist Party leaders on its Politburo Standing Committee meet, they plan for increasing China's comprehensive national power, and that formulation involves strengthening China's military, economic, diplomatic and cultural power, and their goals are for a powerful nation with global reach and influence.

As China rises to meet these goals, its neighbors in Asia and many American military and political leaders are concerned that China will eventually emerge as a competitor that will challenge the leadership the United States and its allies provide in the region and upset a delicate balance of power.

A straight-line analysis forecasts China achieving economic parity with the United States by the middle of this century. So American leaders have to adjust their own plans on the possibility that China will achieve these goals.

But frankly, there is no guarantee of a straight-line outcome, and that's really what today's hearing is about. Chinese leaders may plan for achieving this status, but they confront very serious domestic challenges that could easily derail or delay their own hopes for China's rise.

There's economic hurdles, environmental degradation, shortfalls, serious shortfalls in the social welfare programs, and these things have provoked growing dissent in China.

Confronted with the dissent, concerned with their hold on power, the Chinese leadership has demonstrated its own resolve to maintain an authoritarian one-party control and it's doing that in some cases through expanded censorship of public debate and crackdowns on public protests.

So what we hope to do today is to examine China's key domestic challenges, the manner in which Chinese society and its leadership are addressing those challenges, and how these issues might affect U.S. economic and security interests.

We are pleased to welcome two executive branch officials to our first panel to talk about what keeps Chinese officials awake at night. Mr. Jim Keith is State Department Senior Advisor for East Asian and Pacific Affairs. He's a career Foreign Service Officer who served overseas in embassies in Beijing, Jakarta and Seoul, and he was the Consul General in Hong Kong.

I have to say he was in Beijing under Ambassador Lilly, and serving next to me at one time, so I have a lot of faith in everything Jim says and does. He is a good solid guy and a good officer.

I just met Mr. Jerry Clifford, the Deputy Assistant Administrator for International Affairs at the U.S. Environmental Protection Agency. He has over 25 years experience at EPA. He has managed to make some inroads with China's own environmental management people and we're eager to hear his views of China's environmental challenges and the actions that China has taken to address these issues.

Now, I'd like to spend a moment talking about the order of events for you two. The oral remarks should be seven minutes in length if you're able to do that. We can accept longer written statements and documentation for the hearing

We've got electronic problems. I have a watch and I can see the clock so I'll give you a little high sign if you're starting to run over.

Mr. Keith, the floor is yours. Thank you.

[The statement follows:]

Prepared Statement of Commissioner Larry M. Wortzel, Hearing Cochair

Good morning. I join Chairman Bartholomew in welcoming our distinguished witnesses and guests. Welcome also to Commissioner Houston.

China has achieved a remarkable economic expansion with strong annual growth. This surge in economic growth has, among other things, facilitated the modernization of China's military and encouraged a Chinese leadership that is confident and assertive in international affairs.

When China's Communist Party leaders on Politburo Standing Committee meet, they plan for increasing China's "comprehensive national power." This formulation involves strengthening China's military, economic, diplomatic, and cultural power. Their goals are for a powerful nation with global reach and influence.

As China rises to meet these goals, its neighbors in Asia, and many American military and political leaders, are concerned that China will eventually emerge as a competitor that will challenge the leadership the United States and its allies provide in the region and upset a delicate balance of power. Straight-line analysis forecasts China achieving economic parity with the United States by the middle of this century. American leaders must base their plans on the possibility that China will achieve these goals.

Nonetheless, there is no guarantee of a straight-line outcome. Chinese leaders plan for achieving this status for China, but they still confront serious domestic challenges that could easily derail or delay China's rise. Economic hurdles, environmental degradation, and shortfalls in China's social welfare programs have provoked growing public dissent. Confronted with this dissent, and concerned with their on hold on power, the Chinese leadership has demonstrated its resolve to maintain authoritarian, one-party control through expanded censorship of public debate and violent crackdowns on public protests.

This hearing seeks to examine China's key domestic challenges, the manner in which Chinese society and its leadership are addressing those challenges, and how these issues might affect U.S. economic and security interests.

We are pleased to welcome two executive branch officials to our first panel to discuss "What keeps Chinese officials awake at night?" Mr. James Keith is the State Department's Senior Advisor for East Asian and Pacific Affairs. He is a career Foreign Service Officer who has served overseas assignments at the U.S. Embassies in Beijing, Jakarta, and Seoul, and was Consul General in Hong Kong.

We are also pleased to hear from Mr. Jerry Clifford, the Deputy Assistant Administrator for International Affairs of the U.S. Environmental Protection Agency. He has over 25 years of experience at EPA. We are eager to hear his assessment of China's environmental challenges and what actions China is taking to address these issues. I thank you for taking the time to join us today and I look forward to your testimony.

This morning's second panel will discuss the "Major Internal Challenges Facing the Chinese Leadership." The panelists are experts working outside the U.S. government.

Dr. Flynt Leverett is a Senior Fellow with the Saban Center for Middle East Policy at the Brookings Institution. His work focuses on the Middle East and he recently completed a research article entitled, "China and the New Geopolitics of Middle Eastern Energy."

Dr. Elizabeth Economy is the Director of Asia Studies at the Council on Foreign Relations. She is an expert on Sino-American relations and Chinese domestic and foreign policy, with particular focus on the environment. Her
recent book, *The River Runs Black*: *The Environmental Challenges to China's Future*, was named one of the top 10 books of 2004 by *The Globalist* and best social sciences book published on Asia in 2003 or 2004 by the International Convention on Asia Scholars.

Dr. Bates Gill holds the Freeman Chair in China Studies at the Center for Strategic and International Studies. Dr. Gill is a specialist in East Asian foreign policy and politics, primarily focusing on China's domestic transformation, China's regional diplomacy, and U.S.-China relations.

My co-chair for these hearings, Commissioner William Reinsch will be joining us a little later this morning.

I want to remind all panelists that the Commission welcomes oral remarks up to seven minutes in length. We will accept longer written statements and documentation for the hearing record.

Mr. Keith, the floor is yours for seven minutes.

PANEL I: ADMINISTRATION VIEWS: What Keeps Chinese Leaders Awake at Night, and What are U.S. Leaders Doing in Response?

STATEMENT OF JAME R. KEITH, SENIOR ADVISOR, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, DEPARTMENT OF STATE

MR. KEITH: Thank you very much. It's a pleasure to be back and an honor to be part of your opening session. I think you've chosen wisely a very salient topic, and I certainly want to associate myself, Madam Chairwoman and Commissioner Wortzel, with your comments. The insight that you already have is gratifying to me and it makes me wonder if I have much to add to what you already know about this, but I'd be certainly very happy to put a few things on the table that might help you as you raise questions throughout the hearing.

I also want to pay tribute to Ambassador Lilly. Like Commissioner Wortzel, I learned a lot through my experience working for him over the years, but all the mistakes I make today, of course, are my own and not his. So please don't blame him.

It is an honor to be here. I'm pleased that you chose this particular topic. I should mention that having just returned from China with the Deputy Secretary of State, the question you pose, that is what keeps Chinese leaders awake at night, was precisely one that he put to the governor of Sichuan Province during a brief stopover in Chengdu after he'd been in Beijing.

I should describe to you in very general terms that the governor's response sounded very much like a response that one might get from asking the same question of the governor of an American state. He essentially described the problems of economic growth and his concern for advancing the standard of living and sustaining the rate of economic growth and everything that goes into it, and I think that's

something of an insight into the kinds of problems you raised and opportunities you raised in your opening remarks.

I think it's useful as an analytical tool to talk a little bit about the internal challenges facing China and how they also fit into the international challenges, because I think you can't separate the two.

Clearly, there are questions of strategies and resources on the daunting task of economic modernization. I think it's certainly right to look to the future when the next quadrupling of GDP occurs and try to define what China will be and how it will define itself. I think one of the key challenges for China looking ahead is assuming it can sustain the internal success that it's had. Twenty-six years of 9.5 percent growth has created a class of Chinese citizens who have new expectations and new demands on the government, new awareness of what's happening in the outside world because of their travel, because of their interaction with the outside world through business, because of their children's study abroad.

For any number of reasons, you have a new class of people in one of the economies in China, that is the coastal economy that is doing so well, that has this traditional or recognized perspective of rising expectations and a successful economy. The dislocations that come with that, however, are clearly the focus of the Chinese government.

In the Five-Year Plan that is now under consideration and will go before the National People’s Congress in March for ratification, the Chinese government is focused on the question of harmonizing society, and I think simply by focusing on that subject, they acknowledge that there are severe inequities throughout Chinese society and that this is an issue for them to focus on in the future and at the present.

These inequities include urban versus rural problems, coastal versus interior problems. Throughout Chinese society, you have a polarization that is creating a real focus on social stability and order, something like 80,000 incidents related to social disorder according to the Chinese government statistics last year.

This is forcing the Chinese to make a number of decisions, some of them good and some of them not so good from our perspective, including some backwards steps that we've seen with regard to press freedom and the operation of non-governmental organizations in China of late.

These backward steps related very directly to Chinese government concern about social order and stability, reflecting I think something that is worth bringing out, a very distinct and fundamental difference between us, the Chinese government and the U.S. government, with regard to the broad question of human rights. I think the Chinese have come to understand that our intent in pursuing human rights issues in China is very clearly, and this on the basis of the president's enunciation on down through other senior officials, very clearly aimed at what we believe is necessary for China to succeed in this modernization effort.

From our perspective, unless they tap the full potential of their people, unless they allow the exercise of various freedoms, they

won't be able to achieve the goal. So it's on the basis of a desire to see China succeed, to have it be confident and stable, secure, that we believe they need to protect fundamental freedoms.

Clearly, the Chinese have a different view of this, and have essentially aimed their efforts at expanding economic reform as quickly as possible, bringing political reform along behind in a modulated fashion. Generally the phrase that the Chinese use is "gradual and orderly."

From our perspective and one that we enunciate to them on a regular basis, whether it's on the subject of Internet usage or free-flow of information across provincial borders or allowing more press freedom, our perspective is that these kinds of steps to implement what is in the Chinese constitution and to protect the fundamental freedoms that are defined in the Universal Declaration of Human Rights will provide China the wherewithal through tapping the full potential of its people to achieve its economic goals.

Clearly it's had tremendous success on the economic side so far. The track record would suggest that those 26 years of 9.5 percent growth will continue to propel China further into the higher ranks. Just to cite a few specifics for you, China is now the world's third-largest trading nation, the fourth-largest economy most recently, and at the same time, though one has to recognize that it's in many respects still a very poor country.

Per capita income is about $1,700 and this I think illustrates part of the problem for China. If the Americans were to define for China the most serious challenge, I suspect we would focus on rule of law and the need for China to undertake reforms that would bring to the economy and the society everything that goes with a deeply based system of the rule of the law, including the kinds of transparency that would on the military side, for example, preclude some of the hedging that goes on around the world because we are uncertain about China's future and we are uncertain about its goals and how it will define itself.

I think from the Chinese perspective, they would include the rule of law and all the challenges that go with it in a broader question. For them the major issue, the biggest challenge, what really keeps them awake at night, is to define themselves in the future.

I think they've set the tactical goals. They know what the benchmarks are that they want to achieve in terms of quantification of success, quadrupling the economy or improving per capita income, but the larger question for them, the conceptual problem for China, is for the time being do they define themselves as more of a developing nation or more of a developed nation, and for the future, once they succeed and become a developed nation, what are the consequences and how do they define their responsibilities?

This is what the Deputy Secretary had in mind, I think, when he made the point that China should be a responsible stakeholder in the international system, contributing as much to it as it benefits from it, and for the Chinese, I think, society in transition facing the economic

dislocations, facing the social dislocations, it's very difficult for them in their own minds to determine precisely where they are at present.

Increasingly they're defining their goals and objectives and defining success for themselves in terms that are convergent with our own and this is a gradual process, and it's moving faster in some sectors than others. As I mentioned, for example, on the internal side, with respect to press freedom, this is not moving as quickly as we would like. In fact, we've seen real setbacks.

In other areas, such as regional stability and global trade liberalization, we're seeing a little bit more from China, and perhaps seeing China look to its long-term interests in a way that converges with ours.

Another example is the tremendous challenge of energy imports for China. It's already importing I think it's something like half of its oil and that's only going to increase in the time ahead. I think if you look at China's perspective on the import of energy, as they look to the Middle East, they increasingly have a long-term view that's convergent with our own. That is they're looking for stable sources of supply of energy. They're looking for stability in the Middle East, and that argues for working with us and with the EU and other permanent members of the U.N. Security Council on issues like Iran.

So around the world, whether it's on the security or the trade side, I think we're starting to see China converge with our interests over time, but internally I think it's going to take a lot longer for those sorts of perspectives to work their way through the system, and with that, I recognize that my time is up.

[The statement follows:]

Prepared Statement of James R. Keith, Senior Advisor, Bureau of East Asian and Pacific Affairs, Department of State

Mr. Chairman, Commissioners, thank you for inviting me to participate in today's hearings to discuss the major challenges facing China's leadership. How China deals with these challenges – creating jobs for the more than 20 million people who enter the job market each year, finding enough energy to continue fueling its nearly ten percent growth per year, expanding the fundamental freedoms of its citizens, ensuring that the summer Olympics which it hosts in 2008 will be a showcase for China's successes – and the choices it will make to sustain its remarkable progress of the past twenty-five years will tell us much about the kind of country China will become. You have excellent panelists who will address this important topic throughout the day and I too look forward to hearing their views.

For the Administration's part, as the Secretary of State has said, a confident, peaceful and prosperous China is in America's interests and in the interests of our allies and friends in the Asia-Pacific and the world. The choices are China's, of course, but America has a role to play in helping China shape those choices. Our goal, as the Deputy Secretary has said, is to engage China in ways that will lead it to become a responsible stakeholder in the international system.

The statistical data underlining China's economic success are well known. The economy has grown at an average annual rate of more than 9.5% for the past 26 years. A recent national economic census revised recent growth rates upward: 10.1% for 2004, 9.9% for 2005, and more of the same for 2006, making China the world's fourth largest economy, surpassing France and Britain, with a GDP of $2.24 trillion.

In addition, China is now the world's third largest trading nation. China's growth and the modernization of its economy has benefited greatly from its access to the open, rules-based trading

system. Commensurate with those benefits, and its role in the world trading system, China now shares responsibility for maintaining the trading system and global economic growth. This past year it registered a trade surplus of over $100 billion, three times the surplus of the year before. China must play its part in addressing the global imbalances that have arisen in the past four years of rapid world growth. This means following through on China's commitment to establish a market-based, flexible exchange rate.

China is also a country that plays an increasingly greater role on a variety of transnational issues, from promoting the adoption of clean energy technology via the Asian-Pacific Partnership on Clean Development and Climate, which recently held a meeting in Australia, to finding ways to block the spread of Avian Influenza. As you know the Chinese recently hosted an Avian Influenza donors meeting in Beijing, where they pledged $10 million to assist the global community in dealing with this serious health crisis.

Behind the numbers, behind the successes, are problems, which Chinese leaders themselves have acknowledged. China remains a poor country - with a population of 1.3 billion people, per capita income is about $1,700. Contrast that to U.S. per capita income which was an estimated $40,100 in 2004.

Rapid change has exposed – indeed, sometimes created – serious inequities and structural weaknesses. China may be a richer society, but those riches are not evenly distributed, especially with more than 200 million people living below the poverty line, defined by the World Bank as a dollar a day. The incomes of urban dwellers are four times those of people in the countryside, where 800 million of China's 1.3 billion people live. Residents in the rural areas of China's vast interior are keenly aware that they are considerably poorer than those in the cities, and have worse health care, worse education, and inadequate social welfare services and infrastructure. They suffer in particular from land degradation, falling water quality, polluted and scarce water resources, severe air pollution, and deforestation.

The people of China are increasingly aware of their personal and legal rights, and are willing to assert them, but are often unable to secure protection from the very courts and legal institutions to which they are appealing. Laws are on the books, but they are not effectively enforced. It is no surprise discontent is rising, and sometimes expressed in disturbing ways. President Hu Jintao and Premier Wen Jiabao clearly want China to be a "harmonious society," as well as a rich one, but the Chinese Government's own figures show that public protests have risen sharply – 87,000 public order disturbances in 2005, up from 74,000 the year before. It's these popular protests, sometimes violent, over uncompensated land seizures, arbitrary and illegal taxes, and the failure to pay workers their wages that partly account for the sense of unease Chinese leaders feel upon the path of modernization. As you asked in your invitation to this hearing, it's what keeps them up at night.

With the withdrawal of the cradle to grave "iron rice bowl," many in China are not sure they have sufficient financial resources to care for their retirement and their families' medical needs. The absence of an adequate social safety net for 80% of Chinese between the ages of 45 and 65, along with a lack of insurance, annuity and savings products, has serious economic consequences; it accounts, in large part, for an extremely high rate of personal savings. In 2004, personal savings were 25% of GDP, a staggering amount given China's still low per capita income. Since China's capital markets are still forming, it is difficult for this savings to be put to productive use as domestic investment. It also limits domestic personal consumption, leaving China overly reliant on exports and foreign direct investment for growth.

The government and party recognize that they need to find ways to deal with – as happened in prosperous Guangdong province this past December 2005 – protests that sometimes lead to injury or deaths of rural residents in clashes with paramilitary police and hired thugs, who may be in the pay of local power brokers. As Premier Wen said in a speech December 29, "we absolutely can't commit an historic error over land problems."

Also keeping the leaders up at night is a pervasive sense that, while they can raise standards of living, they may also be breeding levels of corruption that turn people against the government and that in turn lead to demands for the kind of public accountability for which the government and the party historically have been averse. In other words, China's economic "miracle" is unfolding at a high cost, not just in terms of environmental degradation and public health, but also in terms of an erosion of social and ethical values.

And as Beijing looks at the world around it, it sees a flow of information into China – not just from the internet but from cell phone conversations, text messages and a large and growing foreign business, student and tourist presence – that challenges old ways of doing things, from political organization to religious movements. Cell phones in the year 2006 are what faxes were in conveying information in China in the late 1980s. In fact, there were 390 million cell phone users in China in 2005, up 15 percent from the year before. China is also concerned about the "color revolutions" of Central Asia and wants to ensure that such movements do not take root in China. This certainly accounts for the great sensitivity to calls for greater autonomy in China's western provinces, especially by people in Xinjiang, where the Chinese are concerned that ethnic Turkic Muslims will make common cause with Muslims in the "Stans" and threaten China's control in the region. And in Tibet as well, where the Chinese believe that the Dalai Lama's agenda is to separate Tibet from China.

In the region, there remain serious tensions with Japan over a variety of issues, even as trade and investment ties deepen and the number of people traveling between the two countries increases. To mention just three: military modernization, energy and history. The first of these three – military modernization – is, of course, a problem that concerns others beside Japan, especially the lack of transparency in China's build-up as well as the lack of clarity about China's operational capabilities. China's ever increasing demand for global energy resources will also impact countries not just in Northeast Asia, but around the world. But this is not the place for an extended discussion of these important issues.

And of course, there is always the great challenge that keeps them up at night: what to do about Taiwan. China is engaging selected representatives of the people in Taiwan, but it has declined to meet with the ruling party. In the interim, China will, of course, seek to use the inducements of a great and growing market for trade and investment to attract Taiwan businesspeople who may see their economic futures as closely intertwined with those of Chinese on the mainland.

As I noted earlier, it is China's people and government who will address these challenges. What can the U.S. do to help shape some of the choices they make?

We are prepared to work with China to assist in its efforts to build a society governed by the rule of law, respectful of international human rights standards, and tolerant of people of faith. In addition to our diplomatic efforts to promote human rights and religious freedom, we also underwrite programs through the Department of State's Rule of Law program – currently funded at nearly $23 million by Congress – to support legal reform, encourage public participation, and help strengthen civil society in China.

We are also prepared to work with China on a variety of financial, environmental, health-related and energy issues. Resolution, whether a chemical spill on the Heilong River, a pandemic disease, or improved energy efficiencies, will be vital to China's future. Let me cite a few specific examples:

- The U.S. Treasury Department regularly consults with senior Chinese officials on macroeconomic and financial issues, and has begun a dialogue among US and Chinese financial regulators. A senior Treasury official has been assigned to our Embassy in Beijing and should arrive within the next few months.

- The U.S. Trade Representative and the Secretary of Commerce regularly take part in high-level meetings with the Chinese and their staffs and are in near daily touch with counterparts in China, discussing market access, intellectual property and next steps in reaching an agreement in the Doha Development Round.

- The Department of Energy has a high-level and comprehensive bilateral energy dialogue with its Chinese counterpart to improve the efficiency of coal and oil use, and to spur research into alternative sources of energy. Also, DOE has recently established a permanent full-time office at the U.S. Embassy in Beijing.

- The Department of Labor is conducting programs in China on labor law and mine safety, and has letters of understanding with the Chinese on mine safety, occupational safety, pensions, and wage and hour law. The Federal Mediation Service has visited China several times, most recently in November and

December of last year to discuss ways in which disputes can be resolved without recourse to the judicial process.

- The Environmental Protection Agency has a regular dialogue with Chinese environmental officials.

- The White House Science Advisor, the Chairman of the Council on Environmental Quality, the Under Secretary for Global Affairs at the State Department and other government agencies similarly engage in wide-ranging discussions on science, technology, and environmental matters.

- And HHS, whose components (NIH, the Centers for Disease Prevention and Control, Office of Public Health Emergency Preparedness and the Food and Drug Administration) work closely with Chinese counterparts on emerging infectious diseases, such as Avian Influenza, HIV/AIDS, and SARS as well as on other efforts that will ultimately improve the disease surveillance and response networks in China.

I should also add here the Senior Dialogue between Deputy Secretary Zoellick and PRC Executive Vice Foreign Minister Dai Bingguo. It is truly a broad strategic discussion in which the two sides are able to take a look over the horizon at where we want to be in the next 15 to 20 years and then to think creatively about how we might cooperate together to get there. The Deputy Secretary has used a phrase – work with China to become a responsible stakeholder in the international system from which it benefits – that I think captures the goal of this discussion. In fact, he was just in China last week for very good meetings and discussions with leaders in Beijing and Chengdu. In addition to the Senior Dialogue, State also leads a discussion with China's National Development and Reform Commission on macroeconomic and structural reforms.

Clearly there is a fertile agenda, both at the senior levels of leadership through more frequent Presidential meetings and the personal involvement on a daily basis of key cabinet officials, such as the Secretary and the Deputy Secretary of State, as well as senior White House officials. I've cited examples to indicate the breadth of our agenda just to give you a sense of how much is going on and how many meetings there are directed at addressing the bilateral, global or regional challenges that confront our two countries.

Mr. Chairman, as the President has said, we want to build a strong, respectful, co-operative relationship with China. We want to see China become a prosperous nation and a responsible member of the international community. We are prepared to work with China to achieve that important end and meet the challenges that confront it in ways consistent with America's core values and interests.

HEARING COCHAIR WORTZEL: Thank you very much. Your comment about greater transparency precluding hedging, I think, is a very important one and it's something that I'm going to take to heart when I talk about it. I think it's an important point.

Mr. Clifford, the floor is yours.

STATEMENT OF JERRY CLIFFORD, DEPUTY ASSISTANT ADMINISTRATOR, OFFICE OF INTERNATIONAL AFFAIRS, U.S. ENVIRONMENTAL PROTECTION AGENCY

MR. CLIFFORD: Thank you and good morning, Vice Chairman Bartholomew, Commissioner Wortzel, distinguished members and commissioners of the China Commission.

It is truly an opportunity to be here before you and talk possibly for the first time about environmental challenges in China. I'm pleased to join Mr. Keith here with you to represent the administration's perspective on these particular challenges.

When I was first asked to make a presentation before the commission, I was advised to focus on the key environmental challenges

in China, the efforts China's leadership are undertaking to address these challenges, and the steps the United States government is taking to assist these efforts.

When I received the agenda for today's hearing, I noted that the title for this panel had been changed to read "What Keeps Chinese Leaders Awake at Night?" Well, I think the answer to that is relatively easy: 1.3 billion people. China has an enormous environmental footprint on the planet.

It is only getting larger as its economy speeds forward and it is responsible for an ever-increasing portion of the world's manufacturing, and as Chinese people begin to enjoy some of the consumer comforts that citizens in the United States and other parts of the developed world enjoy, that's going to create additional burdens on the world's environment.

The cumulative impact of 1.3 billion people will grow dramatically as incomes and purchasing power continue to increase. For example, right now, China's per capita annual income is $1,700 compared to over $40,000 in the United States.

What may be keeping leaders up at night is how to improve the efficiency of their industrial sector and balance the high cost of needed environmental improvements.

It's important that our understanding of China is limited with respect to the environment. Our efforts are hindered by a Chinese government that controls information and access to that information. In many cases, the U.S. must rely upon data that has been provided by the government, some of which is inconsistent with information that is gathered and produced by other people collecting information in country.

In other instances, we have had to work with no data at all, though we've had some success in collecting new data, especially when cooperating with universities and technical institutes.

From what we have been able to learn about China's new Five Year Plan, China's leaders intend to address industrial pollution, energy efficiency, as well as some of the environmental infrastructure inequities between urban and rural populations.

The United States has shown over the past 35 years, and EPA just celebrated our 35th anniversary, that significant economic growth is not inconsistent with dramatic reductions in environmental pollution.

More than 90 percent of China's energy consumption relies on fossil fuels, the combustion of which leads to greenhouse gas emissions and air pollution such as ozone, fine particulates, mercury and acid rain. These are all pollutants for which no boundaries exist globally.

NASA, NOAA and EPA have been collaborating with other researchers in the U.S. and abroad to study the long-range transport of aerosols and other air pollutants in the northern hemisphere. We are gaining a better understanding of how this pollution moves from continent to continent and are seeing episodes of pollution in the form of ozone precursors, particulate matter and mercury transported from Asia to North America.

In April of 2001, satellites observed a dust cloud originating in the Gobi Desert in Inner Mongolia, gathering air pollution as it traveled over China, then over the Pacific Ocean and ultimately reaching as far as the east coast of the United States.

China is expected to overtake the U.S. as the world's largest emitter of greenhouse gases in the next 20 to 25 years. In addition to its high levels of carbon dioxide emissions from coal combustion, China also is the world's largest emitter of methane and the largest emitter of coal mine methane, accounting for 40 percent--40 percent--of the global total.

EPA is helping China develop methane recovery technologies for coal mines and landfills and we're assisting China to capture and use its coal mine methane, which will have added benefit to reducing mining deaths from accidental explosions which we read about regularly here in the United States.

China's current air pollution problems stem in large measure from weak air pollution controls on coal-fired power plants. Two-thirds of China's total energy comes from coal. By comparison, coal is responsible for 22 percent of the energy produced in the United States.

In 2003, China burned 1.6 billion tons of coal, three times the amount burned in the United States.

As much as 75 percent of the mercury deposited in the United States today is from sources outside of the United States and China is one of the largest of those sources.

The high incidence of premature deaths in China has been linked to ambient and indoor air pollution in China. The World Health Organization estimates that there are as many as 450,000 premature deaths from indoor air pollution alone. The State Environmental Protection Administration statistics show more than two-thirds of China's urban residents live in cities with poor air quality.

A study by the World Health Organization just a few years ago indicated that seven of the dirtiest of the ten dirtiest cities in the world from an air pollution perspective are in China.

Pollution from vehicles is also making up an ever-increasing percentage of the problem. The Beijing Environmental Protection Bureau estimates the vehicular share of air pollution to be 79 percent.

And as those of you who have visited China like Mr. Keith over the years have seen, automobiles are rapidly replacing the bicycles. Energy efficiency has been a national policy in China since 1980, and from '80 to 2000, Chinese energy use increased at half the rate of economic growth.

However, since the 1990s, energy demand has been growing at an ever-increasing rate at over one and one-half times the rate of economic growth.

Let me move a minute to a program that China, India, Japan, South Korea and Australia joined with the U.S. in announcing just last year, an initiative to reduce air pollution and greenhouse gases in the Asia Pacific region. These six countries, which account for about half the world's population, half the world's GDP, energy use and greenhouse

gas emissions, form the Asia Pacific Partnership on Clean Development and Climate.

The partnership will develop, demonstrate and implement cleaner and lower emission technologies. The partnership expects to marshal considerable resources, financial, human and other, from both the public and private sectors to help address these problems in the Asian Pacific region.

In the limited time I have left, let me focus most recently on the November 2005 chemical spill in the Songhua River following an explosion at the China National Petroleum Company near Harbin. This provides a valuable lesson for all of us.

As you may know, the Chinese public was not notified of the spill for more than a week. And water intake at water treatment plants had to be shut down at cities downstream to prevent contamination, nitro-benzene, from contaminating water supplies and equipment.

The U.S. offered assistance immediately to China, which was subsequently declined. As the toxic plume approached the city of Harbin, there was a run on bottled water and public confusion about the nature of the contamination as unofficial Web sites filled the information vacuum with wide-ranging reports.

China did invite a team of experts from the United Nations Environment Program, but this international team was not allowed to visit the site, the site of the accident, nor were they allowed to take water samples.

The data provided by the Chinese authorities led U.S. and UNEP experts to conclude that the situation was steadily improving and that the Chinese response had been appropriate and sufficient.

We will learn as time passes on exactly how efficient and how sufficient their response was. In December, China announced that it would spend $3.2 billion over the next five years to improve drinking water quality to communities along the Songhua River.

When two more chemical spills followed before the end of the year, the Chinese government announced it would be addressing the threat to surface water from chemical plants in their 11th Five-Year Plan, and on January 8, China published its first National Emergency Response Plan.

Our work in China has increased dramatically over the last few years. We now have a memorandum of understanding with the China State Environmental Protection Administration. We are working on a similar MOU with the Ministry of Water Resources. We are beginning to develop a good working relationship with the Ministry of Science and Technology.

But their challenges are enormous, far more than we can help them address. Their resources that are devoted to environmental protection are minuscule for a country of 1.3 billion.

Our challenge here in the U.S. is that their pollution is ultimately affecting the lives and the public health of citizens in the United States. That's what drives our interest in China and to that end, that's where we hope to be able to help them make improvements.

I have a longer written statement submitted for the record, and I appreciate your time for my public statement, and would be happy with Mr. Keith to answer any questions you may have at this time.

Thank you.

[The statement follows:]

Prepared Statement of Jerry Clifford, Deputy Assistant Administrator, Office of International Affairs, U.S. Environmental Protection Agency

Thank you, Chairman Reinsch and Chairman Wortzel for this opportunity to take part in the opening panel of the Commission's public hearing on "Major Challenges Facing the Chinese Leadership." I am pleased to join James Keith, the State Department's Senior Advisor for China in presenting the Administration's perspective on these challenges.

Two weeks ago, when I was asked to make a presentation before the Commission, I was advised to focus on the key environmental challenges in China, the efforts China's leadership are undertaking to address these challenges, and the steps that the United States Government is taking to assist these efforts. Yesterday, when I received the agenda for today's hearing, I saw that the title for this panel had been changed to read "What keeps Chinese Leaders Awake at Night?" Well that's easy. 1.3 billion people.

China has an enormous environmental footprint on the planet and it is only getting larger as its economy speeds forward, as it is responsible for an ever larger portion of the world's manufacturing, and as the Chinese people begin to enjoy some of the consumer comforts that citizens in the United States have known for decades.

The cumulative impact of 1.3 billion people will grow dramatically as incomes and purchasing power increase. Right now China's per capital annual income is $1,700 compared to over $40,000 in the U.S. Continued economic growth and increasing personal income are top priorities for China's leaders. What may be keeping them up at night is how to keep up the pace of economic growth by improving the efficiency of their industrial sector and balancing the high cost of a lot of needed environmental improvements.

It is important to recognize that our understanding of China is limited. Our efforts are hindered by a Chinese government that controls information and access. In many cases, the U.S. must rely upon data that has been provided by the government, some of which is suspect. In other instances we have had to work with no data at all, though we have had some success in collecting new data, especially when cooperating with universities and technical institutes.

From what we have been able to learn about China's new Five-Year Plan, China's leaders intend to address industrial pollution, energy efficiency, as well as some of the environmental infrastructure inequities between the urban and rural populations. The plan also calls for local officials to be evaluated in part on the basis of their environmental performance.

There are only a few numeric targets in the plan including: doubling the per capita gross domestic product (GDP) of 2000 by 2010; reducing energy consumption per unit of GDP by 20% of 2005 levels by 2010; and increasing renewable sources of energy to 5% by 2010. Reaching these targets will mean a lot for China's environmental quality, but it also will mean a lot for the United States and the global environment.

The United States has shown over the past 35 years that significant economic growth is not inconsistent with dramatic reductions in environmental indicators. Since 1970, our GDP has grown by 187%, we are driving our vehicles 171% many more miles every year, energy use is up 47%, and our population has grown by 40% – even as we have reduced the aggregate emissions of the six major air pollutants by over 50%.

It is in our national interest that China decouple its emissions growth from its economic growth. This is true in the broad economic sense that unsustainable growth and hard landings in the Chinese economy now affect global growth and trade. But we are also learning more and more over time about China's global environmental footprint.

More than 90% of China's energy consumption relies on fossil fuels, the combustion of which leads to greenhouse gas emissions and air pollution such as ozone, fine particles, mercury and acid rain. NASA, NOAA and EPA have been collaborating with other researchers in the U.S. and abroad to study the long range transport of aerosols and other air pollutants in the northern hemisphere. We are gaining a better understanding of how pollution moves from continent to continent, and are seeing episodes of pollution in the form of ozone precursors, particulate matter and mercury transported from Asia to North America.

In April 2001 satellites observed a dust cloud originating in the Gobi Desert in Inner Mongolia gathering air pollution as it traveled over China, then over the Pacific Ocean, and ultimately reaching the East Coast of the United States. Other data is demonstrating the impact of emissions released in the United States on foreign receptors. We will continue in the coming years to study this hemispheric transport of air pollutants so that we can better understand the hemispheric-wide impacts of emissions of different pollutants from different regions.

China is expected to overtake the U.S. as the world's largest emitter of greenhouse gases (GHG) in the next 20 to 25 years. In addition to its high level of CO2 emissions from coal combustion, China also is the world's largest emitter of methane, and the largest emitter of coal mine methane, accounting for 40% of the global total. EPA is helping China to apply methane recovery technologies for coal mines and landfills under the Methane to Markets Partnership, the international initiative that focuses on advancing cost-effective, near-term methane recovery and use as a clean energy source. Assisting China to capture and use its coal mine methane has the added benefit of reducing mining deaths from accidental explosions.

China's current air pollution problems stem, in large measure, from weak pollution controls on its coal-fired power plants. Two-thirds of China's total energy comes from coal. By comparison, coal is responsible for 22% of the energy produced in the U.S.

The high incidence of premature deaths in China has been linked to ambient and indoor air pollution in China. The WHO estimates that there are as many as 450,000 premature deaths from indoor air pollution alone. China has a high incidence of respiratory disease, with chronic obstructive pulmonary disease being the leading cause of death—a disease burden more than twice the average for developing countries. The State Environmental Protection Administration (SEPA) statistics show that more than two-thirds of China's urban residents live in cities with "poor" air quality. EPA is working with China to apply assessment and modeling tools to better characterize regional air pollution in order to help decision makers develop more effective policies.

Urban ambient concentrations of SO_2 and particulate matter in China are among the highest in the world. While SO_2 concentrations overall are declining in many parts of China as more and more pollution controls for SO2 are installed at power plants, the problems associated with transport of SO_2, specifically acid rain and fine particles, are worsening. Approximately one-third of the country now experiences severe acid rain. EPA is working with SEPA to develop an air pollution cap and trade program in the power sector, but many obstacles remain, including lack of effective monitoring, enforcement, and incentives.

Pollution from vehicles is making up an ever-increasing percentage of urban air pollution. The Beijing Environmental Protection Bureau (BEPB) estimates the vehicular share of air pollution to be 79%. EPA is working with SEPA and the BEPB to demonstrate advanced emission control devices on municipal buses, to assist in developing sound low-sulfur transportation fuel policies, and to establish effective compliance and enforcement programs.

Energy efficiency has been national policy in China since 1980, and from 1980 to 2000, China's energy use increased at half the rate of economic growth. However, since the late 1990s, energy demand has been growing at over one and one-half times the rate of economic growth. To generate every U.S. dollar of GDP, China uses three times more energy than the global average. The growth in power consumption has outpaced supply, and during one recent summer peak load season local governments had to ration power in 24 of 32 provinces.

China has been constructing 400 million square meters of building space every year for 15 years. This is the equivalent of building 1,000 Sears Towers each year. China's buildings consume 27.5 percent of the

nation's total energy. The increase in energy demand from new air conditioners in China in 2004 alone exceeded the entire generating capacity of the Three Gorges Dam. EPA is working with the China Certification Center for Energy Conservation Products (CECP) to reduce energy use in buildings through market-based voluntary energy-efficiency endorsement labeling.

China has adopted efficiency standards for refrigerators, air-conditioners, clothes washers, and televisions that will avoid 30 million tons of carbon emissions and save electricity equivalent to that generated by 17 1,000 megawatt coal-fired power plants by 2020. EPA also is helping China to strengthen its mandatory minimum energy-efficiency standards program by adding covered products, increasing efficiency levels, improving enforcement, and implementing improvements to a government energy management program.

Wind power is the fastest growing source of renewable energy in China. Renewable energy currently generates less than 5% of China's energy production, up from 3% in 2003, but the government has set a goal of 10% by 2020. China expects to generate 20gW of wind power by 2020. EPA and DOE have assisted China through the Wind Technology Partnership in drafting its national renewable energy law and in developing implementing regulations.

The U.S. and China joined India, Japan, South Korea and Australia in launching a new initiative to reduce air pollution and GHG emissions just last month in Sydney, Australia. These six countries, which account for about half of the world's population, GDP, energy use, and greenhouse gas emissions, formed the Asia-Pacific Partnership on Clean Development and Climate. The partnership will develop, demonstrate and implement cleaner and lower emissions technologies. The partnership expects to marshall considerable financial, human and other resources both from the public and private sectors.

The November 2005 chemical spill in the Songhua River following an explosion at a China National Petroleum Company facility near Harbin provides a valuable lesson about the limits of our knowledge about China.

As you know, the Chinese public was not notified of the spill for more than a week and water intake at treatment plants had to be shut down at cities downstream to prevent nitro-benzene contamination of water supplies and equipment. As soon as the United States learned of the accident, President Bush offered assistance. China declined the U.S. offer to send a team to help China respond to the accident, but both sides exchanged information and the U.S. provided China with examples of how we have managed benzene and nitro-benzene spills in freezing temperatures. As the toxic plume approached Harbin there was a run on bottled water and public confusion about the nature of the contamination as unofficial websites filled the information vacuum with wide ranging reports.

China did invite a team of experts from the United Nations Environment Program, but this international team was not allowed to visit the site of the accident nor were they allowed to take water samples. The data provided by the Chinese authorities led U.S. and UNEP experts to conclude that the situation was steadily improving and that the Chinese response had been appropriate and sufficient. Although the risk remains that nitro-benzene may be re-released during the spring when river ice thaws and there are likely to be areas where the chemical has settled into the sediment, this may be a situation that does not require any further action although we do not know. Disturbing the sediment in an attempt to remove the nitro-benzene could disturb and release other contaminants in the process.

In December, China announced that it would spend $3.28 billion over the next five years to improve drinking water quality to communities along the Songhua. When two more chemical spills followed before the end of the year, the Chinese government announced that it would be addressing the threat to surface water from chemical plants in the 11th Five-Year Plan. On January 8, China published its first National Emergency Response Plan.

What can we learn from the Songhua spill? That we don't know much about how China manages this kind of emergency and that improvements in our working relationship may provide opportunities for EPA to share its considerable knowledge. To this day, we still do not know how much chemical was released even though the petroleum facility very likely had an inventory and the size of the chemical containers was known. Government estimates of the amount of chemical product ranged from 50 to 100 tons. We do not have an accurate breakdown of the amounts of the various chemicals in the spill. We also do not know how much water from firefighters was mixed with the chemical.

The Songhua spill occurred on the heels of the first meeting of the U.S.-China Joint Committee on Environmental Cooperation while EPA and SEPA experts were in the process of drafting a strategy for joint work on hazardous waste management. As a result, they were able to include cooperation to build China's capacity to respond to chemical emergencies as part of this plan of work.

According to SEPA Vice Minister Pan Yue, water pollution is the most important issue, a "bottleneck constraining economic growth." About two-thirds of China's water use is for irrigation. China is aggressively building wastewater treatment plants and some cities already recycle as much as 20% of wastewater, nevertheless it is estimated that China would have to spend $50 billion and build 10,000 waste treatment plants in order to reach only a 50% treatment rate. China is making this investment primarily in its medium and large cities.

Falling water tables and receding surface-water supplies are acute in three north-central river basins critical to agricultural production -- those of the Hai, Huai and the heavily silted Huang (Yellow) rivers. Since 1985, the Yellow River has dried up and failed to reach the Yellow Sea for part of almost every year.

Working with China as it faces the challenge of water scarcity may help the U.S. in managing its own shortages. Both China and the U.S. have problematic upstream and downstream relationships due to competition among water users that is at times intractable.

China has expressed a strong interest in adapting some of the water policy tools used in the United States, such as total maximum daily load (TMDL) and economic instruments that would address these use and discharge equity issues. China's authorities also are looking at ways to use wetlands to augment wastewater treatment and best management practices (BMPs) to reduce agricultural contamination of surface waters, especially from animal waste.

For the past two years, EPA has been working with the Tianjin Environmental Protection Bureau to monitor, assess, and protect its main source of drinking water for 4 million urban residents, the Yuqiao Reservoir. We found that policies were in place to protect the reservoir but were being ignored by local farmers and businesses. Each year tons of animal waste were being spread on fields in the low lying areas and at least once each year water was diverted into the reservoir to store drinking water for Tianjin and to relieve pressure from upstream reservoirs in other provinces during the rainy season. The net effect of the diversion was to flood the reservoir and stir up the nutrients into the water supply. This problem was exacerbated by the discharge of nutrient rich water from fishponds that continue to operate around the reservoir in spite of a decision to close them. In the midst of this critical area where water enters the reservoir, a massive dredging operation is removing mountains of sand from the lake and river bottom for use by the construction industry.

The Yuqiao Reservoir would be an excellent candidate for the use of wetlands to filter the nutrient loads from surface water runoff were it not for the annual diversions that raise water levels by 3-5 meters, enough to destroy any efforts to cultivate grasses. The local residents have been told that the water in the reservoir is off limits as a source of drinking water and irrigation as well as for fishing and recreation. The farmers are prohibited from farming in the flood plain and from allowing their animals to graze there. But the only one of these restrictions that is enforced is the ban on the use of the reservoir for drinking water and irrigation. The unintended consequence of this policy has been to draw down on precious groundwater at alarming rates.

The 11th Five-Year Plan recognizes that more has to be done to assist the rural economies. It calls for policies that "extract" less and put more back, such as more investment in rural infrastructure and more protections against the unfair taking of farmers' land for development.

On Sunday, the first day of the Chinese New Year, President Hu Jintao and Premier Wen Jiabao visited poor farmers in the countryside continuing a New Year tradition for China's leaders of doing something to stress the government's priorities for the coming year. 2006 will be the year of the poor rural farmer.

EPA is also working in rural China on priority health concerns. We are working to help villagers in Yunnan and Guizhou provinces to reduce their exposure to harmful smoke and chemicals released from using solid fuels for home heating and cooking. About 80% of Chinese households and nearly all rural homes depend on solid fuels such as coal, wood, and crop residues for cooking and heating. Emissions from these fuels account for a large percentage of the 450,000 premature deaths each year in China from indoor air pollution. The highest rates of lung cancer in the world are found in Yunnan province.

SEPA's leaders have recognized the challenges of inadequate and uneven enforcement and are trying to make improvements through the creation of six regional offices. In December, EPA hosted a study tour for three of the new regional office directors and EPA and SEPA plan to develop a "sister region" relationship between at least three EPA regional offices and their Chinse counterparts. We expect to involve U.S. states' environmental departments in providing advice to China on how to develop better cooperation between national and provincial authorities on issues from monitoring and information management to enforcement and emergency response. While we do not have funding for this effort, we expect to use distance learning and study tours by Chinese officials to develop these regional partnerships.

EPA also is working with China through various networks of enforcers including the International Network for Environmental Compliance and Enforcement (INECE,) INTERPOL, and the Asia Environmental Compliance and Enforcement Network that was formed recently by the U.S.-Asia Environmental Partnership and the Asian Development Bank.

I should not close without mentioning the development pressures in Southwest China and the threats this development poses for one of the most biologically diverse regions in the world. China's leadership is considering the construction of numerous dams to generate electricity, increase water supply, control floods, and facilitate barge traffic along the Mekong River basin. This could affect water flows to Burma, Thailand, Laos, Cambodia and Vietnam and have an impact on agricultural and urban water demands.

One policy tool that may be proving useful is something that the U.S. and China have been working on for several years -- environmental impact assessment (EIA.) China has made progress in the use and integrity of its EIA process, especially from a technical perspective, as marked by last year's temporary suspension of dam projects in the Southwest. However, China still has a long way to go in achieving sufficient public involvement in the process and in allowing and responding to public comments and objections.

EPA expects that its ongoing cooperation on watershed management, regional air quality, reducing port emissions, and reducing mercury in health care products will provide opportunities to demonstrate how the public and other stakeholders can be involved in achieving environmental results and in assisting Chinese leaders to face their daunting environmental challenges. It is in the interest of the United States to help address these problems in China before they become our problems here at home.

In closing let me leave you with one last factoid. In the next five years China will triple its spending on S&T research. China's future leaders are thinking beyond coal and oil to hybrids and hydrogen and nanotech. China's dreamers are not worried about getting a sound night's sleep because they are too busy working to get ahead. Thank you.

Appendix

EPA Cooperation with China

Many of EPA's activities in China are conducted under the framework of a Memorandum of Understanding with China's State Environmental Protection Administration (SEPA) that was signed in December 2003. The MOU and its three annexes on Air Pollution, Water Pollution, and Pollution from POPs and Other Toxic Substances established a mechanism for the U.S. and China to determine strategic environmental objectives and to coordinate environmental activities. The MOU replaced the 1980 Environment Protocol under the U.S.-China Agreement on Cooperation in Science and Technology that was signed in 1979 and extended most recently in 2001.

The MOU also established a Joint Committee on Environmental Cooperation (JCEC) that had its first meeting in November 2005. The objective of the JCEC is to strengthen ongoing collaboration between the EPA and SEPA and to explore new areas for cooperation. The JCEC also aims to facilitate contacts between environmental and scientific groups from the U.S. and China, including other government agencies, research institutions, business and industry, and universities.

EPA also cooperates with the Ministry of Science and Technology (MOST), along with the U.S. Department of Energy, on energy sector projects, with the National Development and Reform Commission on climate change and energy efficiency, and with the Ministry of Agriculture on pesticides. The Ministry of Water Resources has asked EPA to enter into a MOU on water management issues, especially wetlands and water quality. Last summer, EPA and the Asian Development Bank signed a Letter of Intent which both sides expect will enhance our mutual work in China.

Panel I: Discussion, Questions and Answers

HEARING COCHAIR WORTZEL: Thank you both very much. Commissioner Wessel, I think you have the first question.

COMMISSIONER WESSEL: Thank you both for being here, and for your testimony. I appreciate all of your insights as well as your service. I'd like to ask a question, Mr. Keith, about your comment about convergent goals.

It is a bipartisan concern over many, many years about the freedom/democracy issues in China. President Bush's second inaugural address spoke at great length about this challenge worldwide and how that should be a fundamental driving force of U.S. foreign policy.

Eighty thousand incidents that we know of or that China is willing to talk about of public unrest, many of which have been responded to with deadly force, or at least some have been. I don't want to say many. What are we doing about that? Do we view that as a sign of success that there are more and more incidents of public unrest, even though China appears to be dealing with them with a firm fist, as it always has?

Is that a sign that engagement is yielding results?

MR. KEITH: Well, I think you put your finger on one of the key issues that you should be looking at if you're focused on those issues that Chinese leaders worry about and that are a threat to the continued development of China on the track that's been laid down over the last several decades.

In addition to their response to the security incidents, senior leadership, as evidence in the Five-Year Plan that's now before them, is focused on other means of trying to deal with these issues, and I think

this relates to the other point I made, which was the fundamental disagreement between ourselves, the Chinese government and the U.S. government, about the way that political reform fits into economic reform.

As I said, from our perspective, our firm belief is that this is a means of getting stronger. That this is, whether it's through NGOs participation in civil society or the role that a free press plays in an open society, whether it's publishing statistics about environmental pollution or giving people the opportunity to make judgments about the free access to and equal access to justice, these are issues that we believe can and must make a society stronger.

I think from the Chinese perspective, they're weighing the risks and balances of social order. They're coming at it from a different point of view, one which we think ignores and creates a real vulnerability, ignores the basic tenet that these kinds of incidents are a symptom of stress in society and that there ought to be outlets for those stresses, and without those outlets, the incidents will continue from our perspective.

So as I say, we've got a basic disagreement about exactly how political reform fits in, but if you look at the broad trend, I think you have to say that engagement has resulted in improved lives for the Chinese people over time. That's not to say that one should be satisfied with where the Chinese are now or, as Commissioner Wortzel said, that there is any guarantee that the past is prologue.

It may be that this is a track that leads to gradual and steady liberalization of the society and it may not be, but certainly if you look at a statistic such as the flow of information. If you go back to 1997, there was something like 600,000 Internet users in China. Today, there are 111 million Internet users in China. The number grew by 17 million last year.

So there are changes that are positive and that will help empower the Chinese people and help over time give them more choices. I think, again, one has to be realistic about where that might go and it's something that the U.S. government has to monitor on a regular basis.

But I think the record shows that engagement, not only with the United States, but also with North America, with Western Europe, across the board, engagement has resulted in changes in the perspective of the Chinese government and improvements in the lives of Chinese citizens to date.

COMMISSIONER WESSEL: You mentioned the NGOs, and Mr. Clifford addressed the issue of working with universities, et cetera, to address some of the environmental calamities that they face. What are we as a government doing to expand our relationships with those NGOs, those environmental groups, to help build the infrastructure for reform?

MR. KEITH: Well, there's both an affirmative and I suppose you could say negative approach, negative in the sense of identifying the deficiencies and working to try to improve them.

For example, we've sought to engage the Chinese government on this issue of civil society and the role of NGOs in civil society, not

only as a government, but I have to say that, as a society, a broad engagement from both the public and private sector in the United States with China has resulted in some gradual improvement in the opportunity for grassroots power to be recognized and for some representative element of local government to occur and be recognized as valuable.

The International Republican Institute and the Carter Center, for example, have witnessed grassroots democracy experiments throughout China, and these are very small scale. I'm not trying to generalize from this, but these are the kinds of things that have been put in place to show that it's better for the Chinese people if the decision on where to base a wastewater treatment plant includes in that decision-making process a feedback loop to the people who have to live near it rather than whether it's the party cadre's cousin who benefits from this kind of thing.

So there is this going on. Also, in the broad range of the rule of law, both publicly and privately, we're deeply engaged in trying to promote civil society. This takes the form of sister relationships between law schools, creation of law libraries in China, exchange of experience and expertise on administrative reform and laws, a wide range of efforts to try and open the doors. I think the government's job, of course is not to spend U.S. taxpayer dollars to develop this for China, but rather to point to the doors, to help open them, so that the private sector can come in behind us and so that over time the Chinese will see their own interest, identify their own interest, and move in this direction.

I think we're starting to see it again. The greatest progress is in those areas that are least politically sensitive from the Chinese government's point of view. So on rule of law, for example, you have fairly sophisticated development on the economic side and increasingly on the administrative side, but when it gets to questions that are more politically sensitive such as the independence of the judiciary, as we point out in our annual human rights reports, there remains significant distance to go.

COMMISSIONER WESSEL: Thank you.

Thank you, sir.

HEARING COCHAIR WORTZEL: Thank you. I have actually two questions for Mr. Clifford and one for Mr. Keith.

Mr. Clifford, I tend to shop at a military commissary on Fort Eustis, Virginia, and I notice them stocking their shelves with Chinese farm-raised tilapia, boxes of them. So given what you've said about groundwater pollution, can you tell me the mechanisms that they have or we have as a government to make sure those tilapia are safe to eat?

That's a short personal question. But I do have another one. As you talked about the problems of emissions, particularly from coal, it occurred to me that there are tremendous opportunities for American business that work on emissions cleaning. So I'd like to hear from you a little bit about how either American companies work through your agency or with your agency or with the Department of Commerce to help China with these problems, and whether you as an agency, EPA, works with

Commerce to make sure our industry is aware that there may be places for them to help out?

For Mr. Keith, the concept of private property and property rights and personal rights is strengthening, and I'm very interested in your assessment of how that concept is beginning to affect one-party rule, corruption as it occurs and the whole problem of arbitrary decision-making in the government?

Mr. Clifford.

MR. CLIFFORD: Thank you, Mr. Wortzel. First on the talapia, I was actually born in Fort Eustis. My father was in the military. What a coincidence.

Food and Drug Administration is responsible for ensuring that food imports are meeting U.S. standards here, and it's not an area that the Environmental Protection Agency regulates per se except as it relates to pesticide tolerances.

But I will say that one of the concerns that we share is that there may be lots of chemical contaminants that we screen for here in the U.S. for food that shows up on our shelves that are different in China, so there could be contaminants in the food that are imported from places such as China because of some of their contamination problems over there that we may not be measuring here in the United States.

With respect to opportunities for business, Department of Commerce has a quite robust program--Mr. Keith might know a little more about that, and I'll defer to him and his experience on this--and we worked with them on environmental technologies. They have a good program to try to advance those environmental technologies. In our efforts in helping them address their pollution problems, because we're so familiar with the U.S. environmental technology capability, it's very integrated into the conversations and discussions we have with the representatives over there.

So we're doing what we can to help advance those interests on environmental technologies. The Department of Commerce also has quite a robust program there.

MR. KEITH: If I may, I'll just add, in addition to what FDA is doing directly in a bilateral way with the Chinese government, and USDA also plays a role here, in terms of sanitary standards and ensuring that the appropriate standards are kept up and that they're reciprocal, in addition to that, we're working with the Chinese through APEC, the Asian Pacific Economic Cooperation Forum, on food safety issues. This is a function of standardizing and also energizing host governments to look at these issues in the same scientific approach that we do.

On the Department of Commerce, we clearly identify not only in China but also in large parts of Asia environmental technology and equipment as a priority for our commercial advocacy. This is, number one, because we're among the best in the world and we've got a great product, and, number two, because there's tremendous demand there. As identified, seven of the ten largest problem cities in the world are in China, and I don't know the list by heart, but I think there are other Asian cities on it too. So this is something we're working through our

foreign commercial service in each of the embassies which then connect back not only to the Department of Commerce, but also to each of the district offices throughout the United States.

We work closely with them through our embassies and the country team in the embassies to advance our commercial interests in the environmental area.

On the subject of property rights, clearly, this is one of the areas where these divergent views are coming together in the same way that that's been raised previously, and this relates also to this question of transparency which is important internally as well as externally, and it also illustrates a point that the Chinese have to do everything at once.

In terms of the development of the rule of law and identifying abuses of property rights and equal justice before the law, to deal with those abuses so that the representatives of single party rule, the party cadre in each of the provinces, don't have a free pass and are also subject to the law and not above it and then this also relates directly to the whole question of social order and the social safety net.

For example, savings rates in China are just incredibly high, and one reason for that is anxiety about the future on the part of individuals who have to save for retirement, and now as property rights are changing have to save to buy their homes. No more iron rice bowl, no more cradle-to-grave support from a state enterprise. One has to save for private property that's operating in a market as we would recognize, but wages are such that you have per capita income at $1,700, so this relates directly to China's external approach in terms of foreign policy and foreign economic policy.

China would like to move from an export led and foreign direct investment led growth for GDP to consumer led growth, but so long as savings rates are so high and they are so few trusted vehicles for domestic investment, they've got a real problem. There is no way to turn that interest in the market and private property into consumer-led growth for the economy as a whole.

So all these problems come together. You can pick out, and property is a good one, any particular issue and undo the threads and find all of these issues we've just been discussing really caught up. In other words, they're really daunting challenges domestically for the Chinese.

HEARING COCHAIR WORTZEL: Thanks, Jim. Commissioner Houston.

COMMISSIONER HOUSTON: I'd like to thank both of you also for being here and for your wonderful enlightening statements and for us and for our visitors today. My position on anything as a public policy analyst is always about the people. The government controls what they do or doesn't control what they do, but at the end of the day, my concern is for the Chinese people.

So I have a question for each of you if I may, and again it comes from my perspective of what goes on with individuals in China. For Mr. Keith, you talked about your visit with the governor of the province of Sichuan. Well, here in America as with many countries, of course, we have local, state and federal government.

They don't always like each other that much. They're usually fighting over dollars. They're fighting over services. They're complaining a lot. I know here in Congress, if there is a complaint from a citizen and it lands here on Capitol Hill, it's addressed, it's read, it's taken care of.

If a number of complaints come in at the local congressman's office, they get very excited very quickly because they know the locals know what they're up to. Often the difference between the local and the federal government creates frustrations and tensions that have to be dealt with, usually at the local level. So my question for you is local is where the people live. When you're in China, and local individuals are complaining about water, lack of rice, environmental problems, do you see a tension between local governance and the central governance as far as taking care of the people, taking care of their needs, and how does that back and forth work for the Chinese people?

MR. KEITH: Thank you for the question, Commissioner. It's clearly not too analogous to the American situation, no tradition or history of states' rights and a very different perspective on the constitution, if I could put it that way.

But clearly, there are these major issues between the central government and the provinces, and this is one of the major challenges for the central government to try to sustain a coherent plan and that's especially true given the varying degrees of economic development between the coast and the interior.

If you look at an issue like intellectual property rights protection, the central government seems absolutely committed to essentially a Western perspective on protection of intellectual property, and this is based not only on our successful diplomacy but based on their development of their own intellectual property, and their recognition that it serves China's own interests to move in the direction that every other country in the Western world has moved in.

The problem is translating that down into enforcement and implementation at the local level, and there are serious deficiencies throughout the country despite the fact that at the central government level, the right laws and regulations have been passed, and the right interaction occurs between us and between our Department of Commerce and others, and their counterparts on the Chinese side.

So you identify a key question and a key challenge for the Chinese government going forward from the top down.

Looking at it from the bottom up, I think you see these frustrations--this figure of 80,000 incidents at least as published by the Chinese government, I think does reflect real frustration with the government as a whole, and I think there you do start to see an analogy. I think if you take a farmer or a retail shop owner on the streets of Sichuan Province, you do get the same sense of the government that people have all over the world, and the desire for the government to work for them, and this is an area where I think the Chinese have perhaps their largest challenge when it comes to streamlining the system, and they've got a party apparatus and a state government apparatus, and it's not at all

clear over time how that will develop and whether over time again coming back to the rule of law, a clear transparent system that's open, has open access to all, will operate or whether in many of the provinces, there will continue to be an informal network of personal association and it's through that informal network that one gets redress of grievances rather than through transparent and honest system of government.

This dual application of the party and government system, I think, is a tremendous challenge for the Chinese and clearly a part of not only providing the kind of honest and open service that you refer to but also an efficient and effective form of government that doesn't soak up too much of the country's resources as it becomes more and more difficult for China to sustain its economic growth.

COMMISSIONER HOUSTON: Thank you. Thank you very much. Mr. Clifford, we talked a lot today about property rights, and I think that's probably one of the most challenging things when the EPA is looking at China, because so often environmental problems come down to property rights.

If you don't own it, you don't clean it. It's just that simple. So again, my question comes down to how do the people in China view these environmental problems? As with anything else here in the U.S. or anywhere in the world, things don't change unless people try to engender that change.

Here in the U.S. we have an environmental movement that is very strong. Sometimes I would argue that they hamper economic progress and hamper private property rights, and other times, they're wonderful in pointing out problems and deficiencies that we really need to address.

In China, is there any kind of grassroots movement or grassroots acknowledgement of the environmental problems, and is there any attention paid to the pollution/the industrial problems in China by the U.S. environmental groups, as obviously the Chinese problems and the environment really do affect our citizenry here?

MR. CLIFFORD: Thank you, Commissioner. If I may begin by just commenting on the previous question with respect to the environment.

The State Environmental Protection Administration, they pass the regs, they develop the standards to be implemented countrywide. But it's the provinces and the local governments that are responsible for ensuring those standards and regulations are complied with.

The State Environmental Protection--we have roughly 18,000 people at the EPA—China has less than 500 people in their State Environmental Protection Administration. Now, that's bolstered because they're able to tap into some of their research organizations for the research part of their work.

But their ability to enforce their laws and regulations is modest at best with those types of resources. The provinces then are required to implement the standards, but they have full discretion, as do the local governments as to how many resources go to implement those standards and require compliance with the regulations.

So as Jim was mentioning, they have some very solid laws on the books at the national level. Where they have seriously fallen down is in getting those laws and regulations and standards translated into implementation at the local level.

The other thing I'll just mention, I don't know about the other programs, but for the environment, in the United States, as the environmental programs developed in the U.S., it was a U.S. based program, a federally-based program that with government assistance encouraged states to take on the leadership and implementation. States developed their own funding capacity then to give money to help locals implement regulations. That mechanism doesn't appear to exist as it relates to the environment in China, and so there's no financial help coming from their federal government targeted at environmental protection and public health protection. That's a huge challenge for them in terms of being able to implement and comply with the standards and laws that they've passed.

Coming to the second question, then, directed with respect to the locals and their participation, by and large, their organization of NGOs is very limited. There are a few significant national environmental NGOs in China, largely it's individuals, and I will say quite loosely organized at the local level, beginning to raise concern about particular environmental issues.

Some of the work that we're doing in Tianjin is to help them protect their watershed for the water supply for about four million residents, and what we've been doing is helping to instill the involvement of the communities around the watershed in the development, helping them understand why it's important to protect the watershed because they're drinking the water, and the cost of having to clean the water before they drink it.

But they have, as you have probably learned over the course of this commission's tenure, a huge agriculture business. Their pork production is second to none in the world, and much of that pork is grown at the family level. They have their own hogs. They share the sidewalks and a lot of the waste goes right on to the street, pushed out of their communal living area, pushed out on the street, washed into the reservoir.

So much of our work is helping to engage the public and use that as an example for how engaging the locals can help the city and city officials solve their problem.

As to national U.S.-based NGOs and their role there, World Resources Institute, World Wildlife Fund, those national organizations are quite active in China in trying to help promote environmental awareness, helping fund environmental projects over there. It's simply the amount of resources that those national NGOs have to spend there are just limited, given the demand that they have to and the challenges that they have to address that.

HEARING COCHAIR WORTZEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman. I want to join Chairman Bartholomew in saluting Ambassador Lilly for

being here, and the great service he's done for the Republic over his career.

I also want to thank you both. As career public servants, you have contributed much to the Republic over your lifetime. Thank you for being here with us today.

I talked to Mr. Clifford when he first came in. I worked on the U.N. Conference on the Human Environment over 35 years ago when I was a young FSO in the State Department working for Christian Herter, Secretary of State, and we realized then these environmental problems can't be solved by any one country. You've got to work internationally and we have organizations like the U.N. that can help us do that. We ought to salute them and use them rather than just denigrate them.

Mr. Clifford, you talked about the efforts to work with China on solving some of our environmental problems, and I think you're absolutely right. On page seven of your testimony--you say--and this is what I want to talk with Mr. Keith about--in the next five years, China will triple its spending on S&T research, science and technology research.

China's future leaders are thinking beyond coal and oil to hybrids and hydrogen and nanotechnology. China's dreamers are not worried about getting a good night's sleep because they're too busy working to get ahead. When I go to China and when I read about China, I send this dynamism in the Chinese people and the drive to build comprehensive national power.

Science and technology is part of that. When you look at their economic growth, you salute them for it, and you say that's fine. I think too much of it may be done at our expense, and we have to address some policies to change that.

But you, Mr. Keith, say China understands its short-term goals, but we don't know where they're heading in the long term. I worked on the U.N. Conference on Human Environment 35 years ago. Believe me, 35 years goes very quickly, but it's a long time. If we wanted to know where China is heading thinking about it 35 years from now. Do we look at their history and the way they behaved in the past as guidance for where they may be headed in the future? Or some other way?

But if we look in their past, and the way they behaved when they were the dominant power in Asia, what does that suggest that they want for themselves in Asia and how other people would relate with them?

MR. KEITH: Sir, it's a good question, and I'm not sure I have the answer. I think from a practical or operational point of view, the way we look at this is to try to identify how China perceives its national interests, what it believes to be in the interest of its people and how the government expresses that, and then make our judgments on the basis of those perceptions.

So this has to be in some degree interactive between the government and the people of China. There is public opinion in China and clearly the government does respond to it. I think the current Five-

Year Plan focus on the inequities of development is an example of that. I think it's clear that China is making decisions now on the basis of criteria that are new, that were not evident 20 years ago, or even ten years ago.

So this is, as you say, a very dynamic society and evolving situation, and all we can do is continue to try to identify national interests.

For example, the question of import of energy for China. Certainly they're going to look to alternative sources of energy as are we all, but clearly for the foreseeable future, in order to sustain the rate of growth of GDP that they're looking for, which they see as essentially a matter of regime survival, they need energy imports. As they look around the world, I think they're taking steps to secure energy imports that are probably mistaken, that are, from our perspective, misguided on the basis of our own experience.

We went through the lessons in the 1970s of trying to identify sources of energy and lock those up and we're trying to convey to the Chinese now our sense that there's a better way to ensure orderly global markets for energy, and that the Chinese ought to look to multinational--sir?

COMMISSIONER MULLOY: Yes. The Chinese from what I understand don't have a big democratic tradition in their history. We always say, well, maybe we want them to be a democracy. Democracies don't fight with one another. Is there any sense that China wants to move toward a democratic regime in any way or is that in their tradition? Do we expect that or where do we see this going?

MR. KEITH: Sir, as you point out, it's not in their tradition, but it's certainly the case that Chinese societies all over Asia have moved in this direction, and the Asian societies are not in any way alien to this notion. We reject that idea that had come up in some decades past from Asian leaders.

I think, again, it has to be a question of national interest. I think they're driven to allow for more individual responsibility, greater flow of information, the gradual evolution of political reform by their economic modernization goals. If they want economic reform to succeed, if they want markets to operate, then they have to allow an increasing degree of this kind of feedback between the people and the government.

As I said earlier, we have this fundamental disagreement about how necessary that is to their ultimate achievement. I think we have to, sir, if I could harken back to Hong Kong, not to make this too fine a point, but I think if you look at the Chinese approach to the transition of Hong Kong after 1997, then leader Deng Xiaoping said in 50 years, this will be easier to accommodate, this transition to the two societies, the capitalist society in Hong Kong and the communist society on the mainland coming together.

The only reason, it seems to me, that he could be optimistic about that resolution 50 years hence was not that Hong Kong would revert to the level of where China was at that time, but rather than China was evolving and growing, and that more naturally the two societies

would come together in, as you suggest, a relatively short span of five decades.

So I think that's the reason for some sense of optimism that there will be further movement, no guarantee of it, but certainly the track record since 1972 in China's opening up to the outside world in economic reform has been that gradually political reform has seeped in with economic reform.

One doesn't want to be Pollyannaish about this. There's no guarantee, but in terms of their own national interest, one would expect continued opening to result in demands from the people and demands from the economy that would force the Chinese to keep going in the same direction.

COMMISSIONER MULLOY: Thank you very much.

MR. KEITH: Yes, sir.

MR. CLIFFORD: Mr. Chairman, may I just add to the Commissioner's comment about the United Nations? I just want to make sure that you understand that in the last four years, the U.S. government with EPA's leadership has taken a huge advantage of the United Nations to help launch three very key initiatives that we are working very closely with China on.

The first is to reduce sulfur in gasoline and diesel fuels worldwide. Mexico just announced by the way that they are going to meet U.S. standards as early as January 2007 on the U.S.-Mexico border consistent with U.S. requirements kicking in, but if we can get China to tackle and develop low sulfur fuel requirements for their diesel vehicles, it will have a huge impact on their air pollution, not just within China, but globally.

Second, we're working on a partnership for clean indoor air. I mentioned in my testimony the number of premature deaths, 450,000 a year, that are based solely on indoor air pollution. We're working very closely with them on some specific projects out in rural areas of China to address that particular issue.

And the last is just last year, we helped rally the rest of the world to agree to a partnership to reduce global mercury emissions, and that's a big part of our work now in China as well, and they've acknowledged their contribution to that and are working with us and other U.N. countries to help address that issue.

Thank you.

COMMISSIONER MULLOY: Thank you.

HEARING COCHAIR WORTZEL: Commissioner D’Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman. I thank both our witnesses for coming. I particularly want to thank Mr. Keith who has been a great supporter of the commission, when you were our Consul in Hong Kong. We had a great visit there, and you testified before the commission several times. Thank you, Mr. Clifford also. I'd like to also recognize an eminent American present here today. Ambassador James Lilly is a former member of the commission, and we appreciate your coming.

I have two quick questions, one for each of you. Mr. Keith, you talk in some interesting depth about the problem of the social safety net, both retirement and other parts of it, in China. We certainly can't provide a model for retirement here in the United States because we seem to be going in the wrong direction on retirement programs.

But what really concerns me is the shredding of the public rural health care system in China. It appears from what I've been reading that it's in serious disarray. Quality care has moved to the cities, the average Chinese family in the rural countryside has had difficulty getting good health care, when they go to a hospital, they're charged exorbitant costs for it, and thrown out when they can't pay for it. It's a very serious question.

The question is: are we working with the Chinese on some of these things. To what extent are we actually working with the Chinese on the question of rural health care. Second, in connection with that, it would appear that we still have a data problem in terms of the reliability of our understanding of what's going on in China on health care and particularly in the area of AIDS.

The recent reporting on AIDS looks to be highly underreported. Do we have a feeling and understanding of what the real gravity of the AIDS situation is?

And then for Mr. Clifford, I have a question for you. A few years ago when the Congress was considering the run-up to the Kyoto Protocol, the Congress, particularly at that time the Senate, laid down a marker for American participation in binding emission limits and making it conditional upon including the big developing emitters, which of course include India and China, signing up to binding emission controls.

Of course, China and India were unwilling to do so. What is the Chinese attitude now toward binding emission controls?

MR. KEITH: Thank you, sir, and it's a pleasure to see you. I'm sorry that I didn't have a chance to say hello to you when you first came in, but I do thank you for the opportunity to be here and it's great to see you again.

If I may, I'll start with the AIDS question. I think we've made tremendous progress with the Chinese on this question from the days when they essentially denied that it was an issue and we really got started with them on this through the issue of narcotics abuse and narcotics smuggling and we have had programs with their Ministry of Public Health which started on that side and have gotten us into the larger issue of the social safety net and how that relates to handling transnational crime and transnational issues.

Also, I should say the Gates Foundation has been very active in China and has also helped produce greater transparency, specifically with respect to the rate of infection of AIDS and the total number of people infected. So while we may not have the same degree of confidence in the figures that we get out of China on AIDS as we do in say Western Europe, we have a much greater degree than we did even as recently as five years ago, and specifically on AIDS.

I think when it comes to rural health and basic figures such as life expectancy and infant mortality and these sorts of things, there is a real lack of accurate information and this is another aspect of the problem of transparency.

So we don't have a lot of good data on which to draw conclusions about rural health. There are some reports available and we are engaged in particular through our Census Bureau in some exchanges with the Chinese on these subjects.

Obviously, this starts to get into some controversial and political areas such as the one child policy and the demographic trends, and so there are political sensitivities that impede our ability to get at some of this data.

But we are, I think, making some strides, mostly focused on transnational issues as opposed to the local development of rural health. I think from our perspective pursuing the American interest in these issues, it's mainly been on that basis and from that perspective, sir.

COMMISSIONER D'AMATO: Can you measure the severity of the AIDS crisis currently in China?

MR. KEITH: Sir, I don't pretend to be an expert on that subject. I'd be happy to get you what the U.S. government has on that, if I may provide it to the commission.

COMMISSIONER D'AMATO: Thank you.

ACTING CHAIRMAN BARTHOLOMEW: Mr. Clifford.

MR. CLIFFORD: With respect to their continued position on binding commitments for greenhouse gas emissions, they don't appear to be wavering from that position for fear largely that any binding commitments would impede their economic progress.

Nonetheless, they are working with us both as I mentioned the Asian Pacific Partnership and with other programs that we have working with them on addressing methane gas emissions from coal mines. So they are talking at least at the national level, like a lot of the issues we've talked about today, there's interest in tackling these issues.

The failure comes in their ability to implement and carry through on what they would like to do at the national level.

COMMISSIONER D'AMATO: Thank you.

ACTING CHAIRMAN BARTHOLOMEW: Thank you to both of our distinguished witnesses. I'll join the chorus of thanking you also for your service to our country, which is really valued and very much appreciated. I have a couple of comments, as much as questions, but would appreciate your thoughts on those, and I think in some ways it will help to set the stage for the next panel, too.

I want to join Commissioner Wortzel on the issue of food safety however. We'll spare you the question of whether you would be comfortable buying that boxed fish. So you won't need to answer that.

Mr. Keith, transparency, actually as you were saying it, I was thinking about that constant problem that we have and the difficulty of getting and trusting the data that we get from China, whether it's economic data, health data and the consequences it has for us.

I was really struck listening to both of you about the link between the issues that you're talking about and a little surprised, Mr. Keith, that you didn't mention corruption as one of the issues that keeps some of the Chinese leaders up at night because I think some of these public disturbances that people are talking about, the issues that people are responding to are issues relating to corruption, land use, pollution. People are seeing the consequences of the pollution in birth defects. They're seeing what's happening with asthma rates. They're just seeing their general health declining and the status of that.

But I'm going to ask a different question actually, which is presuming that national budgets are a reflection of national values and national priorities. Why should we believe that China is serious about tackling its environmental problems if indeed we only hear that they're dedicating 500 people to enforcing environmental regulation. And I'll put as a side question to that one, although it's a whole topic in and of itself, and that's the issue of enforcement.

When we talk about rule of law, be it on rule of law relating to individual rights, relating to environmental issues, relating to IPR, we always hear that the problem is enforcement. Why should we believe that we're making any progress in transforming society if what we can't get is enforcement out of rule of law?

MR. KEITH: If I may go first, just very briefly on the subject of corruption, I didn't mean to neglect it, and it is covered in my prepared remarks, and certainly will be happy to take any further questions on that subject if you have them over time.

I think you're right to point to frustration with the implementation of the rule of law as a key issue, and it's a key issue related to this figure of 80,000 incidents and the frustration that people feel because the system doesn't provide for them what they want.

I think it's, in my mind, over the long term, the reason to believe that this will continue is the bottom up perspective, and this gets back to the question of the environmental NGOs. I think, Commissioner Houston, you pointed to a very clear area where people feel their lives are directly involved, and that is the one area where there is the greatest organization of individual citizens in China outside of what the government controls is in the environmental area. As loosely organized as they might be, they're the closest to the model that we would have an NGO representing people at the grassroots level. That is on the environmental area.

I think the demands that will push the Chinese--the very demands that have pushed the Chinese government in the current Five-Year Plan to focus on so-called harmonious society are the kinds of demands that will push implementation, whether it's intellectual property rights or environmental issues or tackling corruption.

It's the need that the people demand over time, I think, that will help the Chinese government identify this as a national priority, and the fact that the people demand this as a function of the success of economic modernization. They won't be able to get where they want to go without doing this over time.

They may be forced into it and it may go slowly, but my sense is either they succeed in implementing the rule of law and therefore succeed in their economic modernization or both fail.

ACTING CHAIRMAN BARTHOLOMEW: Mr. Clifford.

MR. CLIFFORD: If I may, on the environment, until their general population starts getting more engaged in a much bigger way, their ability to tackle issues such as enforcement are going to continue to be very difficult.

What gives me hope about their efforts is their fiscal response to the spill in the Songhua River, where they have now set aside $3.28 billion for clean water supply in the Songhua River.

Now, for those of us like Mr. Mulloy, we might remember the Cuyahoga River in the United States catching fire, and it's an issue like that that in today's technology in China, everybody in China knew what happened, knows what happened. They know there was a spill.

Years ago, that spill would have occurred, maybe the citizens in Harbin might have known about it, but nobody else along that river would have known a spill existed. Today, they all know about it. So today there's now renewed interest in what the government is doing to address issues around pollution such as that.

The other thing I'll mention is, it's in my testimony, but they just recently established six regional offices, mirrored after EPA's ten regional offices. Now, six offices in a country the size of China is not going to solve their problems, but it's a step in the right direction, getting federal officials out in the field to help work at the provincial and local level to address those issues.

On resources, it's apparent to me that the richer provinces, the coastal provinces, are devoting more money to environmental protection. They have fairly large staff in some of those provinces devoted to addressing environmental contamination.

The rule of law issues, the corruption issues--how many of the people that are actually devoted to enforcement as opposed to collecting data at this time remains to be seen, but they are moving in the right direction.

HEARING COCHAIR WORTZEL: Thank you very much for your thoughtful testimony and your responses to the questions. We appreciate your being here. We'll take a break of about seven minutes and start at 10:30.

[Whereupon, a short break was taken.]

HEARING COCHAIR WORTZEL: Our second panel this morning will deal again with major internal challenges facing China. We have three panelists. Dr. Flynt Leverett is a Senior Fellow with the Saban Center for Middle East Policy at Brookings. His work focuses on the Middle East and he recently completed a research article entitled "Chin and the New Geopolitics of Middle East Energy."

He served on the National Security Council, the State Department Policy Planning Staff, and for ten years before that as an analyst at CIA.

Dr. Elizabeth Economy is the Director of Asian Studies at the Council on Foreign Relations. She's an expert on Sino-American relations and Chinese domestic and foreign policy with a particular focus on the environment. Her recent book, The River Runs Black, was named one of the ten top books of 2004 by the Globalist, and the best social sciences book published in 2003 or 2004 by the International Convention on Asia Scholars.

Dr. Bates Gill holds the Freeman Chair in China Studies at the Center for Strategic and International Studies. He's a specialist on East Asian foreign policy and politics primarily focusing on China's domestic transformation, China's regional diplomacy and U.S.-China relations.

Dr. Gill has been a fellow at Stockholm Peace Research Institute and he has been a named chair, the Fei Yiming Chair at Johns Hopkins University.

Again, it's seven minutes of oral testimony and we'll take longer statements for the written record.

Thank you very much. The floor is yours, Dr. Leverett.

PANEL II: MAJOR INTERNAL CHALLENGES FACING CHINA

STATEMENT OF DR. FLYNT LEVERETT, SENIOR FELLOW, SABAN CENTER FOR MIDDLE EAST POLICY AT THE BROOKINGS INSTITUTION

DR. LEVERETT: Thank you very much, Mr. Chairman. It's a pleasure to be here to speak before the commission. I'm going to start off this panel on China's challenges by focusing on China's challenges in the area of energy, and specifically I would like to address four items.

First of all, I want to say something about the scope of the challenge, the degree to which energy demand in China is mounting, particularly demand for imported hydrocarbons. Secondly, I'd like to say something about Chinese strategies for meeting that energy demand, particularly the demand for imported hydrocarbons. Third, I want to say a few things about the implications of those strategies for both global energy markets and for U.S. foreign policy interests, and then finally I'll make a few brief recommendations for U.S. policy.

I think with regard to Chinese energy demand, even the most casual China watcher has become aware that economic reform, market reform in China has generated exponential increases in demand for energy in that country.

A couple of factoids to give you a sense of scale. Between 1993 and 2004, Chinese demand for oil effectively doubled from roughly three million barrels a day to the current level of roughly six million barrels per day.

Second factoid, over the last four years, 40 percent of the global increment in demand for crude oil has come from China. That increased demand for oil off of world markets from China is probably the

single biggest factor accounting for the dramatic increases in world oil prices that we have seen during that period.

This trend is going to continue for at least the next couple of decades exacerbated by China's notoriously inefficient use of energy. I'd say there are obviously a lot of factors that underlie this demand. I think the two most important are industrial expansion and transportation growth.

Most of China's total energy demand will continue to stem over the next decade to two decades from industrial activities requiring ever more electricity. Although coal is going to remain the dominant fuel source for generating power in China for the foreseeable future, limitations on China's ability to expand its use of coal imposed by technical and infrastructure constraints means that the percentage of China's electricity that's going to be produced by oil and gas-fired plants will increase.

Beyond the power sector, the fastest growing use of energy in China is for transportation driven by an automobile market that is one of the country's foundation growth sectors. This trend also will inevitably sharply raise the percentage of the country's overall energy needs that it must meet through hydrocarbon fuels.

China's automobile market is now the third largest in the world, is adding roughly five million vehicles a year. It should become within a decade the world's second-largest automobile market, a development that on its own would ensure robust in demand for energy. China now has about 23 million cars. Chinese oil company executives have told me in private conversation that they estimate that there will be 130 million cars in the country in the next quarter century, a really, really dramatic growth.

All of this puts a premium on the ability of China to access energy resources increasingly from abroad. Energy imports in China are increasing on a scale and scope comparable to the growth in overall energy demand. Today China imports roughly three million barrels a day. That means about half of its oil is coming from abroad.

That makes it the third largest importer of oil after the United States and Japan, but by 2010 if you project out, China will need roughly ten million barrels per day to meet its energy demand, and it is estimated by the International Energy Agency and other sources that by 2010 China will be needing to take eight million barrels per day off of world energy markets, and that means among other things that China will be going from a situation which today it's getting roughly half of its oil from abroad to a situation in just four years where it's going to be getting something like 80 percent of its oil from abroad, very, very significant growth in energy overall, and an especially significant spike in demand for imported hydrocarbons.

Now, China has obviously been paying a lot of attention to accessing hydrocarbon resources around the world over the last decade and Chinese state-owned energy companies have developed strategies for doing that that have attracted a lot of comment.

Many cases, these strategies are lumped together under the category or rubric of equity oil. Basically what Chinese energy companies are trying to do in a number of situations is to secure privileged access to hydrocarbon resources in various parts of the world on a basis that goes beyond a simple supply contract.

In some cases, this involves equity stakes. In some cases, it involves joint ventures. There are a variety of techniques the Chinese energy companies employ in order to try and secure this privileged access, but essentially what they're doing is in at least a certain range of cases employing basically non-market strategies to secure access to hydrocarbon resources.

This has been going on for at least a decade if you look at the practices of Chinese energy companies. In 2002, this was actually formally defined as Chinese government policy. Around the time that Hu Jintao became the General Secretary of the Chinese Communist Party, China adopted what is loosely translated from the Chinese as a going out strategy, a strategy, a policy of encouraging its three major national oil companies to build up secure supplies abroad by purchasing equity shares in overseas markets, exploring and drilling abroad, building pipelines, doing joint ventures, all the kinds of things that I just mentioned.

And what we see is that Chinese companies are doing these kinds of strategies in more and more places around the world and are now even starting to coordinate their activities with other rising energy importers such as India.

The implication of these strategies for both global oil markets and for U.S. foreign policy interests is significant.

You can make an argument, and it's not factually wrong on the face of it, that if you look at the amount of oil that China is actually able to tie up through these equity oil kinds of deals and you compare that to the volume of oil traded everyday in the world, the percentage that the Chinese are able to lock up is infinitesimally small, and at the moment, that is true.

I wouldn't argue against the point. But I would say that there are two second-order consequences of what the Chinese are currently doing that bear some attention.

First of all, by going out and pursuing these equity oil deals, there is the potential, at least, that this can give rise to geopolitical tensions between the United States and China--I'll come to that in just a moment--tensions between Japan and China. Both of these you can find going on in various arenas.

Beyond the question of geopolitical tensions, and I think this does have the effect, among other things, of bolstering upward pressure on prices, there's also the potential for what the Chinese are doing to be taken as a model for other importer countries.

You already see this going on with India. India is using its national oil company, the ONGC, in a manner that is quite reminiscent of many of the ways that Chinese oil companies seek access to hydrocarbon resources around the world, and even more importantly, I would say that there is a reviving debate in Japan right now about whether or not, at

least on the margins, Japan needs to consider employing some of these state-backed strategies for securing access to energy resources, and if you begin to have a situation in which Japan at the margins began to back away from a complete reliance on the market, I think you'd be talking about a shift of real significance in the structure of the global oil market.

As I said, there's also an impact on U.S. foreign policy interests. China is seeking these equity oil deals in a number of arenas around the world in ways that creates a competition for influence in the United States, and you see this, for example, in Sudan where China vetoed imposition of sanctions over the Darfur genocide.

I think you also see it playing out in current diplomacy over the Iranian nuclear issue, and this is going to be a real problem I think moving forward.

Recommendations for policy. What do we do about it? Well, I don't think we can exclude China from the global oil market, and we can't exclude them from the major energy-producing areas of the world. We simply don't have the tools to do that, and even if in some theoretical sense, we did, I'm not sure it would be desirable to employ them.

Inevitably, we are going to have to engage China on this subject to a much greater extent than we have so far, and I think the goal of that engagement should be to work with China to give it more of a sense of energy security, more of a sense that it can rely on markets to meet its energy needs.

Right now, we basically do that through exhortation, through talking points. I don't think that in and of itself is going to do it. The latest Chinese retort to those talking points is oh, yes, and what is the lesson that we the Chinese should take away from the Unocal experience? Should we really take from that experience that U.S. policy and politics will always let the market operate in an unfettered and equitable manner where China is concerned?

I don't mean to reopen a debate about the merits of the CNOOC and Chevron bids for Unocal from a shareholder perspective, but I'm just talking in terms of the lesson that the Chinese took from that. It does not help us in making a case that they should rely on the market to meet their energy needs.

We're going to have to go further than talking points. We're going to have to initiate active cooperation with China on sharing technologies, clean coal technology, nuclear technology, that will help them meet their energy needs in ways that could moderate their demand for imported hydrocarbons. Even with regard to the oil market, I think we should start to undertake steps to encourage, for example, American IOCs to do joint ventures with Chinese companies.

Right now our policy is, at best, ambivalent on that subject, and I think we need to start factoring energy issues into our expanding strategic dialogue with China. The Chinese certainly see this as a strategic issue, and if we are going to find ways to manage this problem with the Chinese, we're going to have to start considering it as part of our strategic dialogue with them.

There are many other recommendations that I could make. I've taken the liberty of leaving copies of my recent article on this subject on the table, and hopefully there will be a lot we can talk about in the questions.

Thanks very much.

[The statement follows:]

Prepared Statement of Dr. Flynt Leverett, Senior Fellow, Saban Center for Middle East Policy at The Brookings Institution[1]

HEARING COCHAIR WORTZEL: Thank you. Dr. Economy.

STATEMENT OF DR. ELIZABETH C. ECONOMY, C.V. STARR SENIOR FELLOW AND DIRECTOR, ASIA STUDIES, COUNCIL ON FOREIGN RELATIONS

DR. ECONOMY: Thank you. I like this clock. It counts down seven minutes and then it starts counting back up, another seven minutes. I think I'll take advantage of that, too. Okay.

HEARING COCHAIR WORTZEL: Yes, I know. I want you to blink it at seven minutes and keep it blinking until I tell you to stop.

ACTING CHAIRMAN BARTHOLOMEW: So you know just how much extra time you'll be able to take.

DR. ECONOMY: Exactly. Six minutes and 11 seconds. Okay. I thought I'd touch on the four issues that I was asked to address: The nature of the environmental challenges confronting China and its government, what are some of the broader regional and global implications, how is the Chinese government responding to its challenge, and what are some potential opportunities for cooperation with the United States?

You've already had a briefing on the nature of the problem. The most important thing to understand is simply that China faces an environmental challenge across the board. Whether it's air quality or water quality or availability or land degradation, China is facing a set of very serious problems. Two-thirds of the 340 cities that China monitors for air quality failed to meet China's own air quality standards which are roughly on par with WHO standards leading, as Mr. Clifford said, to somewhere between 400 and 450,000 premature deaths annually from respiratory-related diseases.

In terms of land degradation, China is technically a quarter desert, and the desert is advancing at a rate of 1,300 square miles per year. This affects about 400 million Chinese in one-way or the other. It may force them to migrate or it may degrade their land to the point that it is no longer arable.

But I think if you were to ask people in China what is the most serious environmental challenge the country faces, they would focus on the issue of water. About a third of the water that flows through

[1] Managing China-U.S. Energy Competition in the Middle East. Flynt Leverett and Jeffrey Bader. The Washington Quarterly. Winter 2005-06.

China's seven major river systems and their tributaries is not even suitable for agriculture or industry.

Three hundred million people drink contaminated water on a daily basis. One hundred ninety million of those, and this is based on Chinese statistics, 190 million of those drink water that is so contaminated that it's making them sick.

Obviously, what China is doing domestically has implications both regionally and globally. We saw this a little bit in the Harbin disaster. Just to give you a sense of some of the implications that we're seeing, one of the most recent changes is that China has now become a significant contributor to marine pollution.

In the Yangtze River delta, 50 percent of the sewage that is discharged is discharged untreated and flows into the Pacific. In terms of transboundary air pollution, both in terms of acid rain, contaminated dust, clearly Japan, South Korea have long been affected; the United States periodically has also been affected from this contaminated dust.

China is also the largest importer of illegally logged timber in the world. In some cases, in Gabon, Myanmar, you're looking at rates of 90 percent of the timber that's being imported is illegally logged. It's a big challenge now for Brazil as well.

You heard about China's contribution to climate change. It is the second-largest contributor after the United States, likely to surpass the U.S. maybe by 2025. I think one of the newest challenges that we're seeing now has to do with Chinese multinationals going abroad, and this is something that I have just started to look at, but a bit over 50 percent of Chinese foreign direct investment is in extractive industries: mining, timber and oil and gas. As we all know, the record on Chinese labor, safety and environmental standards is among the lowest of any country that's going abroad in this way.

Having been in Africa in October, I can tell you they're very concerned about what's taking place there with regard to Chinese companies and the environmental impact. I think that's something to watch.

So what is the Chinese government doing about all of this? Certainly, over the past two to three years, with the advent of Wen Jiabao and Hu Jintao, we've seen new-found attention to the environment, a big uptick in the rhetoric regarding environmental protection and discussion of harmonious society as was mentioned earlier.

I don't think this has much to do with the environment per se. I think it has everything to do with the attendant social, political and economic costs. I touched a little bit on the public health implications. China is also beginning to feel the pinch economically. Chinese media are replete with statistics that talk about the $13 billion that it costs the Chinese economy because of acid rain or the $28 billion cost to industry because they don't have enough water to run their factories.

They're beginning to understand how the environment is beginning to bite back into economic growth, and certainly in a regional sense, what I call changing regional economies. Shenzhen didn't have enough water for some of their factories to fulfill their Christmas orders.

Look at what's happening in Qinghai and other places. There is enormous impact on industrial development in certain regions of the country.

I think the other issue, and you're going to have a whole panel on this so I'm not going to focus on it, is the issue of social unrest. Any number of those 87,000 protests are directly related to the failure of local officials to respond to environmental pollution and it is pollution that is affecting the health of the local people or is affecting their livelihoods by poisoning their crops.

This is not a new problem. Ten years ago, the Chinese government acknowledged that the environment was one of the four leading causes of social unrest in the country. This is a long-term problem. What has changed, I think, is simply that the scale and the scope of the protests have increased quite dramatically.

That's why I think the Chinese government is more interested now than ever before. What are they doing? Well, again, in the past couple of years, we've seen them come up with some new initiatives. They have a ten-province experiment on green GDP, the results of which should be coming out this coming month, February. This is an effort to try to get local officials to incorporate the environmental externalities into the calculations of their GDP in an effort, I think, to show them how important it is to try to grow sustainably.

They have on their books this target of having 15 percent of their energy by 2020 coming from renewables. They have an environmental impact assessment law that was passed a few years back. They're trying to push it forward. It's being implemented spottily. They also have a new head of the State Environmental Protection Administration, Zhou Shengxian, who comes from the Forestry Bureau. He doesn't have any environmental background really, but he was quite an effective promoter for the forestry interests. So we'll see where that goes.

I think it was Mr. Clifford who talked about the fact that environmental protection is fundamentally a local issue in China. About 10 percent of the entire environmental protection budget comes from the national level, from Beijing, about 30 percent from local and the rest comes primarily from the international community in one form or the other.

We do see that local areas that are wealthier are, in fact, investing more of their own resources into environmental protection. I think one thing that was underplayed in the previous discussion was the role of NGOs, environmental NGOs. This is by far the most exciting area of transformation of Chinese environmental protection taking place today.

There are 2,000 registered environmental NGOs in China and about double that number if you include the unregistered ones, because registration brings with it a certain set of obligations and other annoyances.

These NGOs have moved from being primarily focused on things like biodiversity protection and environmental education and

recycling to things like bringing dams to a halt in China, and informing publics about the public health challenges they're facing. This is a very dynamic sector. Still there are boundaries. While the environment is definitely at the forefront of civil society development, we've seen in the past year and a half at least one environmental NGO leader placed under house arrest, and a second one just very recently arrested, jailed and denied legal representation from Beijing.

So it's very much like the media, constantly pushing the boundaries, but never quite sure when they're going to get pushed back or stepped on.

Last point. The international community plays an incredibly important role in environmental protection in China. In fact, the Chinese government calls upon multinationals to lead in environmental protection. I think this offers a lot of opportunities for cooperation and indeed a number of American companies, Nike, Mattel and even Wal-mart are starting to look at how they're designing products and where they're sourcing from, in an effort to improve the environmental protection efforts.

International environmental NGOs are very deeply involved in China. Virtually every single U.S.-based environmental NGO is engaged in China in one respect or other, and pouring resources into this, not only to address Chinese environmental problems, but also because China is having such an enormous impact on the global environment.

One last point that I'm going to make, I was just at an international conference last week where there were a number of Chinese, and we were discussing issues of energy and pollution. I think the new line that's going to emerge from China based on the fact that I heard this from two people, and that's usually enough to signal a trend in what's coming, is that China's energy consumption and its pollution are basically the result of the international community's engagement in China, their high level of investment, and how the Chinese are serving the international community by being the manufacturing center of the world.

So I expect that we can see that despite the fact that China has had this significant increase in oil and is planning to double its oil and coal consumption by 2020, that somehow the international community will be brought to blame for that.

[The statement follows:]

Prepared Statement of Dr. Elizabeth C. Economy, C.V. Starr Senior Fellow And Director, Asia Studies, Council on Foreign Relations

I. The Nature of the Challenge

The rise of China as an economic power is one of the great stories of the latter half of the 20th century. Twenty-five years of reform have produced staggering results: hundreds of millions of Chinese have been lifted out of poverty, China's economy continues to grow at a rate of 8-12% annually, and by the end of 2005, China became the fourth largest economy and third largest exporting nation in the world, after the United States and Germany.

At the same time, this growth has occurred without much consideration for the country's environment. Building upon centuries of environmental degradation and pollution, the very rapid industrialization of the

last quarter century has contributed to some of the highest rates of air and water pollution in the world, severe land degradation, and a range of emerging resource challenges.

The most visible of China's environmental challenges is air pollution. Almost 2/3 of China's cities fail to meet the country's air quality standards. According to a Vice Minister of China's State Environmental Protection Administration (SEPA) Pan Yue, five of the world's ten most polluted cities are in China.[i] Acid rain affects one-quarter of China's land and one-third of its agricultural land, diminishing agricultural output, eroding buildings and contributing to respiratory problems. Regional haze results in 70% of crops yielding at least 5-30% less than their potential.[ii] According to one report, 75% of the people in China's 340 monitored cities breathe unclean air.[iii]

The sources of China's air quality challenge are multifold: its overwhelming reliance on coal for its energy needs, its poor energy efficiency and conservation practices, and the rapidly increasing role of automobiles in its transportation sector. Even the extraordinary level of construction in developing China's cities and the country's infrastructure has become an important contributor to local air pollution. Moreover, China's drive to urbanize 300 million people by 2020 will likely result in a significant increase in air pollution: per capita energy consumption for urban residents is 250% more than that of their rural counterparts.[iv]

China relies on coal for approximately 70% of its energy needs, consuming some 1.96 billion tons in 2004, according to the China Coal Industry Association.[v] China is the largest consumer of coal in the world and the largest emitter of sulfur dioxide (SO2). Coal consumption is expected to double during 2000-2020.

Low utilization of energy efficiency technologies in China's buildings and industries also add to China's coal use and therefore its pollution. Buildings consume 2-3 times the energy that of developed countries in comparable climates,[vi] and depending on the industry, Chinese factories are 3-10 times less efficient than their Indian, U.S. and Japanese counterparts.

Although some individual municipalities in China have achieved striking success in their efforts to improve local air quality, the country overall has made little progress in the face of its extraordinary growth. As the economy moved into high gear in 2003-2004, coal consumption increased, and acid rain and SO2 emissions jumped to their highest levels ever. Moreover, government pollution treatment projects have fallen significantly behind schedule. During 2001-2005, 279 SO2 control projects were slated for construction; by 2003, however, only 61 had been completed and 72 were under construction. In 2005, the Chinese government reported that government spending on environmental protection would fall 30% short of the US$85billion originally set out in the Tenth Five-Year Plan.[vii] To date, only an estimated 5% of China's coal fired power plants have adequate desulfurization facilities. As Wang Jirong, Vice-Minister of SEPA stated, "they would rather be fined than buy such expensive facilities."[viii]

The future does not look promising. In spring 2004, SEPA announced that it fully expected the damage to the environment and human health from acid rain and SO2 pollution to increase for the foreseeable future. Coal consumption was forecast in late 2005 to exceed 2 billion tons for the first time by the end of the year, with SO2 to jump an estimated 6 million tons. [ix] In Guangzhou, SO2 emissions in the first quarter of 2005 increased by 49% over that of the previous year.[x]

The transportation sector poses perhaps the greatest challenge for the coming decades. While China currently boasts only 23 million private cars,[xi] by 2020, transportation experts anticipate China will have at least 110-160 million cars on its roads. Li Xinghua, deputy director of the Communication Ministry's Comprehensive Planning Department estimates that China will eventually have 250 million cars, more than on U.S. roads today.[xii] Pollution from the growing number of cars is already affecting the air quality in the country's most heavily trafficked cities. In Beijing in 2004, vehicles accounted for 8.5% of particulate matter.[xiii] Indeed, despite its best efforts to move polluting industries well outside city limits and use natural gas for district heating rather than coal, Beijing was unable to meet its air quality targets for 2004, suffering significant embarrassment when it was forced to cancel the two-day French air show in early October. In Shanghai, an environmental protection official has said that 70% of the city's 1 million cars do not meet Europe's oldest emission standards.[xiv] China also has 50% of the world's motorcycles, a third of those being highly polluting oil-burning two-stroke engines.[xv] Even as China moves to adopt tougher Euro 4 emission standards, auto manufacturers have complained that the sulfur level in the fuel is too high for the most aggressive emissions control catalyst technology.[xvi] And as China attempts to push forward with alternative fuels, such as compressed natural gas, environmentalists complain that Chinese

companies are producing retrofit kits that are dual use and don't deliver much benefit in terms of air quality.[xvii]

China's land resources are also under threat. China has taken dramatic measures over the past decade to afforest land as well as to prevent further forests from being indiscriminately logged. As a result, its forest coverage has reportedly increased from 16.6% in 1998 to 18.21% today.[xviii] Nonetheless, Lei Jiafu, vice-director of the State Forestry Administration has stated that China's total forest cover is only around 61% of the world average and 130th in the world. In addition, the quality of forest is not high, species mix needs to be more diverse, and the management quality is low. [xix] Loss of forest land remains a problem: 10.107 million hectares of forest land was converted to non-forest use during 1998-2003.[xx]

Deforestation, along with the overgrazing of grasslands and over-cultivation of cropland has dramatically changed the landscape of the country. Deforestation contributes to biodiversity loss, soil erosion, and local climate change. Overall, approximately 40% of China's land is affected by soil erosion.[xxi] The world's highest water erosion rates occur in China in the Loess Plateau, where 1.6 billion tons of topsoil is washed into the Yellow River on an annual basis.[xxii]

In addition, China, which is roughly the same size as the United States, is now more than one-quarter desert, and desertification is advancing at a rate of roughly 1300 sq.miles annually. According to the State Forestry Administration, desertification affects 400 million people.[xxiii] One study by western and Chinese experts predicts that desertification will cause thirty to forty million Chinese farmers to migrate as a result of lack of access to arable land and water in the coming decades.[xxiv]

The most serious environmental challenge China confronts, however, is ensuring access to clean water. While China's freshwater resources—2800 billion m3—rank fourth in the world after Brazil, Russia and Canada, skyrocketing demand, population pressures, inefficiencies, overuse, and unequal distribution all combine to produce a situation in which two-thirds of China's 600 cities do not have enough water for their needs, and of these 110 severely lack water.[xxv] Today, 60 million people have difficulty getting access to enough water for their daily needs. The country's annual per capita water supply is 25% of the global average, and by 2030, per capita water supply is expected to fall from 2200 m3 to below 1700m3. While agriculture demands 69% of China's total water resources consumed, household and urban consumption are growing rapidly. Over the past fifty years, industrial and domestic users raised their shares from 2% to 21% and 1% to 10% respectively.[xxvi] Urban dwellers increased their per capita daily household water consumption about 150% during 1980-2000 from less than 100 liters in 1980 to 244 liters in 2000.[xxvii] Demand for water is expected to triple from 120 -400 billion tons during 1995-2030.

As urbanization has occurred and Chinese incomes have grown, Chinese, like their counterparts in Europe and the United States, have become water-intensive consumers, watering their lawns, taking showers, use washing machines and dishwashers, playing golf and purchasing second homes. China also wastes more water than their developed neighbors: the country loses as much as 25% of the water transmitted through pipes due to leaks;[xxviii] in contrast Japan loses only 8-9%.

Water pollution is also a significant problem. In a survey of 44 Chinese cities, officials discovered that groundwater pollution was a serious problem in 42 of them.[xxix] More than three-quarters of the water flowing through China's urban areas is considered unsuitable for drinking or fishing, and thirty percent of river water monitored by the Chinese government is worse than grade 5 (not suitable for agriculture or industry). Agricultural runoff and untreated wastewater from rural industries have caused serious degradation in several of China's largest and most famous lakes, such as the Tai and Dianchi. The Chinese government publicizes that 300 million people drink contaminated water, 190 million of whom are drinking water that is contaminated enough to make them sick.[xxx] In addition, according to one Chinese government report, unlike developed countries, China does not revise its standards annually; since 1985, China has failed to update its standards, leaving nitrites, bromates and flagellates[xxxi]—all of which can cause serious health problems—outside the realm of environmental governance. Even as the Chinese government has made a significant push to improve the rates of industrial and municipal wastewater treatment, in 2004, SEPA inspected the sewage treatment plants that had been built during the tenth five year plan and found that only half of them were actually working: the other half were closed down because local authorities considered them too expensive to operate.[xxxii]

II. Regional and Global Implications

China's environmental practices have important regional and global implications. The international environmental NGO WWF reports that the Yangtze delta has become "the biggest cause of marine pollution in the Pacific."[xxxiii] Coastline inspections by the SEPA and the State Oceanic Administration found that in "nearly half of the 20 coastal cities inspected, more than 50% of the sewage is discharged into the sea untreated."[xxxiv]

The acid rain that plagues so much of China also affects Japan and Korea: Japan has blamed China for half of its acid rain problem,[xxxv] and Korea attributes 40% of its sulfur dioxide problem to China.[xxxvi] In addition, Japan, Korea, and Russia all have experienced severe dust storms emanating from Northern China (in particular Inner Mongolia); particularly unsettling is the fact that these dust storms also pick up pollutants such as lead, magnesium, and dioxin from China's east coast, and deposit them elsewhere abroad (including at times in the United States).[xxxvii]

Globally, China has become an increasingly important source of the world's most vexing environmental challenges. One of the areas of greatest concern is China's growing contribution to global climate change. China is the second largest contributor to climate change in the world, and the Chinese Academy of Social Sciences expects that China will surpass the United States as the largest contributor by 2025.[xxxviii] China has signed on to the Kyoto Protocol to the Framework Convention on Climate Change, and has initiated some projects with members of the EU under the Protocol to begin to address the challenge of climate change. Nonetheless, these remain on a relatively small scale and are unlikely to change the trajectory of China's greenhouse gas emissions unless dramatically increased. Even China's efforts to generate 10% of the country's power from renewable sources by 2010 are unlikely to have a significant impact on its climate change contribution.

A second issue of concern is China's growing impact on the global trade in illegal timber. China's booming economy and its efforts to protect its own forests, for example, have made China the second largest importer of wood products in the world. Forty percent of its timber and 20% of its pulp and paper imports are estimated to be illegal.[xxxix] About one third of China's illegal timber imports are subsequently processed and exported, primarily to G8 countries.[xl] Chinese logging companies, now present throughout Southeast Asia and the Amazon, have also been cited and fined for their poor logging practices. Most recently, international environmental organizations have been criticizing Chinese companies for plundering the timber as well as jade, gold, and mineral reserves of the Kachin state in Myanmar.[xli] In 2004, about 95% of Myanmar's total timber exports to China were illegally exported. Greenpeace has also accused China of illegally exploiting ancient hardwood forests in Papua, New Guinea to feed the PRC's plywood industry.[xlii]

An emerging concern for countries in Latin American and Africa are the safety, health and environmental issues presented by the growing role of Chinese mining industries in their countries. Over fifty percent of China's foreign direct investment is in extractive industries, and China's mining companies have some of the worst labor practices in the world. There have been demonstrations against a Shougang group-owned mine in Peru, where water is now available for only four hours per day, and environmental and safety records, as well as workers' incomes have declined precipitously since Shougang assumed control a decade ago, even as profits for the mine have soared.

III. Beyond the Environment: The Economy, Public Health and Social Unrest

As the Chinese leadership witnesses the degradation and pollution of its natural resources, it has also become acutely aware of the secondary impacts that these environmental challenges are exerting on the current and future well-being of the Chinese people. These additional challenges bring a new urgency to the Chinese government's thinking about how to respond to the country's environmental problems.

First, and perhaps most critically, the environment is beginning to bite back into the economy. Costs are wide-ranging, from embarrassment (as when Beijing cancelled the French air show in October 2004) to far more dangerous (as when smog in the Pearl River Delta contributed to the collision of eight boats during summer 2004).[xliii]

Of greatest significance to the Chinese government, however, is likely how environmental degradation and pollution may contribute to impinge on future economic growth, an issue with which Chinese economists

have been grappling in some form or another since the early 1980s.[xliv] In 1997, the World Bank published its report, *Clear Skies Blue Water* that suggested that the cost of environmental pollution and degradation in China was equivalent to 8-12% of GDP annually. This estimate included the costs associated with lost days of work from pollution-related illnesses, contaminated crops and fisheries, and industry closures due to lack of water, among other factors. Today, the Chinese media are replete with such statistics, reporting, for example that in 2003, floods and droughts led to economic losses totaling 200 billion yuan (US$24 billion);[xlv] desertification resulted in direct economic losses of 54 billion yuan or $6 billion;[xlvi] acid rain cost China $13 billion; and water scarcity cost China $28 billion in lost industrial output. China's fisheries lost US$130 million in 2004 due to water pollution; this represented an increase of over $40 million from the previous year.[xlvii] In terms of biodiversity, China's opening up to the international community brought with it the introduction of more than 250 alien species that caused environmental damage with a price tag of US$14.44 billion in 2000.[xlviii]

Regional economies are also shifting in response to environmental degradation and pollution. Statistics from the Ministry of Agriculture demonstrate that in the Bohai Sea, the output of prawns has declined by 90% over the past two decades. Pollution has transformed the Bohai, once referred to as the "storehouse of fish," into the "main pollutant absorber" in Northern China. Almost three billion tons of wastewater flows into the Bohai annually, which accounts for about 32% of the country's total amount of waste water discharged into the seas.[xlix] In an area near Shenzhen, the local monkey population is being slowly starved as the local banana trees that have traditionally supplied them have been "robbed of sunshine, water, and even air," by an alien plant species, the South American Climber.[l] A Hong Kong multinational has noted that because of water scarcity, a spinning mill constructed in 1996 in Turpan, Xinjiang is no longer as economically viable as previously because the cotton must be imported from further and further away. In Shenzhen, too, during December 2004, some factories reported that they could not fill their Christmas orders because they did not have enough water to operate. Along the Yellow River, rising water prices and the poor quality of the water now cost companies in the Yellow River basin about US$300-400 million annually. In addition, declining water quality and availability has left farmers suffering an annual loss of US$400 million in crops. Moreover, a Chinese report suggested a link between the high cost of medical treatment along the Yellow river—$250-350 million—with the water quality.[li] Finally, in Qinghai, the Chinese government reported that by 2001, 2000 lakes and rivers had dried up with severe consequences for local industry, hydropower, and the volume of water in the Yellow River.[lii]

Environment-related public health problems are yet another challenge China's leaders must address. According to one report, 75% of the chronic diseases in China are linked to pollution resulting from industry and personal activity.[liii] The World Bank has stated that annually 300,000 Chinese die prematurely from respiratory disease related to air pollution. In the district of Beijing in which Capital Iron and steel is based, the death rate from lung cancer is on average 30% higher than in other parts of the capital.[liv] The impact of water pollution on public health is an even greater concern. Experts from China's Ministry of Water have stated that there are more than 50 diseases in China resulting from unclean drinking water. While 300 million people in rural China don't have access to clean water, China was able to introduce clean drinking water to only 14 million rural families during the past five years.[lv] In addition to the impact of China's poor air quality on public health, The Minister of Water Resources Wang Shucheng stated at a symposium on sustainable water management that "hundreds of thousands of Chinese are afflicted with various diseases from drinking water that contains too much fluorine, arsenic, sodium sulfate or biter salt."[lvi] Entire communities along China's major river systems report higher than normal rates of cancer, tumors, stunted growth, spontaneous abortion and diminished IQs due to the high level of contaminants in the soil and water. Wang Bin, director of the Ministry of Public Health's Women's Health Division, has also linked environmental pollution with the 25% increase in birth defects China experienced during 2001-2003.[lvii]The relationship between environmental pollution and public health was brought into sharp relief by a World Bank report that indicated that SARS was most potent in areas where the levels of air pollution were the highest. According to one report, experts believe that the cost of environment-related public health problems is in the billions of dollars.[lviii]

Finally, as China's economy has developed in many regions without respect to the environmental and public health concerns raised, the Chinese leadership has had to contend with significant social unrest. In the mid-1990s, the Central Committee of the Chinese Communist Party published a report acknowledging that environmental degradation and pollution was one of the four leading causes of social unrest in the country.

Throughout 2005, there have been several environment-related protests, many of which have spiraled out of control and resulted in beatings, deaths, and large numbers of arrests. An ongoing dispute in central China over mines that have poisoned the water and land of a wide swath of villages has resulted in several violent protests over the course of the past year.

Zhejiang Province has also been the site of many such environmental protests. In April, 2005, for example, 60,000 people in the village of Huaxi, Zhejiang, reportedly protested against the 13 chemical plants that polluted the water and soil around the village. According to one report, two people died in the clashes between demonstrators and police.[lix] In August, villagers again threatened protests because local officials had failed to fulfill promises to redress the situation. In July, 2005, in Zhejiang province, more than 10,000 people protested a pharmaceutical plant that was similarly poisoning the land and water and harming public health. And in August, in Meishan, Zhejiang, villagers blocked the operation of a battery company they believed was poisoning their children, hundreds of whom reported higher than normal concentration of lead in their blood.

IV. What is the Chinese Government Doing?

China's leaders have a four –pronged strategy for addressing their environmental challenges that in many respects is modeled on the country's economic reform strategy: maintain a limited central government; devolve authority to local officials; rely on private initiative, in this case nongovernmental organizations; and engage the international community.

China's capacity to address environmental challenges from the central government remains limited. The State Environmental Protection Administration (SEPA) has only 300 full time professional staff in Beijing, and China devotes only 1.3% of its GDP to environmental protection, well below the 2.2% that Chinese scientists have argued is necessary merely to keep the situation from deteriorating further. Overall, China's central government is reportedly responsible for just over 10% of the overall environmental protection budget of the country, relying on local authorities and the international community to fund the vast majority of China's environmental protection needs. Xie Zhenhua, the former head of SEPA, was removed from his position in the wake of the Harbin chemical disaster in December 2005. While it is too early to know the policy outlook of his successor Zhou Shengxian, he does not bring strong environmental credentials to the table.

The greatest authority for environmental protection rests at the local level. This Devolution of authority has encountered both success and failure in encouraging environmental protection. Local environmental protection bureaus throughout the country are typically ill-equipped to manage the task at hand. In addition, more powerful bureaucratic entities and local officials often attempt to influence environmental officials to ignore laws and regulations out of concern for social stability or because these officials have personal or financial ties with local polluting enterprises. Without a strong central enforcement capability, theses local environmental protection bureaus have little political weight in the system.

Nonetheless, some cities, with proactive leaders, relatively high per capita GDP and strong ties to the international community, have begun to invest greater percentages of their local budgets into environmental protection efforts. Beijing has rewarded such cities with "National Model Environmental City" status, and new experiments, such as the Green GDP, if successful will help reinforce the idea that political benefits will accrue to those local leaders who manage both to grow their economy and protect their environment.

The third prong to China's strategy is encouraging the domestic NGO community and media to serve as both a motivator for environmental protection among the Chinese people and as a watchdog on local government's implementation of central directives. There are more than 2000 environmental NGOs in China, with a wide range of expertise and approaches. While many stress environmental education as their primary goal, increasing numbers have become engaged in lobbying the central government on issues as wide-ranging as promoting recycling or wind power to bringing to a halt large scale dam construction. Legal environmental NGOs have become quite aggressive in pressing lawsuits against companies on behalf of pollution victims, although they face an uphill battle in the still weak court system. The media also work very closely with NGOs to expose corrupt local officials or businesses that are violating environmental protection laws. With support from the State Environmental Protection Administration—with whom NGOs often work quite closely—the NGO community has pressed for greater transparency in

the environmental impact assessment (EIA) process and for open hearings, as the EIA law permits. More broadly, Chinese environmental NGOs are considered to be at the forefront of civil society development in China.
Still, regulations governing NGOs, their activities, their membership, and their ability to expand continue to limit sharply the role that they can play as a real participant in environmental enforcement. Moreover, environmental activists who cross a line politically—becoming engaged in disruptive protests or otherwise "stirring up trouble"—have been put under house arrest or even jailed. During Fall 2005, for example, Green Watch founder Tan Kai was arrested and charged with "Disclosing State Secrets." Tan, a Zhejiang resident, founded Green Watch in the wake of the environmental protests there. Thus far, his request for legal representation from Beijing has reportedly been denied.

Much of what Beijing hopes to accomplish on the environmental front rests on its interaction with the international community. The discussion below outlines some of the major thrusts of this effort.

IV. Working Together to Meet China's Environmental Challenge

Engaging the international community is one of the major tenets of China's environmental policy,[lx] and outside assistance has been crucial to the development of China's capacity to meet its environmental challenges to date.

Cooperation between China and the international community takes several forms: policy guidance, technology transfer, and capacity building, and there are many avenues to consider in pursuing such cooperation. Some examples of ongoing cooperation include:

- The United States, the EU, Japan, Australia and other countries are deeply engaged in promoting joint research on alternative energy sources and transfer of clean coal technologies.

- Institutions and countries such as the World Bank, the Asian Development Bank, Japan, and Canada train Chinese officials to tackle environmental challenges more effectively and support a wide range of energy efficiency efforts, wastewater treatment facilities, and alternative energy development.

- USAID supports environmental conservation and biodiversity protection in Tibet: DOE has established several policy dialogues and working groups, and undertaken capacity building efforts to promote clean(er) energy technologies and nuclear safety. DOE is also the lead agency for the Asia Pacific Partnership on Clean Development and Climate as well as an effort to promote a Green Olympic Village for the 2008 Olympics in Beijing. USEPA supported the adoption of U.S. air quality monitoring system in 11 cities; sponsored workshops in Beijing on managing regional air quality; and is working on water safety in Tianjin and the clean-up of contaminated sites.

- The non-governmental community—from the Nature Conservancy to NRDC to Greenpeace—has long considered China an essential part of its overall global strategy, assisting China in managing its environmental challenges and its contribution to global environmental problems. For example, ED works with China on developing and expanding a system of tradable permits for SO2 emissions; NRDC has invested heavily in educating officials and developing regulations for building efficiency codes; the Energy Foundation supports a wide range of activities designed to promote the use of renewable energy and alternative fuels; and Global Greengrants provides support to nascent environmental NGOs in China.

A pressing issue for China's leaders is also how to ensure that the extraordinary level of foreign direct investment can be channeled in environmentally constructive rather than destructive forms. For the most part, domestic Chinese companies have yet to realize the economic benefits of good environmental practices. In a 2004 WWF survey of 182 of China's largest companies, only 18% believed there was a link between good environmental practice and saving money.[lxi] Chinese officials have therefore called explicitly for multinationals to lead in environmental protection, recognizing the important role they can play in setting an example of best practices for domestic enterprises.

Many multinationals have risen to the challenge, setting high environmental standards, transferring technology, and supporting China's environmental goals more broadly.

- Royal Dutch Shell, for example, dramatically raised the environmental bar by hiring ERM, an environmental consulting firm, to conduct an environmental impact assessment for a joint venture project with Petrochina to bring natural gas from Xinjiang to Shanghai (a joint venture Shell never realized).lxii Shell is also engaged in supporting Chinese environmental NGOs and environmental education.

- Companies such as BASF, Intel, and BP Solar are all donating physical and intellectual capital up front to a demonstration project for a sustainable village in Liaoning Province, with the anticipation of reaping benefits 3-5 years down the line. BASF, for example, has developed a highly energy efficient roofing and insulation material that can be used and reused many times. It is participating in the demonstration project with an eye toward helping the Ministry of Construction as it develops its rural construction standards as China's housing market continues the process of its dramatic growth. The Iowa-based company, Vermeer, has a similar incentive in doing a demonstration project for a brick substitute made from compressed earth. BP Solar is donating a 1000w generating system for the village with the understanding that the system will be hooked up into the local power grid and BP Solar can sell back whatever power is not consumed by the village. Intel is spending three years studying life in Huangbaiyu in order to understand in an organic way the role of technology in rural development, asking the questions what do people really need and want? They are adopting a five to ten year horizon in order to understand for example the most appropriate role of technology in health care or transportation in China's rural sector.

Still, impediments to "doing the right thing" remain. Some firms, such as Britain's Thames Water PLC and France's Veolia Water have invested directly in China's clean-up process, forming joint ventures with municipal waste water treatment facilities. In 2004, however, Thames Water PLC pulled out of one such venture, when the Shanghai government refused to honor its pledge for a guaranteed rate of return on investment.[lxiii] Similarly, as multinationals support Chinese laws or new initiatives, they may find that China's economy does not yet send the appropriate signals to make these new ventures viable. Dow Chemical, for example, is supporting a $750,000 dollar project in cleaner production.[lxiv] Yet, Wang Jirong, a Vice-Minister of SEPA, has stated that despite the existence of a 2003 Law on Cleaner Production, the concept has not taken hold very rapidly because the implementation of cleaner production suffers from lack of funds and technologies, a defective environmental management system, difficulty in getting information, and a lack of market incentives."[lxv]

Moreover, many multinationals continue to view China as an attractive investment opportunity because of its weak enforcement. The Chinese government has become extremely sensitive about being perceived as the repository for the world's waste or polluting industries.[lxvi] In 2004, Greenpeace Beijing undertook an undercover investigation of Asia Pulp and Paper's (the largest paper manufacturer in Asia outside Japan) practices in Yunnan and accused it of illegal logging, prompting an investigation by the State Forestry Administration[lxvii] that eventually found APP guilty of wrongdoing. More recently, Greenpeace Beijing has highlighted the role of a number of multinational, and in particular Hewlett Packard, for the excessive amounts of toxic chemicals used in its computers, thereby contributing to a dangerous computer waste problem in China.[lxviii]

V. What More Can We Do?

The challenge of environmental protection in China is multifaceted. It involves the capacity of central and local environmental institutions, the evolution of China's economy which both offers new opportunities and inhibits environmental protection, the development of the rule of law, the gradual growth of civil society, access to new policy ideas and technologies, and the extraordinary level of multinational engagement in the country's development. Opportunities for further cooperation between China and international actors are available in each of these arenas.

At the same time, the likelihood of successful cooperation depends significantly upon the ability of local partners or the central government to provide a felicitous institutional infrastructure and policy environment. While China's leaders have supported the development of such an infrastructure rhetorically, there remains a vast divide between their statements of intent and their commitment both in terms of human and financial capital.

To that end, supporting the development of this infrastructure should be a primary goal of U.S. policy. Some opportunities in this regard include the following: is at least as important as focusing on opportunities for technology transfer.

- Lift the ban on USAID involvement in China. Although USAID indirectly funds some programs related to Tibet and the environment, with its broad emphasis on governance, public health, rule of law and poverty alleviation, it could be far more effective in addressing China's most pressing needs and the United States' most direct interests. USAID also has developed a highly effective model for promoting energy efficiency and conservation in India—supporting zero emission automobiles, for example—that could be replicated in China.

- Enhance existing efforts to promote the rule of law and environmental governance. This should be a priority area for the State Department's Democracy, Human Rights and Rule of Law program. Coupled with work by organizations such as the American Bar Association, the Ford Foundation, and the Woodrow Wilson Center, the United States has established an important foothold in this area. Given the long term reform benefits of these nascent efforts, however, significantly greater resources—through training, exchange, and education should be provided to strengthen both the legal and NGO sectors in China. The opportunities for public-private partnership in this area are significant.

- Remove restrictions on the Overseas Private Investment Corporation to provide assistance to U.S. businesses eager to gain a foothold in China's environmental technologies market. This market is currently dominated by Japan and the European Union.

- Encourage U.S.-based multinationals that source from China to place pressure on their suppliers to meet environmental, safety and labor standards or risk losing the multinational's business.

HEARING COCHAIR WORTZEL: Thank you very much, Dr. Economy. Dr. Gill, can we turn to you?

STATEMENT OF DR. BATES GILL, FREEMAN CHAIR IN CHINA STUDIES, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

DR. GILL: Thanks very much, Larry, and let me thank as well Vice Chairman Bartholomew. Very seriously, I want to commend the commission for taking up these important issues of internal challenges facing China.

I think it's fair to say that it's something of a change of a direction in some of the issues and topics that you've pursued in the past, and I think it's a very welcome development because clearly the China that we have to deal with ten or 15 years from now is going to be profoundly shaped and maybe even most profoundly shaped by what happens inside that country.

We need to be better at understanding what's going on there, and through the work of the commission, we can hopefully channel some of this very interesting information and assessment and analysis into the policy decision-making process. We've got a lot of work to do on that, and I really commend you on taking up this very important set of issues.

I was asked to talk about China's health care and its retirement pension system and the problems it poses domestically. I've done a lot of work in recent years on China's health care work, and it's taken me to some very interesting conversations, from the Minister of Health all the way down to village level, clinics and so-called barefoot doctors in some pretty far-flung parts of China, in Xinjiang, southern Yunnan and southern Sichuan, Hubei, Anhui provinces, et cetera.

It's a very fascinating and interesting set of issues to try and tackle, and I think importantly an area where America has enormous

interests to know more about it and to try and shape outcomes there that are beneficial to us.

Allow me to talk about some of those here. I'll try to do this in five parts. Just a few words about the overall health situation in China, then talk about China's health care and health insurance system. Thirdly, let's talk a little bit about China's aging challenge and the demographics surrounding that, and what kind of preparations China is making in terms of retirement pensions to address its aging population. Then last, I was asked to talk a little bit about U.S.-China cooperation. What is our government doing in some of these areas?

On the health situation, clearly, compared to 50 years ago, China's overall health situation today has dramatically improved. Remarkably, China has raised its life expectancy from about 35 years in the early 1950s to 71 today, almost 72 years today. So that's really approaching developed world levels and they've done it in a pretty short time.

Overall, the rapid economic development of China and the past public financed provincial-based approach of its health care system, I think, can be attributed to this remarkable improvement overall.

But there are weaknesses in the system and the weaknesses are growing. In spite of several important key health indicators that are positive, China's health situation faces a lot of problems. Its ailing public health care system, which I'll talk about in just a minute, means that China is increasingly vulnerable to emerging, so-called emerging and reemerging infectious diseases, and the problem of chronic disease in China has grown remarkably in just the past decade.

I've done a lot of work on HIV/AIDS in China, and I've left some reports and things here for the public as well as for the staff and for the commission to review. We can talk about that in some detail. I think the key takeaway on the HIV/AIDS problem in China is that even though they've recently estimated lower overall numbers for HIV positive persons in China, it's still the case that there are 70,000 new infections a year in China and something between 80 and 90 percent of the persons in China who are HIV positive don't know it, and the government doesn't know who they are, which raises tremendous issues then for the continued spread of the disease.

Obviously, avian flu is an issue we all ought to be concerned about. As of last week, the Chinese Ministry of Health had announced ten confirmed human cases in seven provinces and regions. Seven of those ten confirmed cases have been fatal. So for whatever reason, the fatality rate in China has been slightly higher than elsewhere around the world.

In a country like China with a human and poultry populations often living in close proximity with one another, the possibility that a global pandemic of avian flu emerging from China is very, very real.

And here, we face again this problem of local implementation. By the admission of China's senior-most health officials, there are very serious problems at local levels, both for technical reasons -- not having the equipment -- but also for practical

reasons of lack of education, lack of resources, trying to deal with these threats emerging out of China's countryside.

There is some further data on China's chronic disease problem that is quite remarkable. Take a look at that inside the prepared testimony.

What can China do? Its health care system is in big trouble. It is increasingly a pay-as-you-go system. Increasingly, the public-financed or health insurance or public health insurance is weakening and covering fewer and fewer persons. Out-of-pocket spending on health care in China today represents twice as much as a percentage of GDP as does public health care spending.

According to a recent report coming out of China State Council Development Research Center, the country's medical insurance system only covers about half of urban residents or about 100 million persons, and covers only about 10 percent of China's rural population.

This report says that increasingly because of the unbearably expensive cost to patients of health care in China, most, many increasingly dare not even show up at a doctor's door or go to the hospital when they fall ill.

It's interesting. In China when you talk to the common citizens, they look at doctors in the same stereotypical way as we in America look at lawyers. Doctors are considered shysters. Doctors are considered out to steal you blind and to charge you too much money and to rip you off and not really care about your health situation. It's a very interesting situation there, but it speaks to the problems generally of the health care system in China.

The aging problem. Again, I'm not an expert in demography. I would point, though, to the work of my colleague Richard Jackson at CSIS who has done an enormous amount of work on this. He has a very interesting sound bite on this, which I think is worth remembering: China will grow old before it grows rich.

In the West, in the developed world, we grew rich and then we became old. Because of the socioeconomic development of our countries, that's altered the birth rates and so forth and we've become a more aging society. Not so in China. Because of the one-child policy, but also because of China's socioeconomic development, longer life expectancies and so forth, China is reaching a point where it's going to be old before it's rich, and that's going to present enormous challenges obviously to the health care system and to the pension system.

China doesn't really have a viable pension system. Fully three-quarters of Chinese workers, both in the cities and in the countryside, have no formal pension or retirement system at all except for savings and hoping that their kids will take care of them. That's the retirement plan for the vast majority of Chinese citizens.

State-owned enterprise workers and government workers do have retirement pension plans available to them, but by most estimates, these pension plans are facing imminent fiscal collapse as the numbers grow and the system is having increasing liabilities and because the system is not well invested: the financial system in China is not well

structured to allow for growth of these monies. They face an enormous problem.

According to some estimates coming out of the World Bank, for example, currently China's unfunded pension liabilities, if they had to pay everybody what they owed them right now, it would be equivalent to somewhere in the range of 70 to 100 percent of Chinese GDP. Some estimates say that the current unfunded pension liability for China is about $1 trillion, and that's obviously going to grow as China's society continues to age. So it's a huge problem, and I don't think China has any answers really right now about how they're going to deal with it.

U.S.-China cooperation. Then to conclude, there are a number of very interesting areas where our two countries are trying to find areas of some cooperation, obviously led by our Health and Human Services Department. There's been established, for example, in cooperation with our Department of Commerce, a so-called U.S.-China Health Care Forum. I think U.S. interests here are largely trying to learn more about the Chinese health care system and seek opportunities for American businesses and financial services to work with China on the Medicare system, on medical insurance in China, on health care products and services, and research and development for health care products and services in China.

So, in other words, it is looking at China's health care problems, but it's also seeing its potential market for American businesses in the health related field.

Chinese Health Minister Gao Qiang and Health and Human Services Secretary Leavitt signed in October 2005 during the Minister's visit to the United States a new memorandum of understanding between our two countries. Its primary intention is to work together to provide technical assistance to deal with the problem of emerging and reemerging diseases such as SARS, influenza, West Nile Virus and plague, all of which are prevalent or SARS was prevalent, but prevalent in China, I think trying to make sure that it doesn't emerge out of China and begin to affect American interests.

I've spoken a little about how U.S.-China cooperation on HIV/AIDS and that continues to expand. I think the United States government has committed approximately $35 million over five years coming out of NIH, CDC and our Health and Human Services Department to help China tackle its HIV/AIDS problem.

Looking ahead, I think there are enormous opportunities for U.S. firms and non-governmental organizations as well as U.S. government agencies and research institutions to intensify cooperation in areas such as pension financing, including the development of viable investment vehicles inside China, health care insurance, and financing, aging and elderly care, drug pricing and availability, chronic disease, occupational health and safety and environmental health. These are all areas where we I think have a lot to contribute to China and where the opportunities for cooperation are good.

Just as Liz Economy has so well described the emergence of the environmental NGO movement in China, I think we might test over

the coming years the thesis that it will be health-care related NGOs which may become a kind of second wave of NGO development in China. We in the United States can play a role in trying to foster that development.

Thanks very much.

[The statement follows:]

Prepared Statement of Dr. Bates Gill, Freeman Chair in China Studies, Center for Strategic and International Studies

Introduction

Let me begin by thanking the Chairman of the Commission and the Co-Chairmen for this hearing for inviting me to provide my views this morning. I commend the Commission for taking up issues related to China's domestic political, economic and social challenges. The China we will face in 10 years' time will be profoundly shaped – for better or for worse – by the enormous domestic challenges unfolding in the country. Our political leadership and policy community needs to be better prepared to assess and respond to these developments, and our work here can make a contribution to that process.

As China's socioeconomic system moves increasingly toward the market and the role of the state diminishes as a provider of social services and public goods, the country's social safety net systems – traditionally core aspects of Chinese socialism – have suffered and declined. Moreover, the central government is cutting back on financial support to localities, and increasingly expects provincial and local governments to generate their own revenues to support social services in their jurisdictions. Poorer parts of China – where governments are less innovative, economic development lags, and tax revenues are scarce, and where the vast majority of Chinese citizens reside – are particularly hard-pressed to provide decent health care, pensions and other social benefits.

In response to the Commission's request, I have divided the remainder of this testimony into five parts, covering:

- China's overall health situation
- China's health care funding and medical insurance
- China's aging challenge
- China's retirement pension situation
- U.S.-China cooperation and assistance programs in these areas

Health Care Situation

Compared to 50 years ago in the early years of the People's Republic of China, health conditions have improved dramatically. According to statistics from the World Health Organization (WHO), the average life expectancy of people in China has been raised from 35 in the 1950s to 71 in 2003. The mortality rate of Chinese infants declined from as high as 20 percent during periods in the 20th century to 2.5 percent at present. There are more than 300,000 hospitals and other medical institutions across the country.[2] For the most part, China's overall improved health situation is attributable to its rapid economic development and its past public-financed disease prevention strategy.

Despite remarkable gains in key health indicators, however, China's health situation faces many problems. With an ailing public healthcare system and social safety net (discussed below), China is increasingly vulnerable to the spread of emerging and re-emerging infectious diseases. For example, China is facing a considerable HIV/AIDS epidemic. China had approximately 141,241 cumulative known cases of HIV infection by the end of November 2005, a more than 50 percent increase from 89,067 cases reported the year before.[3] Importantly, China estimates there are approximately 650,000 HIV/AIDS cases in China, meaning that about 80 percent of those infected with HIV in China do not know it, and health authorities do not know where and who they are.

"Almost 200 people are infected [with HIV] every day in China. The situation is grave." -- Wang Longde, China's Vice Minister of Health, New York Times, January 25, 2006.

[2] "Chinese People's Health Condition Advanced in Developing Nations," *People's Daily*,

[3] "Epidemiological Fact Sheets on HIV/AIDS and Sexually Transmitted Infections, 2004 Nations Joint Programme on HIV/AIDS, 2004.

Although the new estimate of 650,000 cases is lower than the previously believed, the rate of infection is rising at rate of at least 70,000 new cases per year as of 2005.[4] In 2004, the United Nations projected that, if the epidemic is left unchecked, the number of people living with HIV/AIDS in China could exceed 10 million by 2010.[5] The epidemic clusters among several marginalized groups that live outside mainstream society, such as commercial sex workers and intravenous drug users (IDUs) in several regions. However, several emerging factors – increase in China's sex trade, increasing pre-marital and extra-marital sex, greater social tolerance for homosexuality and men having sex with men, and risky behavior in the "floating population" of migrant workers – could serve as a bridge to spread the epidemic into the general population.[6] In some provinces, such as Yunnan, Henan, and Xinjiang, HIV prevalence rates exceed 1 percent among pregnant women, and among persons who receive premarital and clinical HIV testing. This meets the criteria of the United Nations Joint Program on HIV/AIDS (UNAIDS) for a "generalized epidemic."[7]

Avian influenza, or "bird flu", is another concern. Since China first acknowledged that it had identified one case of bird flu in July 2004, the virus has spread among chickens in numerous villages in southern and western China. In 2005, Chinese agriculture authorities reported 32 outbreaks in poultry in 12 provinces, resulting in the culling of more than 24 million birds.[8] The government announced China's first confirmed human cases at the end of 2005. As of January 25, 2006, Chinese MOH has announced 10 confirmed human cases, seven of which have been fatal. The cases have occurred in 7 provinces and regions: Anhui, Guangxi, Liaoning, Jiangxi, Fujian, Hunan and Sichuan.[9] With a potential human pandemic at hand, China faces grave challenges due to the large size of both its human and poultry populations. The central government has candidly expressed its determination to fight HIV/AIDS, bird flu, and other infectious diseases, however, local-level implementation remains a big problem.

Chronic and non-communicable diseases are also continuing to increase in China. According to the WHO, chronic diseases are projected to account for 79 percent of all deaths in China in 2005. A WHO projection in 2005 estimates that over the next 10 years, over 80 million people will die from chronic diseases in China, a remarkable increase of 19 percent over the previous 10 years.[10] In large measure, this trend reflects China's transition to an aging society (discussed in more detail below). The continuing increase of chronic disease cases will result in an increasingly heavier burden on the healthcare system and affect overall GDP. It is projected that China will lose US$558 billion over the next 10 years from premature deaths due to heart disease, stroke and diabetes.[11]

Other lagging health-related factors contribute to increasing chronic and communicable disease as well. According to the United Nations Development Program, for example, only 44 percent of China's population had "sustainable access to improved sanitation" in 2002 (though that is double the percentage in 1990), and some 23 percent of the population in 2002 did not have "sustainable access to improved water sources", down only 7 percent from 1990.[12]

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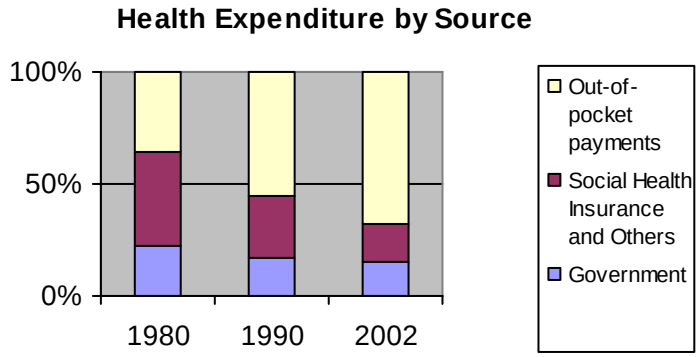
[4] *2005 Update on the HIV/AIDS Epidemic and Response in China*, Chinese Ministry of Health, United Nations Joint Program on HIV/AIDS, and the World Health Organization, January 24, 2006.
[5] "Epidemiological Fact Sheets on HIV/AIDS and Sexually Transmitted Infections, 2004 Update China," United Nations Joint Programme on HIV/AIDS, 2004.
[6] Bates Gill, J. Stephen Morrison, and Andrew Thompson, *Defusing China's Time Bomb: Sustaining the Momentum of China's HIV/AIDS Response*, CSIS HIV/AIDS Task Force Report, June 2004.
[7] *2005 Update on the HIV/AIDS Epidemic and Response in China*, Chinese Ministry of Health, United Nations Joint Program on HIV/AIDS, and the World Health Organization, January 24, 2006.
[8] "Avian influenza – situation in China – update 2," World Health Organization, January 25, 2006. acccessed at: www.who.int..
[9] "Avian influenza – situation in China – update 2," World Health Organization, January 25, 2006. acccessed at: www.who.int.
[10] *The Impact of Chronic Disease in China*, World Health Organization, 2005, accessed at: www.who.int/chp/chronic_disease-report/en/.
[11] *The Impact of Chronic Disease in China*, World Health Organization, 2005, accessed at: www.who.int/chp/chronic_disease-report/en/.
[12] See the *Human Development Report 2005* (New York: United Nations Development Programme, 2005), p. 241, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

The Chinese central government is increasingly open in recognizing the problems posed by its public health situation. Chinese news has reported experts' concerns on health care and pension issues. For instance, in 2002, Xinhua reported that among the top ten mass concerns was the need to "set up a sound social security system", and noted that "the current pension insurance fund system of payments from current accounts can hardly be maintained over the long term." *People's Daily* reported in 2004 on the top ten challenges facing China, including "AIDS and public health." In the past year, a State Council researcher, Ge Yanfeng, issued a highly critical report on China's health care reform efforts, and in July 2005, Chinese Minister of Health Gao Qiang went on record in a public speech on the need to dramatically improve China's health care conditions. In drawing up the 11th Five Year plan, central authorities pointed out the need to "accelerate the pace of perfecting the social security system." According to the plan, "the basic pension, medical care, unemployment, workplace injury, and birth insurance systems for urban workers should be perfected. Fiscal investment in social security should be increased; social security funds should be raised through multiple channels; and personal accounts should be established gradually." It also emphasized the issue of social security for migrant workers in the cities. [13]

Health Care System and Funding

China's health care and medical insurance system face a number of challenges. China's once admired public health care system has degenerated considerably since privatization began in the 1980s. Prior to 1980, China adopted a collective health care financing system, relying heavily on public subsidies. In the course of rapidly developing its market economy in the past two decades, the old health care system has been abolished as China has attempted to switch to a market-oriented health system. In so doing, the government has failed to establish a viable substitute for the old health care system.

Today, private, out-of-pocket spending on health care in China represents almost twice as much as public health care spending as a percentage of GDP.[14] The United Nations also estimates that, as a share of total health expenditure, such private health-spending rose from 36 percent in 1980 to 68 percent in 2002. In contrast, the government's share declined from 32 percent in 1978 to 15 percent in 2002.[15]



Source: *A Health Situation Assessment of the People's Republic of China*, United Nations, July 2005

As a result, according to recent report released by China's State Council Development Research Center, the country's medical insurance system currently covers less than half of urban residents (approximately 100 million people) and only 10 percent of the rural population. The same report also notes that "China's medical reform has been unsuccessful because it has become unbearably expensive to patients and many dare not go to the hospital when they fall ill."[16]

In addition, the disparity in government health care spending between urban and rural areas is stark and increasing. United Nations' data show that in 2002 the average level of per-capita health spending in

[13] "CPC Central Committee Proposal on Formulating the 11th Five-Year Program for National Economic and Social Development," *Xinhua*, October 18, 2005.
[14] *Human Development Report 2005* (New York: United Nations Development Programme, 2005), p. 241, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.
[15] *A Health Situation Assessment of the People's Republic of China*, United Nations, July 2005.
[16] "The Medical Reform Controversy," *Beijing Review*, vol. 48, no. 38, September 22, 2005.

urban area was more than twice the national average and 3.5 times the average health spending level in rural areas. China's medical resources have been mostly allocated to benefit urban areas and to government departments or state-owned units. Meanwhile, the lack of funding in rural areas means poor and declining health services over time.

Population vs. Health Expenditures in Rural and Urban China, 2002

	Population (million)	Health Expenditure (RMB billion)
Rural	800	190
Urban	500	280

Source: *A Health Situation Assessment of the People's Republic of China*, United Nations, July 2005

China's urban social health insurance, named as the Urban Employee Basic Medical Insurance System (UEBMIS) was launched in 1998. Employees of the non-state sector have recently been urged to join the scheme as well. UEBMIS enables urban employees to use private medical saving accounts and social-risk pooling funds. However, it sets a ceiling, above which medical expenses should be covered by supplementary insurance or out-of-pocket money.

In the countryside, the new Rural Cooperative Medical Scheme (RCMS) was started in 2002, which aims to pool funds for catastrophic illness and in-patient medical services. Nevertheless, the participation rate of rural individuals is very low, as mostly those at higher health risk are interested in the scheme. As mentioned above, more than 90 percent of the rural population still does not have any medical insurance.

China's Aging Challenge

China's age wave is crashing upon the country at an exceptionally fast pace. Unlike the experience in the West and other developed economies which became "rich" before they became "old", China will be the first major country to become "old" *before* it becomes "rich."[17]

Unlike in the West and other developed economies, China will grow "old" before it becomes "rich." – Richard Jackson and Neil Howe, The Graying of the Middle Kingdom

There are two fundamental forces behind China's aging population – falling fertility and rising longevity. The total fertility rate (TFR) of Chinese women has decreased dramatically from 6.1 in 1949 to 1.8 in 2002, reaching below the replacement level of 2.1 children per mother, a birthrate required to keep the population steady.[18] Within only a short period of time, China's TFR pattern matches that of more developed countries and China now has one of the lowest fertility rates in the world. This is partly the result of the Chinese government's one-child policy, introduced in 1979 in order to strictly control its growing population. A more important factor is China's overall socioeconomic modernization, which, as shown across the world, results in significantly reduced birthrates.

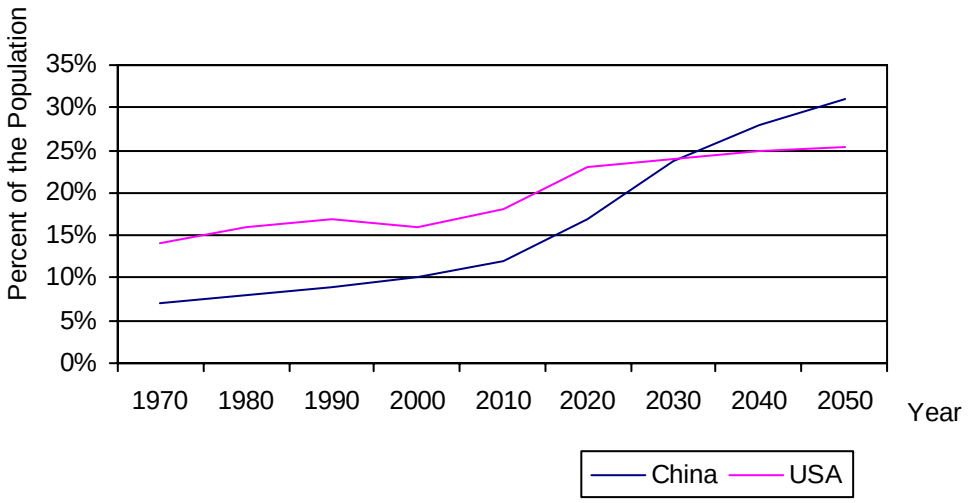
Along with a remarkable decline in birthrates, China's rapid socioeconomic development has also lead to noticeable improvements in public hygiene, nutrition, healthcare and hence people's life expectancy in recent decades. As noted above, life expectancy has risen to over 71 years in 2003, making China one of the world's longest-lived, low-income nations.[19] Socioeconomic modernization, together with the implementation of strict population control policy measure has caused China to age faster than any major country in history.

As a result, despite the fact that China's present population is relatively "young" with only 11 percent considered elderly (those aged 60 and over), the United Nations projects that the proportion of elderly will

[17] Richard Jackson and Neil Howe. *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China* (Washington, D.C.: Center for Strategic and International Studies, April 2004). p. 3.
[18] Data from National Population and Family Planning Commission, accessed at: www.npfpc.gov.cn.
[19] *Human Development Report 2005*, United Nations Development Program, 2005, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

increase to about 28 percent in 2040, by which time over a quarter of the world's elderly population will live in China. The projected share of elderly in the population will begin to exceed that of the United States in 2030 (see chart below). Furthermore, the very old, those aged 80 and over, will increase from about 8 million in 2000 to 50 million in 2040.[20] In terms of absolute numbers, China has the world's largest elderly population, with 134 million people over 60 years old, a figure that is likely to hit about 397 million by the middle of this century, assuming current demographic trends continue.[21]

Percentage of the Elderly (Aged 60 & Over) in China and the U.S.,

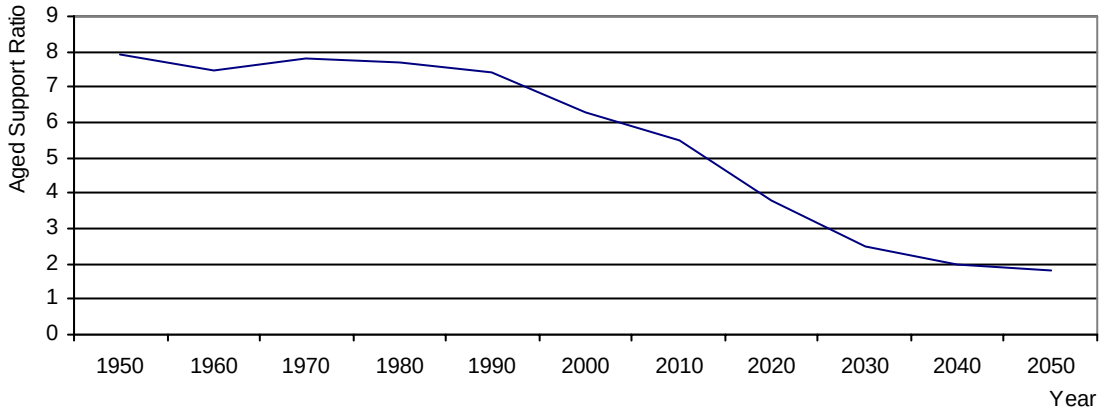


Source: U.N. (2003)

With the continuation of the one-child policy, demographers predict a "4-2-1 problem" among individual Chinese families in an aging society. Ten years from now, as China's baby boomers begin to retire, the first single-child generation will assume the burden of caring for the elderly. Specifically, in many Chinese families, two elderly parents and four grandparents who can expect to live longer in the future, will have to depend on one child in their old age. This informal safety net will come under increasing pressure as the population ages. Looking beyond individual families, there is also a decline in working-age adults aged 15 to 59 in China for every elder aged 60 and over. According to United Nations projections, the number will fall from six at present to just two in 35 years (see chart below).

[20] Data from United Nations China webpage, accessed at www.unchina.org/about_china/html/population.shtml.
[21] "Warning over China's Aging Populace," *China Daily*, June 12, 2004.

Ratio of Working-Age Chinese (Aged 15-59) to Elderly Chinese (Aged 60 & Over)



Source: U.N. (2003)

An increasingly elderly population will become an obstacle to China's overall development if measures are not implemented in a timely manner to address this problem. China is currently poorly prepared for the coming age wave. Chinese financial markets are also poorly-structured and risky investment vehicles, closing that avenue for nest-egg building at present. Improving China's social safety net and pension system to care for its elderly and alleviate the burden on the country's working population will be critical to assuring China's continued economic, political, and social development. If millions of Chinese continue to grow old with no pensions or other forms of social security, the stability of the political regime and economic prosperity could come under threat.

China's Broken Pension System

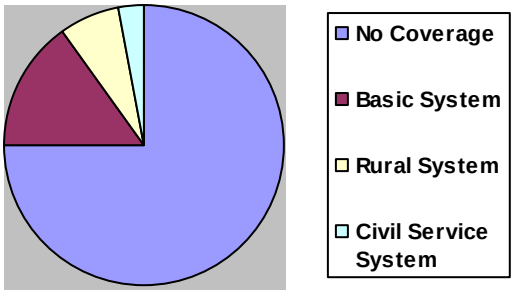
China's pension system is poorly prepared to care for a rapidly aging population. Pension coverage in China is largely limited to urban workers in the state-owned sector, and, as SOEs downsize and put more persons on the retirement roles, the overall pension system is running into financial trouble.

China's pension system consists of three parts – a basic pension system for urban workforce (mostly employees of SOEs and collectively owned enterprises), a civil service pension system for civil servants, and a voluntary rural pension system. According to the United Nations, at the end of 2004, the number of people covered by the basic pension scheme was 163.53 million, including 122.50 million workers and 41.03 million retirees, and very few rural migrant workers.[22] China's public pension system leaves nearly half of the workforce uncovered in the cities, and the coverage in the countryside is merely 11 percent of the rural workforce. In addition to the large discrepancy between urban and rural coverage, the overall coverage is alarmingly low: about three out of four Chinese workers have no pension at all.[23]

[22] *Human Development Report 2005*, United Nations Development Program, 2005, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

[23] Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China*. CSIS and Prudential Foundation, April 2004.

China's Pension Coverage in 2002



Source: Chinese Ministry of Labor and Social Security and Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China* (Washington, D.C.: Center for Strategic and International Studies, April 2005).

In the meantime, as many SOEs started to downsize in the 1990s, the State Council launched a national pension system reform effort in 1997 to extend coverage under the basic pension system to private sector workers. The reform replaced the former "pay-as-you-go" system with a scaled-back pay-as-you-go system plus personal retirement accounts. However, due to the high contribution rates (24 percent of the payroll with regional variations) in order to pay off the unfunded liabilities, the 1997 reform has faced serious problems. In particular, it fails to bring in new contributors to the social pools. As local authorities use account contributions to cover current cash shortfalls, the overall system is gradually running out of money.

Estimates of the size of China's unfunded pension liabilities, or implicit pension debt (IPD), vary. Several calculations made in recent years reach a figure by making the theoretical assumption that the unfunded system is to be terminated immediately and that all pensioners and workers must be compensated for their future pensions and accrued rights.[24] A World Bank report in 1997, citing a rough Chinese government calculation, said the IPD could be three to four times GDP.[25] The Bank stated that these high estimates have discouraged the authorities from explicitly recognizing the debts and reforming the system. Instead, Chinese authorities have been looking at other options to reduce costs, including continuing to increase the contribution rates and expand the coverage. As a matter of fact, these measures are not sustainable and have led to widespread evasion.

The World Bank has since conducted more careful IPD research and generated better estimates. It calculated in 1997 that China's IPD ranged from 46 to 69 percent of the GDP in 1994.[26] Some experts from the World Bank provided a more recent estimate that IPD in China accounted for 94 percent of the GDP in 1998.[27] Another frequently cited estimate is based on a more quantitively sophisticated model and puts the IPD at around 71 percent of GDP in 2000.[28] There are also some higher, non-Bank estimates that China's unfunded pension liabilities are fast approaching $1 trillion.[29] It is reasonable to view China's IPD at the higher end of the range, given the increasing number of laid-off employees from the SOE reforms.

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[24] Wang, et al., *Implicit Pension Debt, Transition Cost, Options and Impact of China's Pension Reform*, paper prepared for the World Bank Policy Research Working Paper series, and also presented at the conference on Developing through Globalization: China's Opportunities and Challenges in the New Century, held in July 5-7, 2000, in Shanghai, China.
[25] *Old Age Security: Pension Reform in China* (Washington, D.C.: World Bank, 1997).
[26] *Old Age Security: Pension Reform in China*, (Washington, D.C.: World Bank, 1997).
[27] M. Dorfman and Y. Sin, *China: Social Security Reform – Technical Analysis of Strategic Options*, Human Development Network, World Bank, December 13, 2000.
[28] Wang, et al., *Implicit Pension Debt, Transition Cost, Options and Impact of China's Pension Reform*, paper prepared for the World Bank Policy Research Working Paper series, and also presented at the conference on Developing through Globalization: China's Opportunities and Challenges in the New Century, held in July 5-7, 2000, in Shanghai, China.
[29] A. Newton and R. Subbaraman, *China: Gigantic Possibilities, Present Realities*, (New York: Lehman Brothers, January 21, 2002).

The World Bank also concludes that, compared with the pension debt ranges from 100 to 200 percent of GDP in most OECD countries, China's IPD is relatively low. This is because of the small coverage of current China's pension system. The low estimate from the Bank means that it is still easy for China to reform its pension system if decisive measures are undertaken soon enough. However, the Bank also warns that as coverage expands and workers age, in combination with the upcoming wave of SOE layoffs, the pension liability will grow by leaps and bounds over the next few years in China.

U.S.-China Cooperation and Assistance

Health care, social security, and pension-related issues offer a potentially rich set of cooperative avenues for U.S.-China relations, providing untapped opportunities for U.S. businesses, scientists, and policy analysts, and opening a new window to understand China's economic and security future. A number of current and potential future areas of cooperation include:

- U.S.-China Health Care Forum (*baojian luntan*): The Forum was jointly held by the Chinese Ministry of Health (MOH), Ministry of Commerce (MOC), and the U.S. Department of Commerce (DOC) and Department of Health and Human Services (HHS) in July 2005. It covered four areas: medicare system, medical insurance system, health care products and services, and R&D for health care products and services.
- U.S.-China cooperation on emerging and re-emerging infectious diseases: Chinese Health Minister Gao Qiang and HHS Secretary Leavitt signed a MOU in October 2005. It aims to increase official bilateral collaboration and technical assistance related to emerging and re-emerging diseases such as SARS, influenza, West Nile virus and plague.
- U.S.-China cooperation on HIV/AIDS: HHS and MOH signed a MOU in June 2002 aimed at promoting enhanced U.S.-China cooperation on HIV/AIDS prevention and research. The MOU calls for increased collaboration in the development of effective intervention strategies to prevent HIV transmission, including new strategies to improve blood safety. The two sides will also focus on upgrading HIV/AIDS epidemiology and surveillance in China, and provide more opportunities for training and exchange of scientists and health care professionals.
- Looking ahead, there are opportunities for U.S. firms and nongovernmental organizations, as well as U.S. government agencies and research institutions to intensify cooperation with China in such areas as pension financing, including through the development of viable investment vehicles in China; health care insurance and financing; aging and elderly health care; drug pricing and availability; chronic disease; occupational health and safety; and environmental health.

Panel II: Discussion, Questions and Answers

HEARING COCHAIR WORTZEL: Thanks very much to all three of you. Commissioner Wessel has the first question.

COMMISSIONER WESSEL: Thank you all for being here, your time. Dr. Gill, I'd like to respond just briefly to one of your initial comments about the importance of this panel. Clearly, we in holding this panel on our first day of hearings in this new year share your views as well in terms of needing to know more about the internal challenges in China.

At the same time, we're looking at them in the new way that I'll call the Wortzel tilapia test in terms of what do those externalities mean to us? As we look at energy, as we look at environment, Congress is concerned not only about the health and welfare of the Chinese people, but of course their own constituents and how those internal challenges are being exported or their costs are being exported in certain ways to us.

Mercury, we heard from Mr. Clifford, 75 percent of the mercury challenge here in the U.S. is external to the U.S., whether it's Canadian, Chinese or anywhere else, not to point specific fingers at China.

We've had the GAO do studies in the past about the impact of lax environmental enforcement in other nations in the sitting decisions of U.S. companies, many who have gone overseas because -- whether it's solvents or other chemicals they use -- there is less concern about the dumping of those products. So we have to engage and understand the internal challenges but also look at their externalities as they relate to the U.S. So that's how we link all of this.

But I'd like to understand a little more if I could from Dr. Economy and others about the environmental concerns in China. We had, as you well know with Lois Gibbs and Love Canal many years ago, we had a real challenge here to address our environmental problems. We had Times Beach. We've had other things, and we've built a base of laws, an environmental infrastructure.

You indicated there are 2,000, I believe, registered environmental NGOs in China. Yet with the recent problems in their rivers, we've also seen governmental action against them. How is that infrastructure working? What kind of public support do they get? Can they weather this new challenge that, as the public focuses more on it, the government is also looking at the challenge?

How vibrant is the movement? How ingrained is it? What are your views of its future success?

DR. ECONOMY: Thank you. I think in answer to the first part of your question, how are they doing, they're doing pretty poorly. I think that there is a danger with something like Harbin. We've seen a number of additional high profile accidents announced since Harbin over the past month and a half, and the Chinese leadership has cracked down very quickly, some officials have been removed from their posts, this kind of thing.

But I think the danger is that this is the tip of the iceberg and it's really an ineffectual way of dealing with the problem because the problem is systemic. It is primarily local implementation, but it's also a function of the fact that Beijing and local officials don't put into place the appropriate incentives or disincentives, that would encourage officials to do the right thing.

So it's not simply corruption at the local level, which is endemic and where you have local officials with ties to enterprise heads that are polluting and they don't want to shut them down.

Certainly, there are a lot of these cases. The problem also rests in part in Beijing and maybe primarily at the local level. With regard to the role of the environmental NGOs, the environmental movement in China is very vibrant. The problem for them is that they are largely concentrated in Beijing and in Yunnan. They are not evenly divided throughout the country.

They tackle a very wide range of problems. There is one environmental NGO that goes around to villages simply to help them understand the health impacts of polluting enterprises. Why is it that their rates of cancer are so much higher in X and Y and Z villages?

There are those kinds of NGOs. There's a phenomenal NGO called the Center for Legal Assistance to Pollution Victims, headed by a

man named Wang Canfa. He operates out of Beijing. He's funded primarily by the Dutch government. And he is the one who is behind virtually every single lawsuit that you see being pressed today on environmental issues in China. His people investigate what is taking place in some of these villages, in some cases at great personal risk. There are a lot of very brave and courageous people doing this kind of work.

Again, though, as I mentioned, a couple of them have been arrested or under house arrest. It's a very delicate dance and NGO leaders tend to be relatively politically quite sophisticated, so there haven't been many of these cases where they've been caught up unawares, but they all operate with the knowledge that the Chinese government could clamp down quite seriously at any given point in time.

COMMISSIONER WESSEL: What is our view of the U.S. government? I don't know what embassy resources we have, what is the EPA doing there?

DR. ECONOMY: There aren't a lot of resources. The U.S. Embassy in Beijing has tried to hold one event where they brought together multinationals and NGOs. Apparently it didn't get a very good reception, but the U.S. government is not very engaged in supporting environmental NGOs except I think indirectly State Department through the ABA has helped to do a little bit of this.

But by and large, multinationals support these environmental NGOs. Shell, for example, supports some of them. They're engaged. Foundations support them and then some other international non-governmental organizations help to support, to provide money, because probably about 95 percent of the funding for environmental NGOs in China comes from outside the country. And that's a very important fact to understand about the NGO situation. They don't have good internal resources. Overall, the Canadian government is active, but the U.S. government is not very active, in part, probably because it doesn’t have much in the way of resources.

HEARING COCHAIR WORTZEL: Vice Chairman Bartholomew.

ACTING CHAIRMAN BARTHOLOMEW: Thank you and thank you to all our witnesses for the work and expertise that you bring to the table, and for appearing here today.

A couple of things. Following up with Commissioner Wessel on the NGOs and Dr. Gill. You had a conference relatively recently on NGOs in China. I was there for part of it, and I remember this talk about GONGOs, government organized NGOs, which seems to be an oxymoron to me in terms of the phrase. Dr. Economy and all of you, how independent are these NGOs that you're talking about?

Are they really what we would consider as NGOs? Are many of them government-driven, government-connected? It gets to the issue of the freedom. I remember that Dai Qing, when she was starting, and she's obviously politically connected herself, so she could get away with some of what she was trying to get away with on the Three Gorges Dam,

but what is the nature of the NGO community that we're talking about here?

DR. ECONOMY: Actually Dai Qing couldn't get away with anything. She got arrested for her book Yangtze Yangtze, and she is actually forbidden from joining any environmental NGO because anybody who has been convicted of any kind of political crime like that is not permitted to participate. .She's back again speaking out on environmental issues, but the NGOs to which I'm referring are not government-organized NGOs. That's a whole different kettle of fish.

Even though some of them can be just as good as the NGOs, I chose not to deal with them because I think they bring something slightly different to the table. So the 2,000 I spoke about are driven from the bottom up, but they have to be registered with some form of a government agency, what they call a mother-in-law. They have to have some kind of body that is responsible for knowing who is a member of the NGO, where the NGO is getting its money from, and what its activities are going to be.

As I also mentioned, there are about equal that number that are not registered. Some of them register as private businesses, register as industrial and commercial entities. Then they have to pay taxes. They don't have not-for-profit status, so that's more difficult. So there are these kinds of limitations, and they're not permitted to —have branches--you can't have one NGO in Beijing and have it have a counterpart in Yunan and Tianjin.

But this is an environmental movement. They all know each other. They're friends. They're linked. They might have an issue around which 16 environmental NGOs sign a petition together. It's a real movement.

ACTING CHAIRMAN BARTHOLOMEW: Dr. Gill.

DR. GILL: Yes. Just on the nature of NGOs, I think the situation is similar although I don't think as well developed yet on, let's say, call them health-related or HIV/AIDS-related NGOs in China. But I think it is building. You've got these GONGOs, and what GONGOs are essentially are research arms or even in some more negative sense kind of holding pens for former officials, persons who did work in the Ministry but have been shunted off to another organization to take care of some of the issues, and they can play a positive role, but because of their connections as former officials, because they receive most of their funding from the ministry to which they're associated, you know, they're not as independent, and you really can't consider them non-governmental organizations.

That said, though, there are groups which either through international support or in some cases able to generate monies at local levels, I think, we would probably look at them much closer as NGOs as we know them. I guess the big difference between what we consider NGOs and what might be the case in China is this registration system.

And it's more onerous. It's more costly. It at least in theory provides the government with a stronger capacity to oversee and monitor and watch what these NGOs are doing. I think in practice that varies. If

you're an NGO that is really confined to a small community or village in southern Sichuan somewhere, and you're basically doing charitable deeds, trying to raise some money and help with the, either the help or the livelihoods of local citizens, the government actually probably welcomes you at the local level and appreciates the kind of public services you might be able to provide that they cannot.

It's unlikely to have a lot of interference there. If, however you begin moving into areas that are political or sensitive or you are seen as responsible for generating unrest, or getting in the way of plans that a certain government official might want to see accomplished at a local level, well, that's a different story and you're likely to run into more complications and less independence.

So I guess it depends on where you are and the kinds of issues you're tackling. If you make sure you play those cards right, I think you can operate as an NGO legitimately and in much the same way that we would consider an NGO to operate.

ACTING CHAIRMAN BARTHOLOMEW: I have a second round of questions, but I'll wait.

HEARING COCHAIR WORTZEL: Oh, all right. Commissioner Houston.

COMMISSIONER HOUSTON: Thank you. I have a question for Dr. Economy having to do with the possibility of reform in the industrial complex there. When I was in high school, the main thing I took away--which I hate to admit was the '70s--but the main thing I took away from history and geography about China, was that China was a political introvert. That it was an isolationist country, it didn't play with the other children in the world, and this clearly started changing in the '80s and now is rapidly, rapidly changing.

So one of my thoughts when hearing about all these changes that need to happen in China to clean up the environment is kind of which way does the flow go? Does China still publicly not address issues of its problems within the world environmental community?

To clean up an environment, you've got to have mechanical infrastructure and you've got to have technical expertise. So does the Chinese government go out and seek these resources or does it develop the mechanical resources and technical resources internally or is it actively going out unabashedly admitting that it has environmental problems and trying to clean them up?

DR. ECONOMY: I think both. As I mentioned, the Chinese government has explicitly called on multinationals to lead in the environmental protection effort, and those that come in and have best practices or support experiments in cleaner production or devote monies to helping the Chinese environment, get a lot of very positive press in the Chinese press. There can be significant articles written about what these companies are doing for the environment.

Part of this has to do with the weakness of Chinese enterprises in thinking about these issues. World Wildlife Fund did a survey--I think it was last year--that came up with the statistic that 18 percent of the Chinese enterprises that they surveyed believe that you

could simultaneously grow the economy and protect the environment. That's only 18 percent.

So there needs to be a lot of environmental education done within the Chinese industrial infrastructure, but certainly they are out there in full force, and the Chinese themselves have a lot of environmental expertise, technical expertise, too. There's a lot of cooperation on this. —I think the real point is what you do to ensure implementation? If you don't raise the price of water, you're not going to encourage water recycling.

If you don't make energy more expensive, you're not going to encourage energy efficiency and conservation. China has had an energy efficiency law on the books since 1996 for buildings. The rate of compliance is about 5 percent. So now you have groups like NRDC in there setting new building codes, really trying to push the issue ahead, and maybe it will happen, but it's less a function of available expertise and technology I think than it is about putting in a system of incentives and disincentives.

HEARING COCHAIR WORTZEL: Dr. Gill, thanks for your praise for the hearing and its topic, we appreciate it a lot. Commissioner Reinsch is the guy that conceived it, and I think he did a great job in touching on the right subject to start the year, and Kevin Lanzit back there did a lot, as you know, did a lot of the work putting it together.

I have questions for all three of you. One of the questions Bates and Liz can address is about what I would call the geopolitics of compliance. If health issues begin to have an international impact and if Chinese large conglomerates are operating overseas in ways that affect countries and regions, how can the United States government organize itself and its diplomacy, or how can NGOs organize, so that they can encourage compliance on a bilateral basis, a regional basis, or through the U.N.?

Dr. Leverett, you seem to be suggesting that this mercantilist gathering of energy resources solely for China's use could be geopolitically destabilizing. In the 19th century, that was always backed up by military force To ensure control of the assets that a nation bought. Is that something we should be concerned about?

Dr. Gill and Dr. Economy, feel free to respond.

DR. GILL: Sure. I'll just make a couple of comments. Larry, you raise a great, great question, and I like the phrase "geopolitics of compliance." I guess I would just have two quick responses. One is that China's companies nor its government will not take this kind of an issue seriously until there is a broader international norm for moving in this direction, and that norm may well exist. You can't walk through an airport or drive down a highway these days and not see a giant billboard from Shell telling us why we need to be worried about the world's energy situation, putting forth this notion that Shell and other companies like it are taking a responsible attitude about energy and the environment.

As that norm builds and as there is real pain that could be felt for companies and governments that don't wish to join in that norm, then I think we can expect China to come closer to the kinds of

compliance we'd like to see. But until that happens, there is little interest, I suppose, yet either for the government or for these companies to take these things on.

Let's face it, it took a long time for our companies and our governments to come and recognize the value of these kinds of approaches. So I guess the answer is we need to push even harder on why this is a norm that is necessary, why it is in their interest to be more compliant with it, and why at the end of the day it's actually a bottom line interest as well, you'll do better financially and economically.

The second thing, and something we haven't come up with yet here to talk about, this is also the responsibility of host countries; is it not? We blame the Chinese companies. We blame the Chinese governments for not taking these compliance questions, worker safety, environmental norms more seriously, but, they always can fall back on the excuse that they are compliant with local laws: "We're not breaking any local laws here with regard to worker safety or environmental regulations."

We have laws on our books that require our companies to be compliant with our own standards as to the greatest degree possible in spite of what might be going on in the host country.

Maybe we can encourage the Chinese government to put forward those sorts of regulations. Whether it's going to be enforceable, I don't know. But, if there are certain countries or certain areas where you have a particular concern with China, maybe it would be up to our government through our diplomatic channels to get the host government to be tougher with China on certain issues.

DR. ECONOMY: Right. I think Bates has hit on the most important things. Part of it is norm setting and there are standards in the environmental field for environmental management and things, and I think we should be pushing the Chinese companies. We're not talking about companies like Haier, which are already operating at top-level standards. But many of the other kind of companies that are going out there. We should be encouraging them and publicizing positively when they do sign on to these standards, when they do meet these kinds of international norms and standards.

I think part of it is that when you look at where these extractive industries are based, a lot of them are in developing countries where, in fact, governance is weak. So while it is incumbent on these host countries to stand up and say, hey, don't do this, in many instances they have as many problems with center local control issues as China itself does.

But one of my thoughts is that as China calls upon multinationals to operate under best practices, it's absolutely reasonable for all of these countries to call upon Chinese multinationals to operate under best practices. This is a point that I've started to make in some of these conferences that I attend that have a lot of people from developing countries because I think it's quite important.

HEARING COCHAIR WORTZEL: Thanks. They were good points. Dr. Leverett.

DR. LEVERETT: Mr. Chairman, you asked a very good question about the strategic implications of what China is doing. I'm not an expert on the Chinese military but my general sense is that it is going to be many years before the Chinese would have the military capability to challenge the United States directly in the way that you were, I think, implying with your question.

But that being said, I think that there are ways in which the Chinese can act in ways that impose costs on our interests and that make it in our interests to manage this problem more proactively.

I've already referred to some of the diplomatic difficulties that can arise as a result of this kind of competition, but I think you could see at a broader strategic level more profound contests for influence with regard to very, very key energy producing states.

Saudi Arabia is I think a very good example. Chinese Saudi relations over the last five years have really taken off in a dramatic way. It's no accident that the first official visit outside the kingdom by King Abdullah since he came to the throne was to China. I think this has more than just economic or energy dimensions.

The Saudis frankly are for the first time in a post 9/11 world having to take seriously the possibility that their traditional security partnership with the United States might at some point precipitously deteriorate and might become dysfunctional for them and they're pursuing a hedging strategy with China at a strategic level.

I think these are dynamics that don't serve our long-term interests, and I think precisely to avoid an intensification of that neo-mercantilist conflict, it's in our interest to try and engage the Chinese on this issue.

HEARING COCHAIR WORTZEL: Thank you very much. Commissioner D'Amato is next. Now, Bates, I don't know if you know it, but Commissioner D'Amato has personal experience with the pay-as-you-go health care system in China. Because I got him into a traffic accident in Huairou.

DR. GILL: Yes, I remember the story.

HEARING COCHAIR WORTZEL: He had to go to the hospital to prevent a riot so one poor Chinese guy could get his broken arm fixed. D’Amato paid for it out of his pocket. So he knows.

COMMISSIONER D'AMATO: The fact that we're here means that I did prevent the riot, but no thanks to Colonel Wortzel who threw me into the gauntlet there and said go ahead and save us, which I had to do.

ACTING CHAIRMAN BARTHOLOMEW: Perhaps we should note that this was not while they were commissioners.

COMMISSIONER D'AMATO: It was not the kind of hospital I'm used to going to, I can say that. It was appalling really. I don't know who the journalist is that asks the mega-question. I want to ask a mega-question because this is a panel on social unrest and stability to get an understanding of where we're going.

It's hard to understand. For example, what does “87,000 incidences” mean? Would it be worse if it was 87 million? Yes. But

what would that mean? Today it's 240 incidents every day of some kind, but you're talking I guess three or four million people involved, as I understand it. Well that's what? Less than .2 of one percent of the population of China.

The question sort of jumps out at you. At what point does unrest affect the stability of the central government? How do you measure that? How do you determine where trigger points might be, anticipate those points? It's obvious that the Chinese government is giving no opportunity for alternative political forms to develop to threaten it in terms of our understanding of politics and political movements.

But it may be that that's not what the problem is in China. Historically, in China, we've had rebellions that may not have arisen from political forms so much as massive social discontent that reaches a trigger point of some kind.

The Chinese are very good at their security system. We understand they've got a 30,000 man or so force dedicated exclusively to the Internet. That's kind of overkill it would seem. But in any case, I don't think we're going to be looking toward alternative political organizations threatening the Chinese government, but do these numbers lead to a point in time where we have to try and measure their impact and be concerned about the actual stability of the government? How to address that?

Is there any model or any kind of way for us to think about this? Have you thought about that, Dr. Gill or Dr. Economy, Dr. Leverett?

DR. GILL: That's the big question all right, the mega question, as you say. You will have some who devote a lot more time on these issues coming in on a subsequent panel. I don't want to duck this, and I urge you to pose this tough question to them as well.

I would just say this. I would tend to agree with your analysis, which flows from what you said regarding the 30,000 persons monitoring the Internet, for example.

What do I mean by that? It strikes me that there is no one more aware of the potential instabilities and threats to even their lives that social instability could bring. There is no one who knows this better than the Chinese leaders themselves, and there is anecdotal evidence from stories, people who have met with Jiang Zemin, people who met with Zhu Rongji, who told them the first thing they see in the morning, is that list of 240, what happened last night. So this is obviously at the very uppermost of their minds.

What we call reform -- that's the term for it -- is an effort to address these issues in a way that keeps them in power. So you see a kind of loosening, a kind of opening in various areas, some effort, for example, to generate so-called inner-Party democracy, to allow citizens in the Party or otherwise to have on a limited basis kinds of town hall type meetings.

But, I see this mostly as a means and not as an end. It's an end to allow some ventilation to occur, so that the Party can still remain in power.

Coaptation is going on. Embracing the elites, embracing the new dynamic intellectual capital that we can see in China, embracing the dynamism of China's entrepreneurs by getting them into the Party, by providing them with certain perks of office and so forth so that they have more sympathies with the regime than with some other political possibility.

So they are doing things and doing it relatively effectively I think, trying to assure that these still scattered and uprisings here and there don't coalesce in any broader movement against the Chinese Communist Party. I think one of the cleverest things that strikes me that the central government is doing is posing themselves as the good guy.

It's the local guys, and in many respects they're right. Here you've got a country that's got almost a trillion dollars in foreign exchange and there is no serious evidence that I'm aware of that the top leaders are pocketing this stuff, right? I'm sure there is a lot of nepotism going on, but they're not robbing the country blind like you see in some places of the world; right?

But down at the local levels, these guys are. Bank presidents are walking off with $30, $40 million at a shot. So the central government is, I think, being very smart in posing themselves as the good guys, and this actually harkens back to real tradition in neo-Chinese social history, are that it's the emperor, the guy at the top who has the interest of the little guy in mind. It's the local warlords and fiefdoms that are trying to squeeze the little guy.

If that dynamic changed, if, for some reason it became a broad consensus across society that it was, in fact, the guys in Beijing who are correct, who don't have our interest in mind, who are trying to squeeze us, then I think you would see a tipping, but I don't see that happening, and I think the central government is doing everything it can to prevent that kind of perception from arising.

DR. ECONOMY: Let me make one very short comment. I think that we're not going to know until we know, right? In five years, we could look back and think, oh, my God, 87,000 protests in a year, of course, the whole system was going to break down and there was going to be a real challenge to the central government.

So I think everything that Bates says is true. They've become very effective at monitoring the Internet. There is this whole thing going on about Beijing being the good guys, local officials being the bad guys, but I actually have seen evidence that people are questioning this now.

I think there is a growing understanding in some places in China that, in fact people try to get recourse in Beijing but they can’t. So I don't think it's necessarily the case that it's only local officials that are being perceived of as the bad guys.

One thing that I would point to is that in the environmental movement, a number of the early leaders of the movement came out of

Tiananmen. And that the environment was really a means for them to promote an opening up of the political system. They didn't know anything about the environment when they started these environmental NGOs.

So it is not that they are ready to march and demonstrate for the overthrow of the Communist Party at this point in time. I would never suggest that. But that if the opportunity were to arise for a push for political reform, would there be a group of elites, of intellectual elites with these kinds of ideas who actually have at their fingertips organizational infrastructure? I think there is.

But I don't want to push this point too far. I guess I just don't want to be on the side of saying, you know, it will never happen, because I was a Gorbachev analyst at the CIA. So I know what can happen.

HEARING COCHAIR WORTZEL: I know you have to leave at noon, so I'm going to interrupt our normal order here and ask whether any commissioner has a specific question for Dr. Economy? I have a short one.

ACTING CHAIRMAN BARTHOLOMEW: I do.

COMMISSIONER MULLOY: I do.

HEARING COCHAIR WORTZEL: Okay. So maybe we can take them all. I'm looking at all your footnotes. They're extensive and they cover a wide variety of sources, but you have not cited a centralized Chinese government database that would permit either a Chinese researcher or an outside researcher to go in and see where they stand on environmental issues.

Is there such a database?

DR. ECONOMY: Sure. The State Environmental Protection Administration posts an annual report on the state of the environment and as much as you can trust Chinese statistics, you can trust these, because they're pretty bad. So absolutely it's there.

HEARING COCHAIR WORTZEL: Pat.

COMMISSIONER MULLOY: Dr. Economy, on page 12 of your testimony, you say we should encourage U.S.-based multinationals that source from China to place pressure on their suppliers to meet environmental, safety and labor standards or risk losing the multinational's business.

We have to encourage that because we have no laws that would permit us to restrict goods coming from China on labor and environmental conditions because they're not incorporated in the WTO's rules.

At one point Mr. Lamy, who is now the head of the WTO, when he was the EU Trade Commissioner, and the United States government both supported the WTO looking at labor and environment and maybe incorporating those things into trade because the thinking was they would make life better for the people in the countries producing goods. But they were dismissed as being protectionist.

Do you think that it's worthwhile for the international community like the Foreign Relations Council or these other think tanks

to take another look at those and say this is worth a renewed effort, having governments address, rather than just encouraging the multinationals?

DR. ECONOMY: Sure. From my vantage point, of course.

COMMISSIONER MULLOY: On the Council on Foreign Relations?

DR. ECONOMY: Yes, well, from my vantage point, somebody who works on the Chinese environment. I think both from the perspective of U.S. industry trying to compete with Chinese industry in some other ways and also from the perspective of Chinese people themselves, I would like to see labor and environmental standards brought back into the WTO. It seems to me though that we have enough challenges right now on the WTO front that I'm not sure how realistic an approach that would be.

But let me just say one other thing on that point, and that is companies are already beginning to do this. As I mentioned I think before you arrived, Nike, Mattel and even Wal-mart, are working on best practices issues, and there is good reason to, too. There is at least one NGO in China, Greenpeace Beijing, which explicitly targets multinationals that are not living up to best practices. So that if, in fact, they're not doing the right thing, they have the potential of being, you know, caught up in Chinese law. So, I think there is some bottom up pressure for this to happen, too.

COMMISSIONER MULLOY: Thank you.

ACTING CHAIRMAN BARTHOLOMEW: Thank you. Dr. Economy, that's actually an interesting observation because what that Chinese NGO that is focusing on U.S. companies also has is a willing audience here in the U.S. that can pick it up, and I think that the U.S. multinationals have had to respond to concerns about labor practices and environmental concerns.

So there is a nice confidence of interest there, especially if people are free to communicate to each other about what's going on.

I want to tie in, though, Dr. Gill, you mentioned the almost trillion dollars that the Chinese government holds in foreign currency reserves, and I get back to a question that I asked in the previous panel, which is about values and priorities.

Dr. Economy, it was very interesting what you mentioned about seeing this coming trend of blaming the internationals for the environmental degradation. Do you think that funds are fungible? Is some of this an interest of the Chinese government in not only being able to blame others for the environmental consequences of what's happened with this development, but also trying to get others to pick up the tab for what has happened?

Is the environment important enough to them that they're willing to dedicate some of these foreign currency reserves, for example, as part of their budgeting in order to address it or are they expecting that because we're concerned about it and it's, quote-unquote, "our fault," that we're going to pick up the tab for this?

DR. ECONOMY: Well, as I mentioned, I think the environmental protection budget in China is probably about two-thirds from the international community in one form or another. And this has been a long-standing idea dating back at least to the United Nations Conference on Environment and Development, when they pitched the Agenda 21, their own Agenda 21. Built into it was to have the international community fund about two-thirds of the projects that were going to be undertaken.

So I think that's already ingrained in their approach. You asked about whether or not the central government is willing to devote the funds to make a difference? They have over the past decade consistently ratcheted up the percentage of the GDP that they devote to environmental protection to the point that it's about 1.5 percent, an upper tier of developing countries.

Clearly it's not where it needs to be, and I am always of a mind that you can tell what's going on when you see where the money is going, right, and in fact, a lot of people have pointed to this next Five-Year Program. It's not a plan now; it's a program, and said that they're again increasing the amount that they're going to be putting into environmental protection. But the truth is they didn't meet their budget last Five-Year Plan. So they fell short in terms of the amount that they had said that they were going to put into environmental protection.

So, as I said, a lot of heightened rhetoric. I wait to see what they really do.

ACTING CHAIRMAN BARTHOLOMEW: Thank you.

HEARING COCHAIR WORTZEL: Do you have other questions? I'm sorry. Go ahead.

HEARING COCHAIR REINSCH: I merely want to apologize to the panel. I was very interested in having this hearing and urged the commission to do it, as Larry said, and I was particularly interested in this panel. I wanted to be here, and I missed the whole thing, and I'm sorry.

I had to testify in the Senate, and, it being the Senate -- and I can say this because I worked there for a long time -- it took about an hour longer than it was supposed to. People who shall remain unnamed talked too much. I was probably one of them. To forestall panic here, I can tell you I was not testifying about China. It was about something else. Anyway, I apologize. I will look forward to reading your statements and perhaps follow up individually if I have something to ask.

I do have one question I'd like to ask Dr. Gill. Others feel free to comment. And that is simply to what extent do you think fear of instability and the consequences of instability is a factor that holds back popular movements for change?

DR. GILL: I think at an academic and theoretical level, people who have the time to think about things at this high level, 40,000 feet above reality, yes, I think it's conventional wisdom. We all say that there is this undercurrent of fear of chaos in China and that that helps to keep a lid on things.

But I would suspect that at a local level, when you've finally become fed up with the way that you think officialdom is treating you, whether it's because they're not paying your pension or because you're not getting the medical care you think you need for your parents, or whether you know that your local leader is in cahoots with a developer to take away some very valuable farm land, I don't think you think about how your action might somehow be the "spark that lights the prairie fire," as Mao Zedong once said.

I think what you care about is your family and your livelihood. I don't think anyone sits and says, well, maybe I shouldn't do this because if I do, it might bring instability to China. I don't think they think that way.

I think their biggest fear probably is, I better not do this or I might end up in jail. Or I might get hurt. Or, I'll end up ruining the lives for my children if I mess around in these politically sensitive areas.

HEARING COCHAIR REINSCH: I agree with that. I think the issue is when or how a small thing becomes a big thing. This is a country where small things have a history of becoming big things unexpectedly and quickly.

DR. GILL: Sure.

HEARING COCHAIR REINSCH: I certainly agree that the individual in that situation would have exactly that reaction. I'm curious at what point does that small group of individuals, are they able to translate that into some kind of a large thing?

DR. GILL: That is really the big, big question, and I don't think we have a good grasp on that. You will have some other people coming in who look a lot more regularly at the question of social unrest in China and might have some thoughts.

From what we can tell so far, by and large, these incidents of unrest while they may have certain common causes, often, there's not a lot of evidence, that they are connected logistically or politically in any respect. It's still true in much of China that what happens in the village two valleys over you don't even know about.

It's not just because the government is controlling the information; it's also because that's just tradition, and you don't really know what's going on in places that are even relatively near by.

Liz made the point about how we see some evidence that the top leaders are being considered for blame. I think that's a very important development, and to the degree that grows and we see more evidence of that, that's a tipping point.

Another development that I'm finding interesting is that there are, in fact, these lawyers or activists who are operating around the country, who do go to different parts of the country with the same ideas in hand of how to organize locally, how to press your case with local officials, how to use China's own constitution and laws for your own interest.

That is happening. It's not as if all 87,000 unrelated. I think we will see increasingly that there are connections across them. As those indicators rise, so too might rise the possibility of a broader

movement on the Chinese government itself, but I don't see that in any immediate sense. Like Liz says, we can't say it won't happen. But we need to look, I think dig deeper to identify the identifiers that will tell us when it may.

HEARING COCHAIR REINSCH: Very helpful. Thank you.

HEARING COCHAIR WORTZEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Dr. Economy, I want to follow up with something that Commissioner Bartholomew said. In your testimony on page 12, you recommend that we lift the ban on USAID involvement in China.

Now, Dr. Gill pointed out that the Chinese have about a trillion dollars of foreign reserves. We have a $200 billion trade deficit with China. If you were recommending that to members of Congress, how would you get them to say we should use U.S. taxpayer money to do this, for what reasons and why is it in our interest to spend our taxpayers' money to do that when they have so much of their own money?

DR. ECONOMY: So I'm going to have to go on record with this, uh? I think that--here's my pitch--that USAID could be an important source of supporting civil society development, environmental NGOs, the legal NGOs, and this kind of activity that has been, and I think will continue to be, a very important force for political change in China.

So if I were trying to identify the reason why China won't spend any of its foreign currency reserves on this particular aspect and approach, and why the United States government might be interested in supporting this. I would think both reasons would be well understood by this panel. Media openness, civil society and the rule of law are incredibly important not only for China's future development but I think for our own interest in China.

So that would be the reason that I would support opening up AID funds.

COMMISSIONER MULLOY: So it would be very targeted--

DR. ECONOMY: Very targeted.

COMMISSIONER MULLOY: Thank you.

DR. GILL: Could I just add a point, Pat?

COMMISSIONER MULLOY: Yes, go ahead.

DR. GILL: Because USAID is also restricted, limited on what it can do on the health related side of things, too, and again perhaps through fostering the development of NGOs in that field, that's one point. But also I think you can make the argument that, you know, there are transnational threats to American interest that could emerge out of China as a result of its poor health infrastructure.

I totally agree that they ought to be feeling responsible for that as well, but we have an interest in seeing that that does not occur, that pandemics or infectious diseases emerge from China to threaten our interest. So we do have some interest in trying to help China get through this although I take your point completely that they need to do a lot better job on their own.

But it's not an either/or. I think we need to figure out ways to do it more collaboratively.

COMMISSIONER MULLOY: Thank you.

HEARING COCHAIR WORTZEL: I think Mike and then you.

COMMISSIONER WESSEL: If I could go back, Bates, to the AIDS issue, and I look forward to reading your publication. I have not seen it. Does that include or could you comment briefly on China's participation in regional or other health-related initiatives? I know on AIDS, there's Treat Asia. There are a number of other things going on.

With SARS, avian flu, are they embracing their regional neighbors to look at solutions to these? How open are they to external work on this?

DR. GILL: I think there are a lot of largely rhetorical agreements and multilateral groups, particularly with ASEAN, for example, to look at the transnational threats that might be posed to those countries as a result of epidemics or infectious disease.

I think China's deepest cooperation with the international community is probably with the United Nations. The WHO and the UNAIDS organization are actually given good access and pretty deep opportunities to cooperate and provide technical assistance and advice to the Chinese Ministry of Health.

Just a good example, they now have an annual report that they issue on the Chinese HIV/AIDS situation. It just came out last week for 2005. It's co-written. It's Ministry of Health, UNAIDS and WHO, all three bodies take equal responsibility for what's in that report. And to make that happen, UNAIDS and WHO was very clear with the Ministry of Health. We're not signing off. You're not going to get our credibility on your document until you're a lot more open and are prepared to accept constructive criticism and to provide serious figures.

So in that area, at least, I think we see some pretty positive signs of China's willingness to cooperate. SARS was a different story obviously, and I think there are still concerns, and I would turn your attention to an interesting FBIS summary on the avian influenza problem in China. They do a very interesting summary of both the good, this is what the Chinese government is saying about our ability to control avian flu and all the good things we're doing to make sure it doesn't emerge as a pandemic, and they balance that with evidence of where maybe we've got some problems and maybe China is not telling us everything that we need to know about avian influenza in that country.

So on the avian flu, we still should fairly have some serious questions about just how much and how well the Chinese government, especially in local levels, is dealing with this problem.

ACTING CHAIRMAN BARTHOLOMEW: Dr. Economy, thank you very much. She has to leave.

DR. ECONOMY: Thanks. It was fun. Okay.

HEARING COCHAIR WORTZEL: Michael, you have a question.

COMMISSIONER WESSEL: I'm done.

ACTING CHAIRMAN BARTHOLOMEW: I just have two comments on the issue of USAID. Which is, of course, we need to make

sure that any resources that would be expended in China don't come out of the development work that's helping countries in Africa and elsewhere in Asia.

The second one is that this administration and the previous administration have had the authority to move forward with using USAID funds in China. It just would require them, of course, to waive the provision about whether China is or is not a gross violator of human rights.

So it is a quandary that in a lot of ways is of the administration's own making in the sense that they either have to move forward with the waiver which acknowledges that China is a gross violator of human rights and they have certainly in the past chosen not to do that.

HEARING COCHAIR WORTZEL: Commissioner Wessel.

COMMISSIONER WESSEL: I'm happy to ask another round. Thank you. Dr. Leverett, I'd like to understand from you if I could a little more about China's energy efficiency concerns. As their manufacturing base increases dramatically, I don't think we've seen that come to world-class standards as it should in terms of production standards.

Autos, if I remember, they use two to three times as much energy inputs per unit of production as we do. How much of a challenge do they see there? Are they seeking to advance standards, energy efficiency standards across the board, whether as we've done with appliances or production or any--how important is this issue and where are they on that issue?

DR. LEVERETT I would characterize it as an issue of rising importance for the Chinese. They really are in a sense caught between two very bad dynamics.

On the one hand, they're in a phase in their economic development where any given increment of GDP growth seems to correlate with a much higher increment of growth and demand for energy than would be the case in say a typical OECD economy. So they're facing that pressure.

And then, as we said, relative to, certainly OECD standards but even some other standards you might abuse, their use of energy is notoriously inefficient.

They really are facing a serious problem, serious challenge on that front, but I do have to say in terms of Chinese policymaking, discourse, debate, this is an issue of rising importance and salience. They realize it's a challenge they are going to have to deal with.

I would argue that it is very much in our interest to help them meet that challenge. That's why I said in my remarks I think it is certainly worth our interest to be very proactive in trying to facilitate the transfer of, for example, clean coal technologies to China. I would go even further and argue that it's in our interest to try and help them upgrade their employment of nuclear energy as a way of reducing their need at least to some extent for imported hydrocarbons.

Then I think there are things we could do in policy terms to try and give them more of a sense of security about being able to rely on the market for hydrocarbons. But I think you're right, this is a challenge that the Chinese face. They're increasingly focusing on it, and I think it's in our interest to help them improve their energy efficiency.

HEARING COCHAIR WORTZEL: Thank you for your time and your testimony. You're doing great academic work on this. We appreciate your being part of this hearing.

DR. GILL: Thank you.

HEARING COCHAIR WORTZEL: We'll reconvene at one o'clock.

[Whereupon, at 12:07 p.m., the hearing was recessed, to reconvene at 1:03 p.m., this same day.]

AFTERNOON SESSION, 1:03 P.M.

THURSDAY, FEBRUARY 2, 2006

PANEL III: CHINA'S INTERNAL UNREST: Worker Demonstrations, Civil Disobedience, Riots and Other Discord, and the Prognosis for the Future

ACTING CHAIRMAN BARTHOLOMEW: I'm going to take the prerogative of the chair to welcome our next panel and speak very briefly to note particularly Mr. Welker's presence here and to congratulate him on the birth of his baby daughter Abby on January 24. We're all really thrilled by this. He actually seems to be getting some sleep, which is also really good.

MR. WELKER: A new taxpayer.

ACTING CHAIRMAN BARTHOLOMEW: Welcome to our panelists. I will turn the gavel over to Commissioner Reinsch, our hearing cochair.

Thank you.

OPENING STATEMENT OF COMMISSIONER WILLIAM A. REINSCH, HEARING COCHAIR

HEARING COCHAIR REINSCH: Thank you. Not only a new taxpayer, but half of us hope a new Democrat as well. But I'm sure you'll take care of that. We could use them. I think there's a deficit of that right now.

HEARING COCHAIR WORTZEL: Not if you look up here.

HEARING COCHAIR REINSCH: Fair point. Let me make a couple brief comments. I've already apologized for missing much of the morning so I won't do that again, but let me say I'm particularly pleased that we're having this kind of a hearing to discuss a variety of internal domestic Chinese issues.

One of the things that I've complained about over the years is that the commission too often has assumed a straight-line upwards trajectory of Chinese growth and power, has made the assumption that they're simply going to get bigger, stronger, richer, whatever the right adjective is, in perpetuity, and then has proceeded to discuss the implications of that growth for our relationship.

That may very well be an accurate view, but my sense for a long time has been that the country faces significant internal challenges that could alter that trajectory in significant ways.

We heard about some of them this morning. In the subsequent panels today and tomorrow we're going to hear both about more of them and how also the Chinese choose to cope with them. I think it's very important for this commission in studying the relationship and the security implications of the relationship to have as clear an understanding as we can get of what the problems are that the Chinese

government faces, how it chooses to address them, and what the implications that has for their growth and prosperity, which in turn has significant implications for the bilateral relationship. If we're facing a situation that is not a straight upward trend line, and they face potentially significant internal difficulties of their own, that has a lot of implications both for the way we relate to them and also for the way that we prepare for how they're going to deal with their problems.

So that's why I'm happy that we're doing this, and I hope it's a focus that we won't lose as we go forward the rest of this year on other hearings.

Now, with respect to this afternoon, the commission is pleased to welcome Dr. Albert Keidel, Senior Association of the Carnegie Endowment for International Peace. He joined the Carnegie Endowment in 2004 after serving as Deputy Director of the Office of East Asian Nations at the U.S. Department of the Treasury.

At the Endowment, his work focuses on China's economy, its poverty reduction strategy and other related issues.

The commission is also pleased to welcome Dr. Joshua Muldavin, who is a Professor of Asian Studies and Human Geography at Sarah Lawrence College in New York. He is a graduate of the University of California Berkeley. His research includes analysis of China's national level policies and the environmental and social impacts of those policies.

We also are pleased to welcome the previously introduced David Welker, who is a Senior Researcher on the staff of the International Brotherhood of Teamsters. He is also a former staff researcher with this commission, and has extensive experience in examining China's labor issues.

The commission looks forward to hearing from all these witnesses in the order in which I introduced them if that's acceptable. I do want to remind all panelists that the commission welcomes oral remarks up to seven minutes in length, and will accept for the hearing record prepared statements up to ten pages in length, and up to 25 additional pages of supporting documentation.

Don't feel that you have to meet that challenge. If you want to give us fewer pages and save some trees, particularly those of you who focus on the environment, we'd be happy to have you do that.

The important qualification is seven minutes and that's what we will begin with now. Dr. Keidel.

[The statement follows:]

Prepared Statement of Commissioner William A. Reinsch, Hearing Cochair

Good afternoon and welcome to the continuation of the U.S.-China Economic and Security Review Commission's hearing on Major Internal Challenges Facing the Chinese Leadership.

China has made significant economic strides during the past quarter century, leading to the rapid development of its national infrastructure, expansion of industry, and modernization of its military forces. Projecting forward, many worry that China is poised to overtake the U.S. economy and use its growing economic and military strength to threaten U.S. interests in the Pacific region. China's economy remains just one-seventh the size of that of the United States, and its per capita economic output is just $1200 per

year, or approximately one-fortieth that of the United States. It will be many years before China's economy will rival the United States'.

More worrisome perhaps in the near term is the potential for growing levels of civil unrest and public protest that is taking place in China on a daily basis to result in widespread political instability and economic collapse that might threaten economies throughout the Pacific region and beyond. During this third panel the Commission will assess China's growing civil unrest, worker demonstrations, acts of civil disobedience, public riots, and other forms of protest. The Commission is interested in the extent of the protests, the principal issues that are inciting protests, and the actions that the Chinese authorities are taking in response to the protests. To assist us in that effort we have invited three distinguished panelists.

The Commission is honored to welcome Dr. Albert Keidel, a senior associate of the Carnegie Endowment for International Peace. Dr. Keidel joined the Carnegie Endowment in 2004 after serving as deputy director for the Office of East Asian Nations at the U.S. Department of the Treasury. At the Endowment his work focuses on China's economy, its poverty reduction strategy, and other related issues.

The Commission is also pleased to welcome Dr. Joshua Muldavin who is a professor of Asian Studies and Human Geography at Sarah Lawrence College in New York. He is a graduate of the University of California-Berkeley; his research includes analysis of China's national-level policies and the environmental and social impacts on of those policies.

David Welker is a senior researcher on the staff of the International Brotherhood of Teamsters. David is a former staff researcher with the U.S.-China Economic and Security Review Commission with extensive experience in examining China's labor issues.

The Commission looks forward to hearing from all these witnesses beginning with Dr. Keidel. I need to remind all panelists that the Commission welcomes oral remarks up to seven minutes in length, and will accept for the hearing record prepared statements up to 10 pages in length, and up to 25 additional pages of supporting documentation.

STATEMENT OF DR. ALBERT KEIDEL, SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

DR. KEIDEL: Thank you very much, Commissioner Reinsch, and thanks to the commission for inviting me. It's an honor to be here. My topic is internal unrest, and as we know, in the last few months there have been some surprisingly violent incidents reported on in China where reportedly for the first time police have fired on and killed demonstrators and citizenry.

The international media have been covering such events for many years, reporting them seriatim as they come up to their attention. My testimony and the written testimony that I've submitted emphasizes that we really don't know a great deal about these incidents. We don't know how representative they are of conditions throughout China. There are very few that are reported on.

We do have a statistic from the Ministry of Internal Security of Public Security that last year, the year 2005, there were 87,000 what are loosely translated as mass incidents, and that these--I would also emphasize--are highly uncertain in terms of their nature. We have no breakdown of them.

All we know is that the ministry has said that they are incidents that disrupt the public order. This can include demonstrations. It also includes fistfights. It can include various public presentations, strikes, and so without a breakdown and much less knowing whether their

causes were dissatisfaction with economic conditions, it's very hard to generalize.

I have at the last page of my written testimony a table that takes what looks to be similar statistics back to 1993 and shows that we have a tenfold increase over this period. I will mention something about the pattern of that increase though because I have also given growth rates that show they had a huge surge in 1998-99 and a second huge surge in 2004, but not last year.

So the growth is quite uneven although it is inexorably growth that's rising. The thrust of my written testimony and of my analysis of the situation is that the nature of China's reforms since 1978 create dissatisfaction of necessity because they are successful.

And this happens in three dimensions, the most important of which from an economic standpoint is price. Prices changed in the 1980s and the early 1990s against the cities and against the established standard of living of the urban population, which had a cradle to grave guaranteed comfort level in the pre-reform period.

Rising rural prices that reached more market determined levels meant that farmers had real incentives to be productive, but the urban population did not. And these worked their way through price reforms and elimination of subsidies in the 1990s until in the late 1990s they erupted in the form of state-owned enterprise losses and led to ten years of layoffs so that employment in state enterprises dropped by 50 million workers in that ten year period.

This in my mind as an economist is a healthy development because it is creating incentives and moving people in the direction of being productive and rewarding those attributes that are also productive. So that's a second factor. Those that have education are now finding that their education correlates with income.

Those that are working hard find that that hard work rewards them including entrepreneurial activity. If you, however, find that you haven't gotten an education or that you don't care to apply yourself in those other ways, then it's not as easy to guarantee for yourself the standard of living that you had become accustomed to in the past regime, and this has resulted in my analysis in a lot of dissatisfaction that any government would have to face if it were as successful as this government is in introducing market forces into the economy.

A final factor in this vein is geographical. Before the reforms, the major technology transfer had come from the Soviet Union, so that there were concentrations of heavy industry and technology-based industries in the northeast at the end of the Trans-Siberian Railway. During the Maoist period, they also moved large segments of their industrial complex to the interior fearing a war between the United States and the Soviet Union or spillover from the Vietnam War.

So that they had at the beginning of the reforms large concentrations of industrial capacity in very unproductive locations, and those areas now are the rust belts full of demonstrating workers that have lost their jobs, are owed back pay, and that have lost their pensions and need to generally move to other locations.

Often we hear in the media that this level of unrest that's reported on a rather casually empirical basis is due to inequality. I would emphasize that that inequality is necessary if people are going to move to new locations and new jobs voluntarily and it's important that China's system allow them to move voluntarily, but the incentives won't be there if these gaps in income and wealth do not appear as they have.

So these again, counter to the usual interpretation, in my view, are healthy developments. How can so many demonstrations occur in a society that seems to be in the public image an authoritarian regime that doesn't broach any criticism?

I would say that from my experience there, that that portrayal of China today is outdated. There is a great deal more flexibility and freedom in the life of an individual in China, as long as one doesn't contribute to what is seen as the demise of the Party's control in the country. But the proliferation of NGOs that we've seen in the last number of years, the freedom to move, the elimination of some of the barriers to migration into cities, these are all changes that if they don't threaten the rule of the Party are allowed, and this includes a lot of constructive criticism.

The proliferation of media that are informative about conditions that are not ideal in the country is much more tolerated now, and I would emphasize that what we're seeing in the form of these demonstrations is, to the degree that they occur, and I have to emphasize I really have no clear knowledge about what they represent. I have not seen studies on a county or township or village level nationwide that say what is the incidence of corruption and what is the incidence of good governance.

They are displacing large numbers of people, say, for housing. It happens all over the country in relatively peaceful ways. What is the incidence of corruption and unrest in this picture, I don't think we know, but the overall trend, in my mind, is a healthy one, and I don't think it portends a breakup of this political system.

Thank you.

[The statement follows:]

Prepared Statement of Dr. Albert Keidel, Senior Associate, Carnegie Endowment For International Peace

Introduction

International news media in recent months have reported a number of violent confrontations between large crowds of angry Chinese citizens on one side and, on the other side, either law enforcement officials or private security forces hired by local officials and business interests. These reported confrontations reflect citizen claims of corrupt government collusion in theft, fraud and destruction of citizen livelihood. Reported violence has resulted in serious injury and deaths on both sides. The Minister of Public Security announced last month that 2005 saw 87,000 public security “incidents” involving 15 or more people, an increase of 6.6 percent over 2004. This is more than 235 such incidents each day. Data for 2003 report 58,000 such incidents, involving a total of 3 million persons, averaging 52 persons per incident. Last month China’s national news agency reported on a December 2005 speech by Premier Wen warning of the danger to China of mismanaging violent social discontent, especially unrest from unlawful or uncompensated seizure of rural land. He placed blame and responsibility with local officials.

It is not possible to verify the accuracy of these official data, or even to interpret their meaning, since such “incidents” apparently include a wide range of events, from strikes to barroom brawls. Nevertheless, the

trends appear ominous. They show a ten-fold increase in "incidents" over twelve years (see Table 1), and international media have repeatedly documented the large scale and violent nature of most incidents they investigate. The incidents they investigate, of course, also represent only a very small number – indeed a tiny fraction – when compared to the official figure of 87,000.

My testimony today must be short, so I will emphasize only a few points. The first is that I believe we know very little if anything about the make-up and character of the 87,000 incidents reported in official statistics. I have not seen any report giving their breakdown by nature, cause, location, violence level or ultimate resolution. The Premier's concern, however, indicates significant systemic and politically threatening characteristics. There are other crucial gaps in our knowledge, but this is the most serious. For example, I do not know if the 87,000 number for 2005 is compiled according to the same definitions as similar numbers for earlier years, going back to 1993. The announced rate of increase over 2004, 6.6 percent, is not compatible with an unofficial statistic, attributed to the same minister in a closed-door speech, reported in the Hong Kong press late last year of 74,000 – which would imply an 18-percent increase in 2005. The fact that the 87,000 figure and 6.6-percent growth came in the same announcement should at least mean that data in Table 1 for 2004 and 2005 are consistent.

Second, there is clearly a strong linkage between these incidents and China's torrid pace of structural reforms, economic growth and international commercial engagement. Both media reports and examination of the 12-year record support this conclusion. So does analysis of the wrenching character of China's economic reforms, which expose the inertia of inherited citizen expectations to the incessant and unsettling demands for higher productivity from exposure to markets and competition. This is a major theme of my testimony. The nature of China's reforms and growth success themselves creates widespread tension threatening social unrest.

I will highlight three aspects of this reform-induced tension. To start, price reform has raised prices for some products produced by some groups and reduced them for others, in a relative sense. For those on the wrong end of price movements, whose accustomed "normal" lifestyle became no longer supportable by what had been an accustomed "normal" level of work effort, the shift to new jobs and harder work can be painful. Next, large numbers of citizens working in isolated "rust belt" locations before reforms now find their locations highly unproductive for the new era of commercial opening, which rewards coastal locations. Many workers have lost jobs and have had to move. Finally, migration reforms have brought rural workers, with low income expectations and willingness to work hard, into competition with previously subsidized urban citizens. For each reform aspect, there is no escaping the requirement to work harder in return for what might be, without overall growth, a lower standard of living. Under these circumstances, any form of government would be faced with citizen dissatisfaction and threats of widespread unrest and violence.

My third major point is that corruption inevitably magnifies these tensions engendered by rapid growth and system reform. Corruption takes many forms and in general is illegal official behavior harmful to citizens, including failure to carry out legal compensation for necessary losses in the modernization process. Corruption also adds insult to economic injury by employing webs of deceit and by flaunting legal procedures in ways that mock whatever reserve of citizen understanding exists for the practical requirements of economic growth and social progress. Eliminating corruption would not eliminate the underlying elevated social tension from growth and reform dislocation, but it would make managing that tension significantly easier.

It is important to emphasize here as well that I do not know of any credible study of the extent of corruption at local government levels. How many county and township officials carry out their duty honestly and how many do not? We know of the corruption cases reported in the domestic and international media, including those prosecuted for corruption. But how representative is this corrupt behavior in the totality of Chinese local governments? Are claims of corruption by local citizens always accurate? I do not think we know.

Whatever its incidence, the challenge of reducing corruption is made especially difficult by several factors. For example, the corporate structure of China's combined governmental and party organization neutralizes efforts to discipline government behavior. Normal channels require higher officials to work through those same local officials who are objects of investigation. Furthermore, the high fiscal cost of monitoring local government behavior in a systematic way is a major barrier to doing so for a country with a per-capita

income as low and a tax base as weak as China's. A different system, with federal components, would be expensive.

Finally, were such discipline of corruption organizationally possible and fiscally affordable, widespread and well publicized punishment of corrupt local officials risks undermining the legitimate authority of honest local officials, whose authority must remain intact in order to manage the many strenuous complaints of citizens inevitably forced to adjust their lifestyles to the requirements of a more productive economy. Nevertheless, China does prosecute both corruption and unjustified citizen acts breaking the law. Ultimately, in most cases, it requires careful sifting of facts and the law to determine in any given situation whether official actions are legitimate and honest. Neither claims of corrupt action nor claims of innocence can be taken as legitimate indicators of the truth in a given circumstance. Chinese arrests, prosecutions and convictions for corruption are an indicator of corruptions extent, but how many evade prosecution, and how often is prosecution based on political vendetta? I do not think we know.

Finally, my fourth major point emphasizes how little we know about the national context of these reported incidents of social unrest. Given the many dislocations and other provocations emerging from rapid growth and structural reforms, how many potentially disruptive circumstances do in fact evolve peacefully, without demonstrations or with demonstrations that are resolved peacefully and without arrests? There may well be studies based on random samples of reforms in different locations that determine how accurately anecdotal information from international media reports actually describes the nationwide situation, but I have not seen them yet. I do know of examples of peaceful resettlement of urban persons whose homes are destroyed for urban renewal—resettlement with compensation in the form of a new home—with better facilities but perhaps not as good a location. One researcher has called this "improving lives through hardship" (Grage 2004). But such studies are not comprehensive in a way that helps us understand whether media reports of violent unrest describe the general situation in China. I just do not think we know.

The remainder of my written testimony investigates the economic foundations of social unrest in somewhat greater detail and then attempts to answer several questions posed by the Commission as part of the preparation for these hearings.

Growth and the economics of social unrest

The simplest economic explanation of social unrest would be that faltering growth causes unrest, but this idea in its straightforward form is contradicted by the facts. The number of incidents did indeed accelerate during growth's difficult years of 1997-99, when domestic economic policy errors affecting the rural areas sent China's overall economic growth rate into a serious slump. But as China's economy boomed in the 2001-to-2005 period, the number and scale of incidents continued to rise (Table 1 and Tanner 2005).

An alternative and more plausible explanation is microeconomic rather than macroeconomic—that dislocations and dissatisfactions accelerate with structural reform and modernization and that in China, reform and modernization are proceeding rapidly during both the boom and the slump phases of its macroeconomic cycle. This was especially evident during the most recent 1995-2005 cycle, but it held in the 1980s as well, with tragic consequences.

In the latter 1990s, GDP growth, measured through expenditure accounts, slumped from over 10 percent to as low as 4.5 percent (Keidel 2001). Losses and the build-up of unsold inventory became so obvious to policymakers and workers alike that officials could feasibly initiate state-owned enterprise (SOE) reforms involving layoffs of one-third of all SOE and collective workers, or 50 million workers, by end-2004—with 30 million jobs lost in the span of just three years from 1997-99 (NBS 2005). Meanwhile, during this same period, the initial farm policy errors caused household consumption in rural areas to decline in absolute terms, while employment in township and village enterprises (TVEs) also declined. These difficult rural conditions increased both the share and number of households below the rural poverty line and pushed increasing numbers of rural workers to migrate to towns and cities in search of jobs.

Since 2000, while growth has boomed in the 9-to-10-percent range, SOE and collective layoffs have continued, with more than 20 million additional lost SOE and collective jobs by the end of 2004

(NBS 2005). In other words, once started, cost-cutting structural reforms continued in good times and bad. Meanwhile, reform and restructuring have taken additional forms that generate new dislocations without alleviating earlier ones. The boom has been centered in regions and sectors both far removed from the laid-off workers in various rust belt provinces and far removed from farmers in low-income grain-belt regions. At the same time, the boom has brought accelerated infrastructure, industry and real estate investments, mostly on rural land in the outskirts of urban areas but also in the aged and dilapidated centers of towns and cities. This stepped-up pace of land conversion from rural to urban use and from old to new structures has speeded displacement of both rural and urban residents from their homes and land. Finally, loss of in-kind health and education benefits for urban workers and separation from village-based support for rural workers have only worsened the impact of layoffs and loss of homes and land. In these ways the economy has become rapidly more monetized without providing adequate monetized income for large segments of the labor force.

A closer look at the data in Table 1 supports this interpretation of the impact of growth and reform. The rate of increase in reported incidents of unrest since 1993 has averaged 21 percent a year, but the pace has not been steady at all. By far the most rapid increase – a 66-percent jump – came in 1998. That year, and 1999 which followed, were the most severe years of state-enterprise layoffs. Labor unrest from factory closings, mergers, layoffs, unpaid wages, and lost pensions and other benefits spread throughout the country.

After 1998-99, the pace of increase in unrest slowed dramatically, as growth and employment improved—until 2004, when unrest jumped 41 percent. 2004 was a year of especially rapid growth, high rates of investment, electric power shortages and a related proliferation of local peri-urban industrial parks and power plant projects. The condemning and confiscation of rural land must have accelerated dramatically, although I do not know of comprehensive statistics on the subject, and it is reasonable to conclude that the nature and pace of this boom-time activity triggered widespread discontent. But this is only conjecture; its testing requires better data.

Whatever the cause of the jump in 2004, the pace of increase in unrest slowed dramatically last year, 2005. The officially announced increase rate of 6.6 percent is the lowest of any year in Table 1. The year 2005 experienced a concerted effort by government to slow the economy's engines. Investment slowed, inflation slowed and import growth slumped. A plausible hypothesis could say that, in spite of continued anecdotal reports of land seizures and confrontations, land seizures declined on a nation-wide basis leading to a sharp reduction in the growth of social unrest. Still, incidents of social instability continued to increase, and from an already high level, so simple explanations based on the rate of growth – whether too high or too low – remain unsatisfactory.

A more disaggregated review of anecdotal information supports the broader hypothesis that a wide variety of structural reforms and increases in economic complexity and monetization create the almost inevitable conditions for proliferation of dissatisfaction and its public expression.

Many forms of social unrest with an economic basis

Research resource limitations for this testimony could not allow a more comprehensive review. The listing of examples here is drawn from earlier research (Keidel 2005). It gives a general indication of the kinds of unrest common in China recently.

Low and unpaid wages. Workers frequently demonstrate to protest low wages and work conditions, in addition to expensive company store, dormitory and other expense charges. For example, in April 2004 more than a thousand workers went on strike in two factories in southern China demanding higher pay and one day off a week, resulting in the arrest and sentencing of the strike leaders to up to 3½ years in prison. (BBC 2004, Chan 2004)

Layoffs and unpaid back wages. Workers frequently take the law into their own hands to protest layoffs and unpaid wages. For example, in November 2004, workers at one factory in southern China took their bosses hostage over unpaid back wages, and also in November workers in another factory in the same town fought with security guards to protest layoffs. (Chan 2004)

Loss of worker benefits. Loss of health and pension benefits has affected large numbers of urban *hukou* workers. For example, in March 2002, 80,000 retired workers protested in two towns in China's northeast over unpaid pensions. (Zhao & Wen 2002)

Union representation. Independent labor unions are illegal in China, but official labor organizations reportedly do little to protect workers from employer malfeasance with local government collusion. Efforts to form independent labor organizations lead to confrontations with police and often violent clashes. For example, in 2004 in Shaanxi Province 7,000 textile workers reportedly struck for seven weeks when they were forbidden to form their own union. (Marquand 2004)

Environmental degradation. Economic development leading to deforestation and grassland overgrazing are converting vast stretches into desert and forcing rural migrants into cities where they are not welcome. For example, in 2001 in China's northeast, migrants from desertified areas working as pedicab drivers blocked the entrance to a government compound to protest local government efforts to use high fees to force them out of town. (Economy 2003)

Access to water. Water shortages in the north of China lead to social unrest over access to what limited supplies are available. For example, in 2000 in eastern Shandong Province a thousand villagers fought with police for two days over access to water for irrigation. (Economy 2003)

Tolls and fees. Many protests object to fees and exorbitant tolls levied by local officials—in part to pay for public services and in part to supplement their official incomes. For example, in November 2004 a woman's anger at bridge tolls apparently led 30,000 persons to riot, confronting hundreds of police and paramilitary units, leaving one person dead. (Chan 2004)

Land condemned for public use. Citizens faced with relocation to make way for roads, airports, dams and other sanctioned public investments have little effective legal recourse to ensure just compensation, leading them to demonstrate publicly. For example, in October 2004 in Sichuan Province, 90,000 peasants reportedly fought with police over losing their homes for little compensation to make way for a hydroelectric dam. Only martial law restored order. (Marquand 2004, Mooney 2004) Demonstrations against both the relocation and environmental damage from dams are reportedly growing in size, frequency and sophistication as activists organize across provinces and with the support of central government environmental agencies. (Economy 2004)

Ethnic tensions. Ethnic tensions apparently often exacerbate the economic stress brought on by economic dislocation. For example, fighting broke out in 2004 in the southern city of Guangzhou between Moslem Uighur migrants and local riot police after security guards stopped Muslims from selling fried mutton in a shopping district. (Mooney 2004) In Henan Province in October 2004 an ethnic battle between Han Chinese and Muslim Hui minorities using farm implements left many dead, including 15 policemen, by one account. But the link to economic tension was not so straightforward, since the widespread fighting was sparked by a traffic incident in which a Hui refused to pay compensation to a Han. The inferior economic opportunities available to the migrant Hui households is one explanation given by a local Hui interviewed by the media. (Marquand 2004, Pocha 2004)

Economic analysis of Chinese social unrest—productivity, remuneration and tastes

In economic terms, a great deal of observed social tension over the past 25 years in China can be better understood by considering what reforms and global opening have done to patterns of productivity, remuneration and lifestyle expectations.

Shifts in productivity, pay and expectations lead to changes in relative prices, location and aptitude requirements. These changes set up conflicts between old accustomed patterns of work and consumption on the one hand and a market economy's tough insistence on adequate productivity as the basis for affording a certain consumption level.

The following analysis is taken from (Keidel 2005).

Relative price shifts since 1978

Relative price shifts since the start of reforms in 1978 are one of the most powerful levers in China's emerging market economy responsible for economic dislocations. The clearest example is in rural-urban terms of trade—prices paid for rural products versus prices for urban products—and what their shift has done to SOE finances and urban standards of living.

Beginning in the early 1980s, prices of rural products began to rise relative to prices of goods made in the city. At the same time, rural productivity in the early 1980s jumped dramatically with the breakup of communes and revival of household farming on individually managed plots. Matters came to a head very quickly in 1984-85, when production of rural goods, especially grain output, grew so rapidly with reformed higher prices so remunerative, that cities and local governments ran out of cash with which to buy them. This was an early and famous incidence of "hard-to-buy, hard-to-sell" (*nanmai nanmai).* "Hard to buy" because while farmers had cash, the stores were sold out of manufactured products from the cities, and "hard to sell" because while farmers had good harvests and guaranteed purchase prices, government procurement offices closed down due to shortages of funds. This trend ushered in more than a decade of urban inflationary booms alternated with credit-tightening job-cutting slumps.

The immediate result of these price shifts favoring rural areas was the realization that urban productivity was not high enough, when combined with the higher relative rural prices, to pay for the standard of living once guaranteed to all registered urban households. Not only were food prices higher, but construction materials and other rural products had become more expensive. The longer-term result of the shift in relative prices was that urban households needed larger and larger direct cash subsidies through official urban distribution centers, and when these became too great a government budget burden, retail price reforms coupled with matching urban wage increases shifted the financial burden onto employers, especially SOEs and urban collectives. As SOE financial burdens in support of the accustomed urban *hukou* standard of living grew, so did SOE losses. The climax to this shift in relative prices began to unfold in the late 1990s as SOEs and urban collectives rapidly began to reduce their cost burdens by laying off workers.

Exacerbating the direct impact of relative price shifts on urban household purchasing power was its impact on urban incentives to work harder to compensate for less advantageous terms of trade. Rather than understanding these changes to be a natural part of the reform shift from central planning to a market-based economy, urban workers saw them as unjustified deterioration in their accustomed standards of living. Hence, instead of providing incentives to work harder and adapt to new realities, these price shifts brought about a series of three major social unrest incidents in the middle-to-latter 1980s, all with deep economic foundations.

While the most famous of such unrest incidents was in Tiananmen Square in May-June 1989, smaller-scale demonstrations also reflected similar economic frustrations—first in the summer of 1985 and second in the winter of 1986-87. In all three cases, the economic roots of the unrest were camouflaged by claims of a higher purpose—anti-Japanese activism in 1985, pro-democracy activism in 1986-87 and at Tiananmen in 1989, and opposition to corruption throughout the period. Despite the publicity given to the pro-democracy rhetoric of the latter two movements, closer examination reveals the shallow nature of their democracy components and the powerful economic underpinnings for the anger and frustration released by students and workers alike. (Keidel 1992) Today, citizen claims of corruption in the face of uncomfortable adjustments are in many cases—but most certainly not all—likely part of a similar phenomenon.

In sum, China's economy today is still reeling from the impact of relative price shifts begun in the early 1980s and stepped up for urban food prices in the early 1990s.

Regional productivity shifts

Nowhere is necessary adaptation to new and natural productivity patterns more difficult than in the dimension of regional location. This is the second great economic dimension of underlying shifts responsible for China's social unrest. Most of the new opportunities presented by market and globalizing reforms are in coastal and other centers of transport and communication. Most of China's labor force,

however, is in interior cities and farm belts. The need to move locations to enjoy modern productivity gains is one of the greatest sources of economic inequality and dissatisfaction.

Interior concentrations of manufacturing labor reflect circumstances and policy decisions in the nearly 30-year Maoist period, as well as patterns of rural population concentration thousands of years old. First, cut off from the rest of the world by the Korean War, China relied completely on the USSR for technology in its first five-year plan (1953-57). Hence, a large industrial concentration accumulated in Manchurian cities, far from the coast, at the end of the trans-Siberian railway. This area is today the northeast (*dongbei*) rust belt.

Second, when fear of global nuclear war and fighting in Vietnam made coastal installations appear vulnerable, the Cultural Revolution's "Third Front" industrialization strategy shifted major industrial concentrations deep into interior provinces where they would be able to support a war of resistance against foreign occupation. These industrial concentrations, from Guizhou to Lanzhou to Xian, are today China's interior rust belts.

Third, the plentiful farmlands of China's central alluvial regions, especially where combined with good rainfall in the Yangtze River basin and all to its south, mean that these regions, because of high per-hectare farm productivity, have for thousands of years supported large populations far from today's centers of modern employment opportunities. These large and heavily populated interior farm regions today contain China's impoverished grain belt areas.

In all three dimensions of inappropriately located population concentrations, no degree of policy success could avoid the market-oriented shift in relative productivity and value added advantages away from these regions toward the coast and other major natural crossroad locations. The only viable long-term solution to these regional gaps in productivity and income is large-scale migration from all over China to major urban hubs of transport and communication—mostly on the coast.

Market requirements for work aptitude – education, initiative and elbow grease

Finally, the third major dimension of shifts in productivity and remuneration is that of *aptitude* for productive employment. Aptitude encompasses education, skills, entrepreneurial smarts and energy, and the willingness to work hard in possibly unattractive working conditions. Between the 1980s and 1990s, for example, as a result of market reforms, educational attainment became increasingly correlated with household income. No amount of policy ingenuity could neutralize the anger and frustration of those who find themselves lacking education and other more productive aptitudes.

A second aptitude gap is between rural and urban workers. Rural workers coming to the city, because of a generally less privileged upbringing, have a much greater aptitude for undertaking dirty and physically tiring work. This gap reflects the difficulties of shifting one's lifetime expectations of a certain established package of job quality and living standard. Tensions generated by productivity and remuneration shifts in this dimension are an unavoidable part of market reforms and modernization.

A third aptitude gap emerges because of the shifting structure of the economy, away from farming and manufacturing into services. Workers, especially older workers, with a traditional aptitude for farming or assembly line work, find it difficult to learn the new skills needed to work in the service sector, much less in the newly expanding higher-tech dimensions of China's manufacturing expansion. To the laid-off worker, it just seems that there are no suitable jobs remaining. And yet this rapid structural transformation of China's economy by sectors is the very essence of market reform and modernization. Related disaffections are impossible to avoid.

What is really going on, and how will it continue?

Given this characterization of China's domestic social unrest, how can these developments be compatible with life in what many perceive to be a tightly controlled authoritarian government known to employ harsh measures to control dissent?

My own answer, from working in rural and urban China over 25 years, and from living there continuously for three and a half years in the latter 1990s, is that the characterization of China as a tightly controlled

authoritarian government is no longer accurate. Life in China has softened a great deal since I first went to the mainland in 1979. A wide range of individual and group patterns of behavior is tolerated because the government and party do not see this behavior as threatening to the social stability deemed necessary for continued rapid economic change.

What is perhaps more fundamental is that gradual shifts, such as the proliferation of domestic NGOs and implementation of legal reforms have legitimized a climate of constructive criticism for which the government has a rather thick skin, as long as the criticism is not seeking or contributing to demise of the established political order. These trends are consistent with a philosophy of economic reform beginning in the 1980s that sought to find ways to compensate losers to some degree. Chinese reforms and the officials implementing them have as a group have not been confiscatory or economically rapacious agents of change. Targeted poverty programs in low-income rural regions all over the country have dramatically reduced rural poverty, a three-level layering of urban social safety nets has continued to receive expanded funding to eliminate destitution in urban communities because of layoffs. When price reforms moved against a particular population group, government subsidies to offset the price effect were for the most part adequately funded—although more so in urban than in rural areas.

Consequently, government's response to unrest that reflects dissatisfaction with the impact of reforms has emerged as multi-faceted and flexible. Grievances are reportedly examined on a case-by-case basis, so that some redress is often forthcoming. At the same time, leaders of a demonstration or strike are frequently reported by international media as arrested, especially if they are deemed to have broken the law by leading a demonstration without a permit or, in the extreme, if they kidnapped a factory head or destroyed property.

In large part, this differentiated response appears to be a calculated strategy for defusing and discouraging further unrest. It reflects the government's realization of its own limits as well as the dynamics of situations where harsh treatment more likely means that information of the incident spreads more widely, causing still greater difficulties, both at that location and at other protest sites. In this context, moderating government's response in a "crowd-control" way complements limitations on media coverage in increasingly heavy-handed ways.

The above description of government's approach means that leaders of such demonstrations or protests can expect to be arrested and eventually punished, while the much larger number of participant "followers" can expect not to be arrested or disciplined, with the exception of cases with criminal violence or where local government and business forces resort to thuggish methods. The net effect is that if potential demonstration leaders consider that a particular protest issue is not particularly crucial, serious, or justified by Chinese law they are much less likely to organize an incident. In most reported situations, however, local demonstration leaders have become so fed up and so incensed by apparent wrong-doing that personal consequences are given less weight.

Will these kinds of demonstrations continue to grow in number and eventually pose a threat to the government and the party? The answer to this question depends on how skillfully government addresses the underlying issues and the problem of corruption. My personal assessment is that policymakers in the politburo and government bureaucracy will continue to craft a hybrid response, combining a younger pool of local leaders with their enhanced supervision by higher levels of government. Media coverage will continue to restrict information about the extent and seriousness of incidents, and when outrageous developments break out, an overwhelming police response will punish both the demonstrators and local officials.

This kind of incentive scheme for local officials, if adequately funded and well designed, can contain unrest within a scale that does not threaten continued rapid economic growth. At the same time, this very rapid economic growth is the medium- and long-term enabler of calmer relations between short-term winners and losers in the reform process. Given my assumption of an informed but stern government policy program to resolve such incidents under the leadership of local officials, I do not see that continued frequent demonstrations pose a threat to the survival of China's government as we now know it.

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Table 1
Incidents* of Social Unrest in China

	1	2
	Number	% Change
1993	8,700	--
1994	10,000	14.9
1995	11,500	15.0
1996	12,500	8.7
1997	15,000	20.0
1998	24,500	63.3
1999	32,500	32.7
2000	40,000	23.1
2001	n/a	*12.2*
2002	50,400	*12.2*
2003	58,000	15.1
2004	81,600	40.7
2005	87,000	6.6

* Incidents involving 15 or more persons

Note: *italics* indicate annual average growth.

Sources: Liaowang and China Ministry of Public Security, cited in Tanner 2004, State Department 2005, Chan 2004.

HEARING COCHAIR REINSCH: Thank you. Dr. Muldavin.

STATEMENT OF DR. JOSHUA MULDAVIN, PROFESSOR OF GEOGRAPHY AND ASIAN STUDIES AT SARAH LAWRENCE COLLEGE

DR. MULDAVIN: You asked me to come here today to discuss China's internal unrest and make a prognosis for the future. It's a complex topic to cover in seven or eight minutes. I will lay out what I think are the key issues and then leave to details for the question period.

Thank you for the invitation and the opportunity to express my views and the results of my research in China over the last 23 years, and during that time I've worked primarily in rural areas. I've lived eight years in a number of villages all over rural China, and primarily in its relative hinterlands, which is where I'm going to focus my discussion.

It's these areas that give us some important clues to China's current predicament and perhaps its most promising solutions. In fact, China's rural areas are the root of the most famous uprising in China during the reform decades, that of Tiananmen in 1989.

China's economic successes since 1978 are undeniable, but the shortcomings and failures of those post-Maoist reforms are also undeniable and are the inevitable outgrowth of China's chosen path.

This rapid growth of the last two and a half decades has been built upon a base of environmental destruction and decay that I think you were speaking about earlier this morning. In this process, the state has lost much of its legitimacy with the country's majority, and now it's challenged by direct and also indirect forms of resistance, which I hope we can discuss.

As China's global integration proceeds, this paradox of growth built on decay and the resulting rural crisis has created a shaky foundation for arguably the world's most important new superpower.

The state has tried to grow its way out of this, and I argue that actually this has intensified rising social unrest in the rural areas, and reflects a real crisis that the state is losing legitimacy in these areas. This has important implications not only for China but also for the world.

In 2005, as the previous speaker noted, there were 87,000 incidents -- meaning that on any given day, a leader is having to deal with 240 incidents of unrest. We can talk about the details of those incidents perhaps later. But if you put on the hat of the state, that means that this is something you are not just dealing with occasionally, but you're dealing with on a constant daily basis.

This is not to be unexpected. In fact, we can probably better understand this by understanding some of these deeper structural roots and the downside to China's growth that is felt by the rural majority. Most of the most vulnerable people in the society are in the rural areas, and since China's implementation of the reforms in the early '80s, there's been about 100 to 150 million people who have entered the middle class, a very small powerful elite, but of the 800 million peasants in the countryside, 400 million of them have seen their income stagnate or decline.

That situation is much worse, particularly for women, children and elders, (and again we can speak about that during the question period), for whom market economies, if they do exist, exist only in probably the most exploitive of circumstances.

So there are two Chinas now, one that the world pays homage to and the other that the world has pretty much forgotten about. One is for investors and those interested in trying to go in and make money. They set up factories and use China as an industrial platform for the world. And the other, in this rural hinterland, is a very different story. In these areas, the reforms brought initial increases in income, but were accompanied by serious problems of subsequent stagnation, declining production, and the rising peasant risk that resulted as they depended increasingly on household labor and declining sized plots of land for their livelihood. (This is one of the things that I hope to talk a little bit more with you about.)

I'll talk about briefly two examples, one in the south in Guangdong and one up in the northeast that are recent. In Guangdong, you read about the recent strife in November, and while rural strife is not new (in 1994, by the way, I witnessed thousands of peasants in Hunan in one of the villages I was working in rise up and fight against a local government militia over unpopular taxation and state policies. So it's something I can again discuss with you in greater detail.) Its scope and its frequency have increased greatly. Lethal violence is fairly rare and the unrest in the countryside going to that extreme is not something we see too often. But in Guangdong in the south, this is an area which embodies many of the great inequalities in a very intense way that have

been created through the reforms, and therefore it's become a focus of resistance to development as peasant lands are overrun with industries.

Peasant land loss is really a time bomb for the state. While avoiding full land privatization and until recently massive rural landlessness, Beijing still allows unregulated rural land development for new industries and infrastructure.

The land seized from peasants reduces their minimum subsistence, leaving them with what I call "two mouth lands" that won't feed a family of five and thus forcing many members of the household to join the 200 million workers who on any given day are wandering the roads of China looking for someplace to work.

In many areas where I've carried out research, some households have lost even that bit of land and contributing at the moment to what are approximately 70 million landless peasants. That group, and that's according to official estimates--I have different estimates of my own--the enormous number of landless or land-poor peasants means that the Chinese state is struggling not only to maintain legitimacy, but that this fundamental aspect harks back to a previous period in China's history and therefore raises some really significant challenges.

Peasants are losing their land to roads, power plants, dams, factories, waste dumps, housing projects, and the compensation, as you've read about, is minimal and not nearly enough to replace lost subsistence in this rural society, particularly given that social security beyond family ties and other collective welfare mechanisms no longer exists in the rural areas.

So these circumstances force residents to take desperate means to try to limit resulting vulnerability, and the peasants in the south, they blocked access to a power plant in December, only after years of petitioning the local government, and that's quite significant.

So after these peaceful protests failed trying to get this compensation, and then they fought back. The peasants and rural workers, they've seen the state increasingly side (and they speak to me about this, in all my villages that I work in), they see the state increasingly side with the newly rich over the past two decades, and that leads to incredible amounts of disenchantment with state policies.

Another example is from the northeast, and that has to do with this recent spate of environmental disasters in the news and the rising awareness of that across China. The spill into the Songhua River that many of you I'm sure read about and benzene which is a carcinogenic petrochemical forced the evacuation of thousands and affected the water source for millions and probably was discussed this morning.

Most people focus on the effects on urban China and particularly the problems, and these are real problems of lax environmental regulatory enforcement, corrupt local officials and delayed sharing of crucial information. But I think they miss two far more significant points.

First, the spill is not a singular event. It's a manifestation of much larger structural problems, which I'm happy to discuss with you, that again disproportionately impact rural areas. And second, the world

as a whole, to varying degrees, I would argue, is implicated in this predicament and actually can't afford to pretend otherwise.

China's rural hinterlands are in essence the engine as well as the dumping ground of China's unprecedented economic growth as well as its trajectory. So these rural areas provide the country's booming cities with cheap unorganized labor principally drawn from extremely poor peasant communities in the midst of their own social and environmental crises.

It's also here that the most toxic industries are located out of sight of the world's media. Rural peasants labor in some of the world's dirtiest, most dangerous conditions in these far-flung township and village enterprises spread across the whole country. These are industrial subcontractors to not only Chinese companies but also international companies that spew pollution into the air and water and onto the land. And when the health of rural workers is destroyed, they return to tilling decimated lands around their villages, which have become toxic waste dumps for this unregulated production.

I spent a good part of the 1980s living along the banks of the Songhua River where this spill happened, and I vividly remember drinking purple water from a well in a village that I lived in for two years--a bright glow in the dark purple--there was no other water source in the village. But this water source had been polluted by the one small local factory, and the choice for local residents was either to drink it or to leave and join this very large migration of rural peasants looking for jobs.

So those kinds of choices are the downside of course to China's economic success and one that has made it not only a producer of an ever-increasing share of the world's industrial output, but also has seen it ravage the rural resource base. And this is accompanied by declining peasant access to basic social services, public health, education, and the profound gaps that we can talk about.

Such matters may seem distant, but their concrete manifestations, however, appear on the shelves of the local Wal-mart and IKEA. Rural China, its environment and its people, are on the bottom of a global commodity chain, tied to China's emergence as global companies' industrial platform of choice.

I'll finish here. While China's workers and environment pay most of the cost, we outside the country's borders are ever eager to purchase low price goods, irrespective of the environmental and social impacts, particularly ones as distant and hidden as those in rural China. We consume the benefits and yet indirectly, I would argue, we also bear the costs.

As the world's companies continue to rush in to set up factories, to avoid environmental and occupational regulations elsewhere, as well as unionized labor, they are backed by the state in this. They are dragging communities worldwide in a downward race to the bottom as they struggle to compete with China’s socially and ecologically destructive industrial platform.

We need to do two things. First, we need to tackle the environmentally and socially unsustainable ways that we choose to produce globally, and that's in the sense that we are complicit.

Second, we need to put pressure on China to focus its development efforts now on the most vulnerable, whom I would argue are in rural areas. Many cite China as a success story of market transition. In essence the previous speaker pointed to this. But the negative costs, the human and environmental costs, should make us question the wisdom of our rapidly expanding global interdependence as well as development models overly reliant on markets to provide needed social goods, occupationally safe employment and environmental sustainability for the majority of the world's peoples.

Unless overall policies are altered to address the needs of China's vulnerable majority, Beijing will surely face more protracted and violent challenges from the country's development, "success" in the foreseeable future.

It's not in our interests in the West or in Asia to have an increasingly unstable China. Its 800 million peasants should not be pushed further into the global market economy, I would argue. That will only lead to rising rural discontent at a time of increasing urban unemployment, and the West can't afford to ignore that growing instability. We're too interdependent as well as complicit. And understanding the rural roots of this, I think, is the first step toward devising pathways of positive change for the lives of one in eight of the world' people.

Thank you.

[The statement follows:]

Prepared Statement of Dr. Joshua Muldavin, Professor of Geography and Asian Studies at Sarah Lawrence College

Introduction

You asked me to come here today to discuss China's internal unrest, and make a prognosis for the future. This is a complex topic to cover in eight minutes, but I will lay out what I think are the key issues at hand, and then leave further details for your questions. Thank you for the invitation and the opportunity to express my views and results of my research in China over the past twenty-three years. During this time I have worked for eight years in rural China, and as such it is China's relative hinterlands that I will discuss briefly today. I believe that it is in rural areas that we can find the most important clues to China's current predicament and perhaps the most promising solutions. In fact, China's rural areas are the root of the most famous uprising in China during the reform decades—Tian'anmen in 1989.

China's economic successes since 1978 are undeniable. But shortcomings and failures of the post-Maoist reforms are also undeniable and are the inevitable outgrowth of China's chosen path. China's rapid growth of the last two and a half decades has been built upon a base of environmental destruction and decay. In this process, the state has lost much of its legitimacy with the country's majority, and is now challenged by direct and indirect forms of resistance. As China's global integration accelerates, this paradox of growth built on decay, and the resulting rural crisis, has created a shaky foundation for arguably the world's most important new superpower. The state has tried to grow its way out of the problems but I argue that this has only intensified rising social unrest which accurately reflects a rural crisis and the state's increasing loss of legitimacy, particularly in rural areas. This has important implications not only for China but also for the world.

In 2005 there were 87,000 incidents of unrest in China according to the state security bureaus own statistics. That means on any given day the state is having to deal with 240 or more uprisings or incidences of unrest someplace in the country. So if you put on the hat of the state leader this is really an important

and very difficult issue on a daily basis, not something that's just occasional. One of the things that I've argued is that this is not unexpected and that in fact by focusing on the paradox above, the fact that these two decades of market reforms and very rapid growth have created serious environmental and social problems— we can best understand current challenges to state legitimacy.

The down side to China's growth is primarily felt by the rural majority and by the most vulnerable people in the society. So you have in China since the implementation of the reforms in the early 1980s, the development of between 100 and 150 million in the middle class, you have a very powerful elite that has also developed, but you also have in the hinterlands 800 million peasants, 400 million of which have seen their incomes decline and lives worsen. Those at the bottom, most hard hit, are women, children and elders—for whom market opportunities, if the do exist, exist in only the most exploitive of circumstances.

There are two China's now—one that the world pays homage to and the other that the world has forgotten about. One is for investors and those interested in trying to go in and make money, set up factories and use China as the industrial platform for the world that it has become. Then there is this rural hinterland—and the rural hinterland is a whole other story. In these areas the reforms brought initial increases in income but were accompanied by serious problems of subsequent stagnation and declining production, leading to rising peasant risk as they increasingly rely just upon household labor and now small plots of land for their livelihood.

I will look at two examples that help explain the Chinese state's lost legitimacy and also connect it directly to two different aspects of the rural unrest stemming from the environmental and social consequences of China's reforms: a recent uprising in southern China's rapidly growing Guangdong Province; and an environmental pollution incident in Heilongjiang Province in the northeast.

Unrest in Guangdong Province

Much of Western reaction to last December's police killing of as many as twenty protesting villagers in China's Guangdong province missed the tragic event's true significance. The dispute, involving the government's seizure of peasant land for a power plant, is symptomatic of deep structural social and environmental problems that challenge the Chinese state and its chosen development path.

Myriad problems—social, environmental and economic—have the state in near panic as it tries to hold down the resulting widespread unrest in the countryside. While rural strife is not new—in 1994, I witnessed thousands of peasants in Henan province fight a local government militia over unpopular taxation and state policies, something I can discuss in greater detail during questions if you wish—its scope and frequency have increased greatly. Although lethal violence in such events is rare, the unrest in the countryside is the biggest political problem China faces today. In 2004 there were 74,000 uprisings throughout the country according to official estimates. This increased to 87,000 incidents in 2005 (a 16% increase). They emerge from a context of widening gaps between rich and poor, urban and rural areas, and the rapidly growing industrial east and stagnating agricultural hinterlands. Booming Guangdong, in the south of China -- an epicenter of foreign direct investment, with thousands of new factories of global and Chinese corporations--embodies these inequalities most intensely. It is thus unsurprising that the province has become a focus of resistance to development as peasant lands are overrun with industries.

Peasant land loss is a time bomb for the state. While avoiding full land privatization and, until recently, massive landlessness of the rural majority, Beijing still allows unregulated rural land development for new industries and infrastructure. Land seized from peasants reduces their minimal subsistence base, leaving them with what is called "two-mouth" lands that won't feed a family of five, thus forcing members of many households to join China's 200 million migrants in search of work across the country on any given day. In many areas where I have carried out research, some households have lost even these small subsistence lands, contributing to China's nearly 70 million landless peasants according to official estimates (official estimates state the 3 million currently lose their lands each year). This harks back to the period prior to China's 1949 revolution when enormous numbers of landless peasants formed the core of the largely rural movement led by Mao and others. Following their victory, it was the redistribution of land to the poorest peasants that gave the Communist party its greatest enduring legitimacy in rural areas. And now with enormous numbers of landless or land-poor peasants, that then means that the Chinese state is struggling just to maintain basic legitimacy in these rural areas. It is the loss of this legitimacy that lies at the heart of the most recent strife.

Peasants are losing their land to roads, power plants, dams, factories, waste dumps, and housing projects for wealthy city-dwellers escaping urban pollution and small apartments. Compensation for land seizures is minimal and not nearly enough to replace lost subsistence in a rural society without social security beyond family ties given that collective welfare mechanisms no longer exist due to the post-Mao reforms. Such circumstances—combined with unresponsive local governments--force residents to take desperate means to try to limit the resulting increase in vulnerability. Peasants in Dongzhou, Guangdong blocked access to the power plant last December only after years of petitions and peaceful protests had failed to get them promised compensation for their lost lands.

The Chinese state is very clear on the rural roots of the 1949 revolution, ones emanating from massive inequality and social insecurity. As a government of rural revolution itself, the Chinese state knows where incidences like this can lead. And so now, in the current situation there is clarity as well for peasants and rural workers who have seen the state increasingly side with the newly rich over the past two decades, often at a direct cost to themselves, their families and communities. Beijing could use the violence in Guangdong as an opportunity to address the structural roots of the larger unrest. Instead the state is focusing on re-characterizing the killings as the mistake of an overly zealous local police officer rather than a systematic attempt to hold down rural discontent by, ultimately, any means necessary.

How heavy handed the authorities are in dealing with rural unrest is actually hard to say in any kind of generalized sense. But I would say that the state is extremely aware and concerned about the possibility of some kind of coalition or gathering of different groups together to start organizing on a broader basis. They're very quick to try to do two things. One is to find out if there are leaders and to pull them out right away and reprimand them or worse. The second thing is also to try to intervene and do a combination of placating protesters and local governments—where the conflict often is most intense, between local peasants and local governments—with populist promises as well as threatening anyone who tries to cause further unrest.

Behind and beyond the chemical spill in northeast China

Another example of the problems that the Chinese state faces can be seen in the recent spate of environmental disasters in the news, and the rising awareness of these across China.

The spill into the Songhua River of 100 tons of benzene last November—a powerful carcinogenic petrochemical that causes leukemia—forced the evacuation of thousands and poisoned the water supply for millions in northeast China including Harbin, the region's major city. Most analysts following the disaster focused on the challenges faced by urban Chinese, and the real problems of lax environmental regulatory enforcement, corrupt local officials, and delayed sharing of crucial information with affected populations. But they missed two far more significant points. First, the spill is not a singular event but a manifestation of a much larger structural problem within China that disproportionately impacts rural areas where the country's majority lives. And second, the world as a whole to varying degrees is implicated in this predicament, and can no longer afford to pretend otherwise.

Far from the bustling megalopolises of Beijing and Shanghai, China's rural hinterlands are the engine and the dumping ground of China's unprecedented economic growth and trajectory. These rural areas provide the country's booming cities with cheap, unorganized labor drawn from extremely poor peasant communities in the midst of their own social and environmental crises. It is also here that many toxic industries are located and through which the benzene spill first flowed and will soon flow again—out of sight of the world's media. Rural laborers work in some of the world's dirtiest, most dangerous conditions in these far-flung township and village industries spread across the whole country. These industrial subcontractors to Chinese and international corporations spew pollution into the air and water and onto the land. And when rural workers' health is destroyed in these factories, they return to tilling the decimated lands surrounding their villages—toxic waste dumps for this unregulated production.

I spent a good part of the 1980s living along the banks of the Songhua River. I vividly remember drinking purple contaminated well water in a nearby village with no other water source than the one polluted by the small local factory. The choice for local residents was to drink the water or leave and join the 200 million peasants searching for work in China's cities on any given day. Such choices are the downside of China's economic success since the early 1980s, one that has made it the producer of an ever-increasing share of

the world's industrial output. The country's phenomenal growth has been achieved through a ravaging of the rural resource base, accompanied by declining peasant access to basic social services, public health, and education, and a profound and rapidly growing gap between urban and rural areas, and a wealthy minority and poor majority.

Such matters may seem distant. Their concrete manifestations, however, appear on the shelves of the local Wal-Mart and Ikea. Rural China, its environment and people, are on the bottom of a global commodity chain tied to China's emergence as global corporations' industrial platform of choice. While China's workers and environments pay most of the costs, we outside the country's borders, ever-eager to purchase low-priced goods, irrespective of the environmental and social impacts—particularly ones as distant and hidden as those in rural China—consume the benefits. And yet indirectly we also bear the costs.

As the world's companies continue to rush to China to set up factories to avoid the environmental and occupational regulations elsewhere, as well as unionized labor, they are dragging communities worldwide on a downward race to the bottom as they struggle to compete with China's socially and ecologically destructive industrial platform. As well, resources around the world are increasingly being funneled through this exceptionally unregulated industrial zone. It is this sad truth we must face, and it is the related challenge to the world's communities that we must directly confront. It is too easy to raise a short-lived cry of dismay at each toxic news event, pointing fingers at corrupt local leaders and industrialists, or even at the failure of China's regulatory system, only to move on to another story next week. Instead we must do two things: tackle the environmentally and socially unsustainable ways we choose to globally produce and consume; and put pressure on China to focus its development efforts on the most vulnerable.

Conclusion

Many cite China as a success story of market transition. But the negative costs, human and environmental, should make us question the wisdom of our rapidly expanding global interdependence, as well as development models overly reliant on markets to provide needed social goods, occupationally safe employment, and environmental sustainability for the majority of the world's peoples. The dilemma for China is not a public relations one, nor is it about how to cope with these particular two events. Unless overall policies are altered to address the needs of China's vulnerable rural majority, Beijing will surely face more protracted and violent challenges from the victims of the country's contemporary development "success" in the foreseeable future.

It is not in the interests of the West, or of Asia, to have an increasingly unstable China. Its 800 million peasants should not be pushed further into a global market economy in which price swings affect distant villages that no longer have government welfare and protective buffers. That will only lead to rising rural discontent at a time of increasing urban unemployment. The West cannot afford to ignore growing instability in China. We are too interdependent, as well as complicit. Understanding the roots of the instability is an important first step toward devising pathways of positive change for the lives of one in eight of the world's people.

HEARING COCHAIR REINSCH: Thank you very much. Mr. Welker.

STATEMENT OF DAVID WELKER, SENIOR PROJECT COORDINATOR, INTERNATIONAL BROTHERHOOD OF TEAMSTERS

MR. WELKER: Thank you to the commissioners for inviting me to participate. Mr. Wortzel, Mr. Reinsch, thank you. The good work of the U.S.-China Economic and Security Review Commission continues to inform the debate and educate the Congress and the American public in the difficult questions of the U.S.-China relations.

I appreciate the chance to speak to the issue of worker unrest in China and that country's prospect for long-term stability under Chinese Communist Party rule.

When looking at China's present system, one has to wonder if the language of economists is useful. The country is one by one-party authoritarian dictatorship that calls itself communist, but tolerates a hybrid market economy that combines some of the worst mercantilist policies, some of the harshest laissez-faire practices, and some blatant state planning under the banner of reform.

Yet this system has defied most expectations for more than 25 years. However, past performance is no indicator of future results. In fact, we don't know too much about China's recent performance either. The revision of the gross domestic product figure shows that even the macroeconomic picture is quite hazy.

Observers' skepticism, as Mr. Keidel expressed towards the quality of the mass incident statistics is equally applicable to many economic figures from China.

In its 2003 monograph, Fault Lines in China Economic Terrain, the RAND Corporation identified eight specific issues of potential dangers to China's assumed growth path:

Massive unemployment and rural poverty; corruption and its effects; epidemic disease; environmental degradation; and energy price shocks; state financial and state-owned enterprise failures; shrinkage of foreign investment; and quote, "Taiwan and Other Potential Conflicts."

I think this seems to me be a reasonable list. Another series of factors has been compiled by the China Labor Bulletin in a report titled "The Workers Movement in China 2000-2004."

One passage is worth quoting at length. One type of participants in the collective demand actions is where the unemployed and the laid off are the majority, but this group includes small numbers of retirees and present workers. They generally are found in the northeast, northwest, southwest and central plains among the older industrial bases. They are concentrated in the energy, forestry, military production, textiles, iron and steel, petroleum, construction, sugar and such industries.

These industries are precisely the primary object of the state sector reforms and restructuring. One type is comprised of workers who do not have city residence hukou yet work in all types of enterprises. This group of workers is called "peasant laborers." These workers primarily found in the southeast coastal regions' economically developed areas among the locally invested or foreign invested private companies.

The CLB report notes, quote: "It must be first pointed out that the predicament faced by Chinese workers is not a problem of lack of rights, but more so of the expropriation of rights. Because of this, over the last few years, the conflicts between labor and capital have given rise to conflicts between workers and local governments and have become major social conflicts."

The difference between lists of economic factors of unrest of many foreign observers and factors identified by Chinese civil rights

activists can be traced to their basic views of reform. I believe that there are two primary camps: a camp that feels that China's reform has followed a bumpy yet correct path and a camp who feels that reform in opening up itself, the methods, the decisions, the policies of the party, is in error and poor party-led implementation has only added to the problem.

But both camps agree that this present CCP leadership is committed to this path of reform, one of economic restructuring with minor support in social safety nets without accompanying political restructuring that would make authorities accountable. And since this present path of reform is exacerbating the contradictions between the people and the government, then the answer to the question of whether protest in China will grow, contract or remain constant is clear.

The protests will grow as the reform accelerates. The question surrounding whether or not China should undertake wholesale economic changes were settled inside the CCP long ago. In the run-up to the great bargain on China's accession to the WTO, there were internal Party discussions and even limited debate between the Party and civic-minded public intellectuals on what exactly reform under the WTO would be and what impact it would have.

The potential for a split in Party leadership where a clique that advocates lesser reform, more focused on supporting the displaced, is quite small in my view. The Party discipline functionaries are still potent, but the enrichment through corruption is much more a factor in keeping Party members loyal to the present policies.

I feel that the widespread demands over the expropriation of workers' rights is a larger threat in the immediate to medium term than the demands over the exploitation of workers' situation. In the case of peasant labor, the migrants are leaving families behind in the rural and agricultural regions to seek wages and jobs in the manufacturing areas and construction near cities along the coast.

There are factors that push them off the farms like subsistence tenancy and hard labor and factors that pull them into the factories like a need for wages in the new cash based reality.

These peasant laborers have a great responsibility to send their wages back home, so they may have a higher sense of obligation to withstand the exploitation they find in the factories. The peasant laborers truly are starting with nothing so the something they get in wages is at least temporarily an improvement.

In the case of the state-owned workforce, there was a full social network of social services and state support up until very recently. The laid off workers and the pensioners of state-owned enterprises were fairly secure in their position and were called in Party propaganda "China's elite."

These workers feel a double loss. First, the loss of their jobs and security, and then the loss, the loss of face, the loss of proper compensation, which compounds the anger and the sense of being cheated.

The potential role of the independent trade union in China is as bleak as the hoped for independent judiciary in China. The All-China Federation of Trade Unions is simply one pillar of the Party's united front strategy on controlling the population.

In state-owned enterprises, the unions are literally a joke among the workers. In foreign invested enterprises, there is very little study of what role ACFTU branch unions exactly are meant to do. The trade union laws in China state that all foreign firms must allow for ACFTU branch unions in the workplace.

The story of Wal-mart's struggle with the ACFTU is indicative of how the union and Party interact. The Workers Daily named Wal-mart deficient in following the trade union law. The initial response from the Wal-mart spokesman in China was that the company didn't have unions anywhere in the world, and they didn't want unions in China.

This answer got the Chinese ultra-nationalists in an uproar with accusations that foreign companies could simply ignore Chinese law. The Party was put in a tough position. The next time the Wal-mart CEO was in Beijing, he announced a correction of the company's policy, that the company would allow the ACFTU if the workers themselves advocated for union representation.

I read that as meaning that the ACFTU central bodies were not empowered to approach Wal-mart workers directly to create branch unions. This suggests that the Party could direct or dissuade the ACFTU from building branch unions inside certain under defined but politically supported foreign enterprises.

Most Chinese workers do not see collective representation as having any power under the present structure, and thus the influence that trade unions had in other countries to bring changes surrounding early 20th century issues like child labor, indentured labor, horrid workplace safety, is absent in 21st century China.

There is no reason to believe in the benevolence of the Party to step in and relieve these basic labor deficiencies, never mind to see the Party thoroughly enforce minimum wage, maximum working hours laws that are already on the books.

In the present laissez-faire market that is China, there are limited external disciplines influencing workplace conditions, officials scrambling to avoid environmental disasters, for one, and in certain local markets, influencing wages as well, even in the absence of a workers' movement.

The size of the Chinese workforce breaks the economic models that forecast a rising tide lifts all boats scenario over a mid or long-term time frame.

The thousands of deaths in the mining industry or the tens of thousands of serious industrial injuries like amputations have yet to inform schools of potential workers to opt out of the labor pool and stay away from the dangerous jobs.

The overall lack of external disciplines on the laissez-faire market in China results in so-called "China price." A government that was more responsive to the workers could impose some regulations to

mandate limits on the exposure to toxic chemicals in a plastic plant, to appropriate a larger compensation for its state employees, or to enforce its standards for wage accounting, for example.

That would put upward pressure on the China price, but again the consensus is that this reform, this leadership will continue down this present path of reform. If the Party rhetoric of addressing the inequality or the deteriorating safeguards is acted upon promptly, then perhaps the scale of unrest will moderate, but the China price will become less of a competitive advantage in attracting new investment. Thus, growth would level off and the bargain between the Party and the people for prosperity in exchange for stability might be questioned by ever-larger numbers of Chinese.

The Party may judge that there is greater threat to their control and the perception of failing momentum behind prosperity than in the slow burn of unrest by those who reform is leaving behind.

Thank you.

[The statement follows:]

Prepared Statement of David Welker, Senior Project Coordinator, International Brotherhood of Teamsters

Firstly, I must offer my thanks to all the Commissioners for inviting me to participate in this hearing. Thank you to hearing co-chairmen, Commissioner Wortzel and Commissioner Reinsch. The good work of the U.S.-China Economic and Security Review Commission continues to inform the debate and educate the Congress and the American public on the difficult questions of U.S.-China relations.

I appreciate the chance to speak to the issue of worker unrest in China and that country's prospect for long-term stability under Chinese Communist Party rule.

When looking at China's present system, one has to wonder if the language of economists is useful. The country is run by a one-party authoritarian dictatorship that calls itself "communist" but tolerates a hybrid market economy that combines some of the worst mercantilist policies, some of the harshest laissez-faire practices and some blatant state planning under the banner of "reform." And yet this system has defied most expectations – maybe defied economic gravity – for more than 25 years. The Party has jettisoned revolutionary zeal as its guiding force in favor of growth and inequality as its cardinal principles.

However, past performance is no indicator of future results.

In fact, we don't know too much about China's recent performance either. The revision of the gross domestic product figures shows that even the macroeconomic picture is quite hazy. As one comment on Brad Setser's weblog put it: the change in denominator means that every "of GDP" figure needs to be revised – it does not however improve the quality of any numerators. One report from a research arm of the official National Development and Reform Commission released earlier this month predicted growth between 8.5% and 9% for 2006 but also warned that deflation could return this year. The Wall Street Journal reported "some economists said the think tank is putting out confusing signals, reflecting official uncertainty about how to keep economic growth on track." No wonder many observers are confused.

In its 2003 monograph Fault Lines in China's Economic Terrain, the RAND Corporation set out to take a "countervailing perspective to what has been a generally prevailing consensus" that "China's economy will be able to sustain high rates of economic growth for the indefinite future." I think they selected a representative universe of "fault lines" that lay underneath the apparently functioning Chinese economy. The report identifies eight specific issues of potential danger to China's assumed growth path: massive unemployment and rural poverty; corruption and its effects; epidemic disease; environmental degradation; energy price shocks; state finance and state owned enterprise failures; shrinkage of foreign investment flows; and "Taiwan and Other Potential Conflicts." This seems to be a reasonable list.

Another series of factors was compiled by the China Labour Bulletin, the labor rights advocacy NGO headed by Han Dongfang in a report titled The Workers Movement in China 2000-2004 published in

Chinese in 2005 that has not yet been translated into English thus is not widely distributed among Western observers. The authors identify two distinct groups of workers impacted by economic policies of the CCP under the banner of "reform." One passage is worth quoting at length:

In the period of the report, the participants in the worker collective demand actions (author translation of *gongren jiti weiquan xingdong*) can be divided into two types:

One type is where the unemployed and laid-off (*xiagang)* are the majority but this group includes smaller numbers of retirees and present workers. They generally are found in the northeast, northwest, southwest and the central plains among the older industrial bases. They are concentrated in the energy, forestry, military production, textiles, iron and steel, petroleum, construction, sugar and other such industries. These industries are precisely the primary object of the state sector reforms and restructuring.

One type is comprised of workers who do not have city residence *hukou* yet work in all types of enterprises; this group of workers is called "peasant laborers." These workers are primarily found in the southeast coastal regions' economically developed areas among the locally-invested or foreign invested private companies.

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Among the collective actions by the unemployed and *xiagang* workers, the primary collective grievances are: to demand their right to active employment; to demand the promised wages, social insurance payments, collective payments; to demand raises in basic living safeguards; to demand the release of detained worker representatives.

The CLB report tellingly notes, "It must be first pointed out that the predicament faced by Chinese workers is not a problem of 'lack of rights' but more so the 'expropriation of rights.' Because of this, over the last few years, the conflicts between labor and capital have given rise to conflicts between workers and local governments and become major social conflicts."

The difference between lists of economic factors of unrest of many foreign observers and factors identified by China Labor Bulletin or other Chinese civil-rights activists can be traced to their basic views of "reform." I believe there are two primary opposing camps: a camp that feels that Chinese reform has followed a bumpy yet correct path and a camp who feels that "reform and opening up" itself – the methods, the decisions, the policies of the party – is in error and poor party-led implementation has only added to the problem.

But both camps certainly would agree that this present CCP leadership is committed to this path of reform – one of economic restructuring with minor support in social safety nets without accompanying political restructuring that would make the authorities accountable. And since this present path of reform is exacerbating the contradictions between the people and the government, then the answer to the question of whether protests in China will grow, contract or remain constant is clear: the protests will grow as the "reform" accelerates.

The questions surrounding whether or not China should undertake wholesale economic changes were settled inside the CCP long ago. Now the questions of what form those changes will take and under what system they will be implemented is the crux of the conflicts both between labor and capital in China but also between those who support "this path only faster" reform and those who support "not this path" reform. In the run-up to the great bargain on China's accession to the WTO, there were internal party discussions and even limited debate between the party and civic-minded public intellectuals on what exactly "reform" under the WTO would be and what impact it would have. This internal debate was stifled by the Jiang clique and the collective party leadership decided to plow forward with wrenching economic displacements under a one-party administrative and legal structure that has no real mechanism to listening to the ever growing voices of the displaced. The potential for a split in party leadership where a clique that advocates "lesser reform" more focused on supporting the displaced is quite small in my view; the party discipline functionaries are still potent, but the enrichment through corruption is much more of a factor in keeping party members loyal to the present policies.

I see China's largest economic fault line lies within the policy disconnect of so-called "privatization" of state-owned enterprises in a country where the authoritarian regime's rubber stamp "legislature" can't pass a law that recognizes "private property." Throughout the entire existence of the People's Republic of China, the workers have been told that the assets of the state are collectively owned and therefore the individuals had a stake not only in their place of work but in the national wealth. Yet, under so-called "reform", the authorities are now saying that the worker has no claim to these assets, that the previous party-cum-managers are now the personal shareholders of the state enterprises and there is no compensation for previously committed wages, benefits or pensions or payment to "purchase" the collectively owned share of the facility and assets.

In an admittedly simplified comparison, at least in the United States when a company like IBM unilaterally changes is pension program, the workers have recourse to taking this decision to the courts for protection of their rights. In this IBM example, the courts sided with the workers and the company was compelled to pay court-determined compensation. In China, the workers are losing their jobs, their back-pay, their right to residence, their right to social benefits like health care and education, their pensions and their "share" of the collectively owned asset. And there is no third party that can enforce external discipline on the authorities.

I feel that the widespread demands over the 'expropriation' of workers' rights is a larger threat in the immediate to medium term than the demands over the 'exploitation' of workers situations. In the case of 'peasant labor', the migrants are leaving families behind in the rural and agricultural regions to seek wages and jobs in the manufacturing areas near cities and along the coast. There are factors that push them off the farms like subsistence tenancy and hard labor and factors that pull them into the factories like a need for wages in the new cash-based reality. These peasant laborers have a great responsibility to send their wages back home, so they may have a higher sense of obligation to withstand the exploitation they find in the factories. In the case of the state-owned workforce, there was a full network of social services and state support up until very recently. The laid-off workers and the pensioners of state-owned enterprises were fairly secure in their position and were called in party propaganda China's elite. These workers feel a double loss: first the loss of their jobs and security and then the 'loss' of proper compensation which compounds the anger and creates a sense of being cheated. The peasant laborers truly are starting with nothing, so the something they get in wages is at least temporarily an improvement.

The potential role of independent trade unions in China is as bleak as the hoped for independent judiciary. The All-China Federation of Trade Unions is simply one pillar of the party's United Front strategy on controlling the population. The workers know that the union officials – in many plants concurrent members of both the Communist Party and management – are primarily there to gather intelligence on the workforce. In state-owned enterprises the unions are literally a joke among the workers. In foreign invested enterprises, there is very little study of what role ACFTU branch unions exactly are meant to do.

The trade union laws in China state that all foreign firms must allow for ACFTU branch unions in the workplace. The story of Wal-mart's struggle with the ACFTU is indicative of how the union and party interact. The Workers Daily named Wal-mart, among a handful of other international branded corporations, as deficient in following the trade union law. The initial response from the Wal-mart spokesmen in China was that the company didn't have unions anywhere in the world and they didn't want unions in China. This answer got the Chinese ultra-nationalists in an uproar with accusations that foreign companies could simply ignore Chinese law. So the party was being challenged by these nationalists. And, conveniently, the next time the Wal-mart CEO was in Beijing to open a university "research center" with company funds, he also announced a correction of the company's policy: that the company would allow the ACFTU if the workers themselves advocated for union representation. I read that as meaning that the ACFTU central bodies were not empowered to approach Wal-mart workers directly to create a branch union. This suggests that the party could direct or dissuade the ACFTU from building branch unions inside certain undefined but politically supported foreign enterprises. In the face of that collusion between party-cum-managers, party-state authorities and party unions, the workers rightly have no expectation that trade unions are a part of the solution to their predicament.

Most Chinese workers do not see collective representation as having any power under the present structure, and thus the influence that trade unions had in other countries to bring changes surrounding such early 20th Century issues like child labor, indentured labor or horrid workplace safety is absent in 21st Century China. There is no reason to believe in the benevolence of the party to step in and relieve these

basic labor deficiencies, never mind to see the party thoroughly enforce minimum wage or maximum working hours laws that are already on the books.

In the present laissez-faire market that is the Chinese labor market, there are limited external disciplines influencing workplace conditions – officials scrambling to avoid environmental disasters for one - and in certain local markets influencing wages as well even in the absence of a workers' movement. The size of the Chinese workforce, however, breaks the economic models that forecast a "rising tide lifts all boats" scenario over a mid- or long-term timeframe. The thousands of deaths in the mining industry or the tens of thousands of serious industrial injuries like amputations have yet to inform scores of potential workers to opt out of the labor pool and stay away from the dangerous jobs. There is potential for a small minority of skilled workers to move quickly up the production ladder and move from the most dangerous employers to more "reputable" domestic employers and even to foreign funded enterprises with international standards. But the rapidly growing gap of the prospects of this minority and the struggle for existence for a large majority of workers in China only fuels the sentiment of dissatisfaction and abandonment and thus unrest.

The overall lack of such external disciplines on the laissez-faire market forces in China results in the so-called "China price." A government that was more responsive to the workers could impose some regulations – to mandate limits in the exposure to toxic chemicals in a plastics plant, to appropriate for larger compensation for state employees, or to enforce standards for wage accounting for example – that would put upward pressure on the China price. But again the consensus is that this leadership will continue down this present path of "reform." If the party rhetoric of addressing the inequality or the deteriorating safeguards is acted upon promptly, then perhaps the scale of the unrest will moderate but the China price will become less of a competitive advantage in attracting new investment. Thus, growth would level off and the bargain between the party and the people for "prosperity" in exchange for "stability" might be questioned by even larger numbers of Chinese. The party may judge that there is greater threat to their control in the perception of failing momentum behind prosperity than in the slow-burn of unrest by those who "reform" is leaving behind.

Thank you.

HEARING COCHAIR REINSCH: Thank you. Mr. Wessel.

PANEL III: Discussion, Questions and Answers

COMMISSIONER WESSEL: Thank you. Thank all of you for being here. I heard a number of interesting comments and I wanted to see if I could weave those together in some way for maybe a larger question or a more fundamental question.

Dr. Keidel, I heard you say that inequality is a good thing. Dr. Muldavin, I heard you say that instability is bad. If one looks back at the demise of the former Soviet Union, the Gdansk shipyard, Solidarity and all the other various issues that the U.S. and in fact our labor movement had a hand in in terms of helping to facilitate in some ways, the larger question is, is the stability of the current system in our interest? Is that what we're seeking?

As I noted earlier today, it has been a bipartisan goal to promote freedom and democracy, which seemed not to go hand-in-hand with the Chinese leadership's long-term goals, which are to maintain power at any cost. Do we have an interest in stability? Or would instability lead to the demise of the current system and ultimately promote the values that we've talked about for decades? From each of the panelists, please.

DR. KEIDEL: I think that's a very fundamental question, and I come down not surprising rather critical of that question, that we

should even wonder whether stability is a good thing in a system that is changing as fast as China is.

I think we make an analytical mistake if we begin with an assertion that this is an authoritarian regime and this is the way authoritarian regimes are and therefore there is no chance for freedom or democracy in its future evolution.

I prefer an inductive approach where we actually find out what's going on, the changes that are occurring, compare where China is now and where it was 25 years ago. If I do that, I see enormous change in the direction of freedom and democracy.

But if you wonder whether maybe chaos would be a good thing, whether instability would be a good thing, given the centripetal forces that it would unleash, the triads, organized crime, violence that are lurking beneath the surface in Chinese society, then you really have to say that would--and you're asking that question--you have to ignore the damage to U.S. national interests of a sick nation spewing boat people in all directions with nominal governments that would be using foreign threats as a way to stay in power and building up tensions in the region.

I don't think anybody can for a moment imagine that instability in China would somehow lead to (a) a better society for China and (b) a safer and more secure world for the United States of America.

COMMISSIONER WESSEL: Mr. Welker.

MR. WELKER: I think generally the instability or growth, one or the other offers a false choice. Mostly what is going on on the course of reform inside of China, suggestions that I raised and that labor individuals active inside of China on the enforcement of existing regulations, is not in order to seize reform. It is in order to make the improvements on the margins that will diminish the numbers of dispossessed and displaced and therefore perhaps maintain stability at a greater level than it is right now.

So I think that from an American policy point of view, we do have a great interest in seeing stability inside of China as we have a great interest in seeing patterns of evolution in the political system over the next few years as we've seen over patterns of evolution in the economic system under the last 25 years.

It's a very tricky thing to try and set out what our evaluation model would be, but I don't think that if you were to say a universally applied minimum wage in China is going to cause boat people. There are things that can be done on the margins and I think that they are worth exploring in every forum we have with the Chinese to talk about their links to larger social stability.

DR. MULDAVIN: I think it's a very important question obviously. The concerns that I would have in taking that apart are to ask who do we care about? Do we care about which groups within China in that question? And then who in the United States, and to me that kind of determines that answer. I don't think it's a monolith. It's not a monolith in China. It's not a monolith here.

So depending upon whom we are focusing on as getting the benefits or the tragedy of that instability, it depends upon further

deciding that. But I think that growing their way out of instability, which has been the Party and the state's method up till now, that's what I argue is paradoxically actually just increasing the problem. Particular kinds of growth are, from everything I've seen in all the areas I've worked, increasing the environmental problems, the social problems, and the economic issues--particularly in these rural areas--that in essence add to this growing intensity of unrest.

So I can think of a couple of scenarios. One scenario would be that this ongoing intensification of unrest continues on for many years because, the state has not shown, despite this growing unrest, has not shown any real inability to contain it. Far from it. It has not even begun to use the level of military and police force that it could use. So there's a lot further down a very ugly road that we could be going in terms of one scenario, and if your folks were a part of that unrest, things can get a lot worse for you.

So predicting timing on that and what might happen I think becomes difficult. But that scenario goes a long ways. And I think one way of thinking about it is to remember that peasants have been rising up in China for millennia. They won once if you believe that in '49 they won, then they won once. And that depends on how you interpret the revolution, right?

But they have been rising up for a long time, and they have failed for a long, long time, and the singularity of that event is quite amazing in many ways. So I think the state has a lot of ability to contain it.

Another scenario would be one, which is what I am urging and arguing for, which is one that focuses on these issues of the most vulnerable and a shift in development path towards focusing on the most vulnerable. The state is doing that rhetorically to come up with a neo-populist line. From all the work I've done in various areas in China, as of yet, we're not seeing a lot of that implemented in real practice, and so I think that's one of the key issues and also how we might support it.

If you want to get into who might or might not benefit back here in the U.S. or there in China, we could pull that apart some more.

HEARING COCHAIR REINSCH: Thank you. Mr. Wortzel.

HEARING COCHAIR WORTZEL: Thank you very much for your time an testimony, gentlemen. I have a question very much related to the one Commissioner Wessel asked. But what are the costs, what are the costs to the United States of this type of, of any kind of unrest in China? What are the potential costs for American business? What are the potential costs for American security? I haven't been satisfied in the responses to that one.

I guess for Dr. Keidel, the question of incidents, and any of the panelists can answer this, I find really murky. It seems to me that a bicycle collision that can gather 300 people and cause a local police officer to have a great deal of difficulty for a number of hours in resolving the collision before a riot starts as the public argues, constitutes an incident, but that doesn't seem to be the kind of unrest that would affect security interests in the United States, unless it's indicative

of a real social dissatisfaction in China that can only express itself in other ways and how do we parse that out?

Dr. Muldavin, you made a couple of statements about the villages you work in, and I am very interested in why the Chinese Communist Party benefits from having a foreign academic so imbedded in local areas for so long? Do outside eyes on this form of corruption function instead of government and Party oversight on inequities?

Or do outside eyes on these serious problems become forms of external pressure for compliance? And if it's either of these things, is having this foreign set of eyes in there almost a type of reform or does it help reform?

DR. KEIDEL: Thank you very much for that question. I think what are the costs to the U.S. of unrest in China and how we can interpret an incident, if we're thinking of the same one, in which a bicycle accident resulted in eventually in a riot in which thousands of people came mustered by cell phones and resulted in the beating deaths of a number of people with farm implements.

The cost of unrest, if we see unrest or no unrest as the question, then I haven't done a very good job of explaining my analysis, that some degree and some kinds of unrest are totally unavoidable and reflect the successful evolution of the society towards greater productivity that rewards people for their effort and their ingenuity because it also at the same time then displaces those that are not as eager to change their modus operandi, their lifestyle. So I don't think that we can hope to avoid unrest in China situation, and that unrest is magnified by corruption.

I don't think it's caused by corruption primarily. So we should have in the U.S. interests that China grow in a peaceful way, join the world community in a rules-based system, and that it be capable of doing that with a per capita standard of living that is much higher than it is now, because otherwise it will not be as responsible a member of the world community.

So that we are very interested in the Chinese government's ability to manage the unrest, to reduce the corruption, and I would say that here the model of our federal system, where you have a separate authority on the ground at the local level, is a direction that China should be encouraged to take.

They have a corporate system in which if you want to do something at the local level, you have to do it through the local government, not alongside it. There are some nascent steps in that direction that I would like to see, but my point is that some degree of violence is necessary. It needs to be managed. If it gets out of hand and is poorly managed, then the United States will be a loser.

MR. WELKER: I think you have to see a protest along the lines of what we saw at Daqing in the oil fields of multiple thousands of workers over a long period of time and the energy infrastructure that really impacts a region as opposed to a local incident, as you mentioned, that would be a level of stability that could interrupt American

perception and therefore American policies on stability inside of China, fundamentally changing what we think is going to happen in China.

In the United States, my brothers and sisters in the longshoremen have a great impact at the ports on the west coast. A large disturbance at a port inside of China that would interrupt the export flow to the United States would capture the imagination of what instability could inside of China really incur.

I think that generally speaking, the costs to the United States are more so that the legitimacy over the long term in this type of reform will be undermined and that the backlash would be as Deng Xiaoping said, keep a close watch on the left. It's not on the rightists that your worries are from. It's from the leftists and although there are very few leftists left inside of China, there are still enough of a possibility, a fear inside of the Party, that they could jump off this path of reform to take on more populist policies, although I don't think we're there yet.

HEARING COCHAIR WORTZEL: And by leftists, in the Chinese context, you mean radical Maoists, radical Marxist-Leninists?

MR. WELKER: Sure, and I think that you would say among state-owned enterprise workers specifically, they have no class-consciousness problem. They know that they are the vanguard of the Party in a purely ideological Communist Leninist way.

But they are atomized and they have no way of collecting strength enough to threaten the Party and whether inside the Party someone would make an appeal in the top leadership of saying that we have to stop reform, there is no way. I think that there is possibility of moderate reform, but there is no chance of saying stop reform and turn the clock back.

HEARING COCHAIR REINSCH: Thank you. Ms. Houston.

DR. MULDAVIN: Could I respond actually to this question?

HEARING COCHAIR REINSCH: Oh, I'm sorry.

DR. MULDAVIN: If that's all right. Yes. I think the cost to the U.S. of any kind of unrest, again, these three groups that you divide--business, security and workers--I would divide further again and to try to answer you.

Let me give you some specifics of direct and indirect kinds of resistance that might then clarify which ones could or could not have some impact on U.S. security or on business or on workers. As you mentioned, you might wonder why I work and was able to work in rural China since 1982 and live on communes before they were decollectivized and state farms and the rest. I've worn a lot of hats in China, but I'm a third generation China person. My father and my grandfather were there. My grandfather was an investor there in the '30s. So there's a long history and it's actually just family name that allowed me in. I think I slipped under the radar because of that.

The aspect of that that I think is interesting is because everything I've said to you I've said to both leaders in China and various other folks in China. I mean it’s not a secret, it's an open discussion.

Every problem that I've raised with you, it's very clear to the vast majority of the leadership and others that these are serious problems.

I think it's very difficult, if you put on the hat of a leader in China, to try to resolve these. If we challenge ourselves in those ways, I think it's a very difficult process.

But let me give you a couple of quick examples. First of all, I'll give you an urban one. I was in Beijing in a car that hit a bicycle in the mid-'90s. We were surrounded by a crowd of about 200. They started rocking the car; they broke the windows. They threatened us. And the chants were about national pride and how could we and rich foreigners go knocking down a person there. We were saved in that incident by an old man about 70, wearing the traditional neighborhood arm band, who walked up, tried to calm everyone down, came through to us and told everyone, look, don't embarrass the country. Yes, you're right, they're bastards, they shouldn't have hit the person, and then let us go.

We zipped away in our smashed up car. But what was key in that moment for me was how clear the nationalistic aspects of response could be utilized at any given moment in a quite threatening way. And that was just one very small urban incident, probably part of that group of 74,000.

Let me give you some specifics on that 74,000 and the 87,000. Of the 74,000, in 2004, 17 by official statistics involved 10,000 or more people. 46 involved 5,000 or more people. And 120 involved 1,000 or more people, and the rest less. So if you want some sense of the size of these and their impact, that's I think helpful.

A second example was in 1994 that I mentioned to you earlier when I was in rural Hunan and I'll withhold the exact place actually to protect some of the people. I was in a village when the local county government came in and took a young couple out of their house in the middle of the night, and took them away. There was a forced abortion. There was the knocking down of their home. And then the county leaders came back into the village with three cars the following day and were met by a number of thousands of rural peasants who surrounded the three cars, pulled the leaders out of the cars. I was in the background; they didn't know I was there. They surrounded them, pulled the leaders out, took them hostage, demanded that they let go this young man and woman, and then proceeded to jump on these cars and with farming implements, in about two hours, one of the most frightening examples in my life of violence, smashed these three cars down into bits and tore them apart until they were about the size each piece of a golf ball or less, including the engine block--smashed down and distributed out into the field like a beehive of activity.

It lasted about two and a half hours--which I witnessed. And then after this incredible display of violence against the local authority, the militia was sent in to get the folks. And this speaks to your question about security and the ongoing issues in rural areas. The militia was ordered, they lowered their guns--I watched them do it--they were ordered to fire upon these peasants by the militia leader, and they wouldn't fire. Why? Because the militia is made up of peasants from the other villages.

This is one of the limitations for the Chinese state on maintaining control in rural areas and why legitimacy of its policies is so key. They could not get the militia to fire on cousins and brothers and sisters. They didn't fire and the peasants started throwing rocks. They hit a man on the head. They killed the head of the militia who had ordered them to fire.

The militia ran away and they later were able to try to send people up to Beijing, the idea being we'll send them to the emperor back in Beijing and they will get rid of these bad local corrupt officials. They were caught on the road, thrown in jail. Another group was sent out. Eventually the central government got wind of it, went down, sacked the local county government and released the couple.

And that village to this day acts as an autonomous zone. They don't pay any taxes. They don't participate in any part of the local economy. They're kind of a self-reliant unit. No one in the county will even go into it. It's a very interesting example.

Does it threaten the United States in any way? No. So as a second example to your question, it's something that is very difficult for the Chinese state, but they also managed it in such a way that it doesn't threaten anything in terms of security interests in the U.S.

And the last one, if we had time, and I don't want to take too much more, I would tell you about indirect forms of resistance that the peasants do on a regular basis. That is, withholding taxes, hiding surpluses, begging for state income on the basis of natural disasters that either are or are not there--a whole bunch of ways in which people make demands upon the state and resist certain kinds of policies, but we could go there if you wish.

ACTING CHAIRMAN BARTHOLOMEW: Thank you.

DR. MULDAVIN: You're welcome.

HEARING COCHAIR REINSCH: Now, Ms. Houston.

COMMISSIONER HOUSTON: Dr. Muldavin actually went where I was hoping to with my questions to bring the panel around to or back to. I really appreciate all your insights and information on this panel. It has been wonderful, but what I'm hearing mostly is economic and labor issues. The panel was really more directed to civil unrest.

During this panel, we've talked a lot about government structure. We've talked about labor structure. We've talked very little about the individual, and that is my question in trying to go back to more to the state purpose.

Dr. Muldavin, you talked about growth and some of the problems inherent in growth. It seems to me the problem is not the growth itself, but the problem is the growth that is not accruing to the individual in China.

I think back to our minuteman and the founding of our country. How different things might have been had they been a little bit more organized, had they been in a union, had they been a government structure.

Your story a moment ago is illustrative of my point, which I think is that the individuality of the protest is something that we haven't

really discussed today. I have a couple of specific questions on that that I'd like to throw out to whomever wants to answer it. One is how are these events disseminated, known about or covered either in the Chinese press or any kind of underground communication system that might be there?

Number two is are they particularly organized generally or are they kind of ad hoc? And also are they more rural or are they more at the local level? And again, you might want to address is there a difference between an organized protest or unrest versus an ad hoc activity that might happen because of an accident or whatever else might be going on locally.

Third part is what is the most common reason for any kind of social unrest? We've heard today about corruption, problems with the environment, lack of payments for either pension or unemployment, those kinds of things.

We haven't really talked about this at all today. I was thinking about earlier--the Olympics are coming. My assumption is that the site of the Olympics and surrounding area of Beijing is going to look absolutely beautiful. It's going to be clean. They're going to be doctors there. Everything is going to be grand so that we can put on a show for the rest of the world.

Do you think that there is going to be dissemination either through the media or underground channels within China out to the citizenry, out to the peasantry, who are going to look at this show and perhaps get a little bit upset. Do we think that there's a possibility with the Olympics coming to China that there will be more unrest, less unrest or because information doesn't travel there the way it does here, is it going to be unrest neutral?

DR. MULDAVIN: Yes, that's quite a good set and I appreciate those questions. The question about the individual I think is a really interesting one. I think in the context of China, one of the key issues to think about is that people in—rural areas (again, I'm speaking primarily about rural areas, and I apologize because I'm not an expert on the urban areas. I spent my time in rural China.) They rarely think in terms of just the individual.

So your question about that would find a funny audience in the places that I work. They would say, well, how does this affect my family, clan, the larger groups in which I associate with? And that would be probably their key concern.

So that's not to say that the individual isn't important, but it makes it I think a little bit hard to answer what you've asked if I understand you correctly.

COMMISSIONER HOUSTON: Let me just clarify for a minute.

DR. MULDAVIN: Yes.

COMMISSIONER HOUSTON: And that's a good feedback for me. When I say individual, I mean what you're describing, the family unit.

DR. MULDAVIN: Okay.

COMMISSIONER HOUSTON: The very community area versus the actual structure of the government or structure of any kind of organizational thing.

DR. MULDAVIN: All right. On the family level, there is a big divide as well, and this is something that is very striking. Young women in the areas that I work in rural China are generally the most unhappy group that I speak to. So within a family, you have some members of the family who benefit much more from a reform context, access to markets and labor opportunities.

Those who have something to sell in the market gain a lot more from it than those who don't, and how that market and the different kinds of opportunities are available is quite different, and for young women in particular their situation has gone backwards many of them feel.

I would take the time for an anecdote if we had it, but I won't at the moment. If you want, I'll give you more detail on that of some of this. But to go on with how are these events known about and what happens to them in China, I think there is very limited connection between the events at this point.

The state's great fear is that there will actually be some connections between the various different groupings, and understanding the various different subgroupings is kind of crucial in this because it is a highly divided set of folks with different kinds of issues that they care about, and I could go through those in a lot of detail for you if you wish. But that aspect of organized though not yet connected, that's what the state fears, and up until this point, generally these have been isolated even when you have 240 across the country on a given day.

The common reasons for that resistance, as I talked about, were direct and indirect, but in the rural areas, the primary ones have to do with the following: that there has been stagnating and declining agricultural income over the last 15 to 18 years. Actually grain production has stagnated and declined in the '90s. And so the costs of production, just at that level, the costs of actually getting grain out of the ground has gone up while the price has stagnated, and the productivity has gone down.

Well, that may not sound that interesting to folks in the city, but what it means is that for people in the rural areas, their fundamental subsistence and their ability to maintain themselves has been in decline for a long time. With that has been a combination of undermining of local resources. There's been rampant overuse of trees and of grasslands, and you heard some of that this morning. But I could tell you the reasons for that, and I think that's actually more important, because I don't point to these impacts just to say, oh, gosh, it's a bad thing that this is going on and we should regulate.

Regulation is not going to actually do it. You'd have to fundamentally alter the conditions under which people, individuals and households, are producing on the land. That takes a lot more than just the regulation. That means having a whole range of different forms in

which they can organize themselves, and I would say to you that, in fact, peasants all over China are coming up with those answers themselves.

In a number of areas that I work, people have recreated cooperative organizations, collective organizations, so that they could invest again in infrastructure. One of the villages I work in, they used to have irrigation, and after 15 years of disinvestment with the reforms, because the collective was no longer there, the irrigation system had fallen apart, and they were only getting one crop in three years. They were really pissed off about that. They were very unhappy. Two years out of three you got no crop. You're forced to go out on the road, find someplace to work. So ultimately in that village, they were able to organize themselves into some kind of a cooperative arrangement, rebuild that irrigation infrastructure, and now they have something back from that. So many of the answers to these problems are being created by the same people who are being impacted by them, and I think that speaks to the previous question, which is how we understand this unrest.

It's also part of a conversation that goes on and people come up with answers to it. The common reasons, though, beyond that have to do not only with those environmental problems, but particularly with the kinds of occupational hazards that people face, declining health care, the complete destruction of the rural health system.

I wrote about SARS when it came out. There are statistics being done on AIDS and on rural health clinics and I find it laughable because in every village I work in now, the rural health clinic is closed. It doesn't exist. So to even come up with the statistics about the numbers of AIDS patients, the viability of the rural health system, I think is really quite a difficult proposition in that context. But the lack of access to health care is a huge issue for people in rural areas. They're very upset about it. We could go on.

DR. KEIDEL: If I could also say something because I think Mr. Muldavin and I both have a lot of experience it seems similar in nature, but our conclusions are somewhat different, so I would like to share mine. I also have worked in rural areas beginning in 1981 in communes for UNDP and for the International Fund for Agricultural Development and later for the World Bank as a consultant and staff member, and I have studied the rural economy intensively.

What is happening, if you are a farmer in China, you're going to be poor. The only poor rural households are those that are doing something in addition to farming or other than farming, and the answer to solving rural poverty based in agriculture in China is for farmers to move off the land so the land can be consolidated and they can have non-farm jobs where they will earn a higher income. And that's where the individual is involved because that's the choice that individuals are making all over rural China is to leave the land, come to the cities and there the research shows that generally the men begin to work in construction, and then as they amass wages, they either take their savings back or they invest in a self-owned business in the urban areas and stay there.

Rules in the cities have relaxed and they are allowed to stay if they have job, and can purchase a home. They're allowed to take on an urban citizenship. These reforms are transformed opportunities for rural persons.

I personally believe it is a major error to think that the future of the vast majority of China's rural persons is in rural China in farming. That is an unrealistic picture of the future of China's rural persons. Their future has to be urbanizing. It has to be taking non-farm jobs or they will be desperately poor for the rest of their lives.

The reforms in the Chinese system are making just those changes possible with very large investments in urban infrastructure, in transportation to make the travel back and forth easier, in rural education so that now compulsory education has been stretched to nine years, and is virtually implemented in most of the country for boys and girls. When you compare that record with the record of other countries in the world that are at that level or who were where China was in the 1980s, there is no comparison.

The efforts on the part of the government to give persons in the rural areas choice is amazing when you look as I did at the record of other countries in East Asia and South Asia that were part of both my work at Treasury and in my extended family through marriage where women that are from South Asia say to me having lived in China, if I were a South Asian woman in rural India, I would want to live in China in the rural areas, not in rural India.

So I just have to emphasize that conditions in rural China have not improved as rapidly as in urban China. Part of the problem is that China has a policy of not importing much grain, and Professor Muldavin is correct, you don't make much money planting grain in China. You make money with vegetables. You make money with orchards. You make money with fish ponds and when the government says that you must plant more grain, they directly the impact the income of rural households, and that has happened repeatedly since reform began because farmers choose not to plant grain when they have the opportunity.

Then grain supplies dwindle. Prices in the city go up and they are forced to plant grain again, all the while farmers are leaving for the city in larger and larger numbers, and that is the dynamic. Those are the incentives that give farmers a chance, that give them hope for the future, is to be able to leave the farm, and that's what this current system of reforms is creating.

So I can't understate the importance of the reform for giving rural households choice and especially rural women.

HEARING COCHAIR REINSCH: Mr. Welker, do you want to comment briefly too?

MR. WELKER: Very quickly on the communications between these individuals. In the state-owned enterprises, they essentially live one on top of each other. So they're confronting a shared circumstance and so the communication is not a problem, but you have a very difficult time in the face of still worries over arrests and the knock at midnight in China. So that you're very infrequently going to see

organized protests. The Falun Gong protests in Beijing from a number of years ago is of a totally different nature.

Your question towards the Olympics is I would imagine that a group like Falun Gong is looking at the Olympics in Beijing as a very serious opportunity, but what is happening in the monitoring of communications dramatically improved since the first Falun Gong, it will be very difficult to see.

As for communications among the peasants, many factories are using peasants from the same towns and they travel back and forth. Chinese New Year, they are back home if they can get there, and those places that have really poor workplace conditions are kind of word of mouth blacklisted among a certain neighborhood or a certain rural county, and then they go out and they recruit from somewhere else in the country where the perception and the reputation is not there.

So I'm very pessimistic that we will find an organized protest along the lines of Falun Gong, but I would say that among the urban workers particularly the possibilities of multiple thousand person protests that spring up in 24 hours or 48 hours is most certainly there.

HEARING COCHAIR REINSCH: Thank you. Ms. Bartholomew.

ACTING CHAIRMAN BARTHOLOMEW: Thank you very much, Commissioner Reinsch, and thank you to all of our witnesses for very interesting testimony. I have questions for each of you, but of course all of you are free to answer them. Dr. Keidel, you and I have debated each other several times and recognize that while we often agree on the facts, we quite frequently disagree on the interpretation of those facts.

I'm only going to comment once again on the relativity of freedom which we seem to disagree on the fact that I believe that if people are not free to criticize their government, then they aren't free, so there is just one statement I needed to make there. You and I have had that debate before.

But my question for you is in some ways more a methodology question, which is given the lack of transparency and the inability to ascertain or to verify the statistical information that's presented or provided, I find it very interesting that you've done this analysis based on statistics from--is it the Ministry of Social Unrest, the Ministry of Public Security. Isn't it possible that the reason that the numbers have changed is because of reporting rather than necessarily--it might be that between 2004 and 2005, there were reasons why people reported more or fewer rather than the fact that the on-the-ground facts of the numbers of unrest took place?

DR. KEIDEL: Absolutely. I mentioned that in my written testimony, that we have no access to, at least I don't--to how these statistics are gathered. The national accounts, however, it's quite a different situation. I have been involved in two detailed teams working with the World Bank as a consultant where we went with statistical bureau personnel all the way down to the village level, examined the

rules, the manuals for how they report, how it related to the old Soviet system, the changes they are making.

There are monthly bulletins that show shifts in definition for statistics, how they're doing their prices. We have a lot of issues about it. But we know a great deal about how GDP growth is measured and the accuracy of those numbers for different purposes.

On these numbers, there may be a specialist somewhere that--and I'm sure Wen Jiabao, the Premier, when he made his statement that was released recently--he made it in late December--saying that these peasant incidents of unrest over land seizure are a real threat to the country's dreams, that he had better information than I do.

But we don't know, and the one thing we can say is that this number that was released of 87,000 and a 6.6 percent growth rate over 2004, it's much more probable that there is consistency in definition when you in the same breath give a number and a growth rate over the previous number, not guaranteed, but much more likely than that is by the same definition than by the string of numbers that I report even though they're from the same source, and reporting standards change, definitions change, so it's a question I raise, how comparable is it, and how can we compare it with crime statistics in other countries? Because when you adjust for China's population, that number of incidents comes down to one per day for every state in the United States.

Depending on how serious that is, is that a country busting level of activity? I don't know because I don't know the nature of those incidents.

ACTING CHAIRMAN BARTHOLOMEW: Right. And raising the question that if it comes down to an equivalent of one per state per day, is it even accurate information? Is it being underreported, and is the problem more extensive than any of us realize, or the Chinese government is willing to admit?

Again, it's an unanswerable question, but I think it's something that given that we have had consistent questions about transparency and accuracy in information, we always need to keep in mind.

DR. KEIDEL: But it could be over reported for our purposes if those are a lot of incidents that we would consider just routine crime situations where people have gotten together, again, because of an automobile accident or something where there was anger that doesn't have anything to do with the system of reforms or the way the state is treating people. We just don't know.

ACTING CHAIRMAN BARTHOLOMEW: Dr. Muldavin, earlier today Elizabeth Economy made an interesting comment about a trend she saw, an argument that she anticipated we would be hearing more on environmental issues. She heard it twice at a conference that she was recently attended, which is it looks like it's the beginning of blame the international companies for China's environmental problems.

I was wondering whether you get any sense of that possibility happening in terms of the workers' grievances? If the Chinese government is going to find it is to their advantage not to take

responsibility for the working conditions that are taking place, but that it will be easier to scapegoat the Western companies?

DR. MULDAVIN: Yes, specifically to that, as I mentioned earlier, the environmental issues, it's a complex set, and in thinking about them and how they might be resolved, I don't focus, as many people do, on good governance and corruption and those aspects, and in regulating through laws. I focus on what I had mentioned to you earlier, that there has to be a real overall change in the way in which people's daily land use and practices are influenced. But it's beyond regulation.

In terms of the industrial one, and this question of blaming, yes, I think what I call the nationalist card is easy to play in certain circumstances. It works. If we were to divide up industrialization in the country, there are a number of different places. One is in the special economic zones, which are in essence, greenfields that have been turned into industrial zones, with primarily rural workers coming in and working in them.

We have suburban areas, which used to be communes, which have now been taken over for industrial process. The big grievances there for people who didn't get work in the factories is that they've lost land, and so there's the loss of arable land issue.

Then we have these very far-flung subcontracting networks that spread into the hinterland all over the country. So depending upon which of those we were talking about, I think we come up with a different answer on whether you could blame the international companies.

I think in the special economic zones, there is the potential for blaming international companies for it because many of these have direct links, although many of those are also subcontractors to international companies without say a Nike name on them or something identifiable.

In the suburban ones, they tend to be less identifiable because again they're often producing one small part of a product that then goes into an urban industry and into another factory, and so it's a more difficult link. In the far-flung rural areas, because these are primarily run through contractors--they're done in very small places, you can have a thousand small little factories spread around the country that no one knows about, no one regulates occupationally, environmentally and any other way--all sorts of things can be going on.

And there is no clear identification of that with an international company. So I think in those senses it would be a stretch. The local people would not buy it because it's local people who are running them, and it's a local elite that's getting most of the benefit from it. So in this case the problem is actually in the local community where you have people fighting against local new factory heads and owners. So again, I think it divides up. It divides up depending on where and which cases you are talking about.

DR. KEIDEL: I might also add that the foreign firms from Europe, North America and Japan have an excellent labor record and, in fact, are doing a great deal to promote a worker community that is closer

to international standards. The worst reputation for foreign firms are Taiwanese, Hong Kong, Macao owned firms with really hard standards and those are the ones where the problems showed up of people just not wanting to work there in the last couple of years.

And then you have the locally owned ones, which is an enormous range in worker quality. But I think it would be very difficult for them to do something about, aim their criticism at American firms for sure.

DR. MULDAVIN: I actually disagree with Dr. Keidel on that, in fact, if you want to hear, and one of the reasons is, is that there are, again, in places that I've worked, there's a clear identification in many of these suburban areas. For instance, in toy manufacturers that identified Hasbro and Mattel, they're making, they're sewing on the ear of the doll, but they know it's a Hasbro doll, and it's a subcontractor, but it's clear that it's a Hasbro doll, and Hasbro has got layers between them and that factory. So, yes, perhaps in their premier industrial sites they're operating in a positive way.

Their subcontractors though are not operating in those same kinds of positive ways. So again, I think there is the potential for the link, but it's primarily between suburban suppliers to the larger factories.

ACTING CHAIRMAN BARTHOLOMEW: I guess in some ways my question is not even to the culpability of Western manufacturing companies that are there. I think there is room to disagree as to whether Western companies are helping to improve standards or not. I think that some of them have changed their practices. Of course, I think that a lot of that is as a result of consumer concern raised here in the United States and some of the things that have happened.

But I guess the way I interpreted what Dr. Economy was saying was not even necessarily about the validity of the on-the-ground complaints, but about the fact that there is a convenient party for people who are in charge who are not able or not willing to deal with the issues at hand to point to, and in which case, that does become a problem or a liability or a concern for multinational companies that are working there.

That if the Chinese government decides that the way that it wants to focus public attention in China away from what it can or should be doing about these workers' grievances and instead put the attention on it's the fault of these companies that are investing here, we have a lot of companies that are going to have a lot of problems on their hands.

So to me it's two questions and maybe I wasn't exactly clear how I articulated it, but it was the first time I had heard actually somebody saying this is a new argument that we're going to be seeing on the environmental front, and I'm just wondering whether we'll see it on labor rights issues. We'll call them labor rights generally.

Mr. Welker, do you have any comments?

MR. WELKER: I just was going to say I think if you look at the listing perspectives and other paperwork for the large state-owned enterprises when they go overseas, they express very clearly that there is going to be layoffs and there's going to be restructuring, but yet you don't see where local officials are blaming the international buyers and the

pressure from international investors to forcing us to making these changes.

The more closer at hand question is that yesterday this guy was the deputy party secretary and today he's the partial owner of the company that you're working at. If I may bring my prop into today's hearing, this chair purchased at a Chinese I understand Wenjo-owned supermarket out in Falls Church, Virginia, has a label on it in Chinese that provides the address of the manufacturer, the actual physical address, the address of the company, phone number and a fax number.

When I go to China and have shopped at the Carrefour or at the Wal-mart or whatever it is, invariably you can find on the products something that identifies. Now, you can say that it's deceptive practice meaning that this is just the top of the chain and that the subcontractors that actually make these are not involved in actually labeling it.

But as we've seen in agricultural products, the country of origin labeling fights that we've had from when Congress tries to regulate whether or not our food is coming from Mexico or somewhere else.

These types of things are actually kind of useful. They don't add much cost. But if the consumer, American consumer or other consumer is more informed, knows where the something is coming from, then they can build a reputation of the product besides just the brand name, and as for international labor monitoring, it provides a great research avenue to say if we take three products that are sold at an American retailer that are labeled clearly where they come from, you have the ability to go and do a spot inspection where the possibility of the media or international attention could possibly play a role in overseeing the conditions inside those facilities.

HEARING COCHAIR REINSCH: Thank you. Did you buy this for yourself, Mr. Welker, or is this--

MR. WELKER: It's a long story.

HEARING COCHAIR REINSCH: Aah.

ACTING CHAIRMAN BARTHOLOMEW: It wasn't a baby present; was it?

HEARING COCHAIR REINSCH: I don't think she's ready for it. Mr. Mulloy.

COMMISSIONER MULLOY: Thank you, Commissioner Reinsch. Dr. Muldavin, on page one of your testimony, you tell us that you've done research in China for over 23 years, and you've actually lived there and know the country as well as probably any American.

Dr. Keidel, on page nine of your testimony, you tell us that you've lived in rural and urban China for over 25 years and are very familiar with the country. You say you first went to the mainland in 1979. I'm reminded of the story in 1962 when President Kennedy sent two people out to evaluate what was going on in Vietnam and they came back with quite different analyses.

The President looked at them and he listened to them and he said are you sure you guys were in the same country? Remember that story? I'm getting quite a sense from two experts that there's quite different impressions of what's going on in China.

For example, Dr. Keidel tells us that what is happening is probably very good for China and the people of China in the long run. And Dr. Muldavin, you tell us on page nine of your testimony that this system that's going on in China is not only bad for China, but it's having tremendous dislocations on other people in the world who have to compete with a China that you called a race to the bottom, as they struggle to compete with China's socially and ecologically destructive industrial platform.

Dr. Keidel, could you tell me what in Dr. Muldavin's analysis is skewed that he doesn't get the picture, and Dr. Muldavin, can you tell us what you think in Keidel's vision is skewed so that he doesn't get what's really happening?

Dr. Keidel, you go first and then Dr. Muldavin. And Mr. Welker, you can comment at the end.

DR. KEIDEL: I don't pretend to appreciate the complexity and depth and wisdom of Professor Muldavin's knowledge and analysis. I'm reacting to some things that he has said in a limited context here. The notion that we are in a race to the bottom in the world, I think, however flies in the face of my understanding of international economic development, which I taught as a professor at graduate school for a number of years.

What China represents is a challenge to countries that are better off than it is to restructure themselves so that their own labor force can be more productive and therefore justifiably earn a higher standard of living rather than stay in a cocoon as the Chinese urban workers used to be in a cocoon, that for other poor countries, China will quickly be moving above the productivity and wage levels, and when I say quickly, in a few decades because that has very deep and large labor pool.

That it will be demanding products from countries that are developing more slowly and be a force for growth in the world economy and for raised standard of living throughout the world.

If we can respond to the opportunity that China's increase in productivity presents us with by in rich countries changing our own internal system so that our labor force has higher productivity, particularly in the service sector, and poor countries then can sell to China as it develops, that role is a very important catalytic one for the welfare of the world as a whole.

That seems to me to be a coherent picture of how China can fit in and is fitting into the growth of the whole world economy in ways that benefit both rich and poor nations.

To see China as forcing us all down into a drain because its standards in terms of the environment and work conditions are so abysmal I think is a mischaracterization of what is happening in China, particularly if you compare it to work conditions in other countries at similar or lower standards of living or even higher standards of living than China's.

China has an active program and is spending as much--maybe it could spend more, but it's spending a significant part of its budgetary resources to try to prove its environmental record. This is a long time.

If you know what the environment was like in the United States around Pittsburgh, say, in the first half of the last century that we had a long way to go then as well.

So I'm impressed with the progress that is being made and the promise of progress in the future in all of these dimensions, and it just seems a contradiction to the experience of development economics in the world heretofore to see that China is pulling us down. I see quite the opposite.

DR. MULDAVIN: As my colleague here said, I certainly wouldn't argue with his own expertise via the World Bank and other organizations in China, and you're absolutely right, we have a completely different analysis.

I have met with and argued with others with similar analyses for the last 25 years so I find the question appropriate and important. I think it stems from fundamentally different assumptions. And those assumptions are in a number of different areas, and I'll try to illustrate them.

First of all, we judge poverty differently--both in China and elsewhere. The World Bank has shown continuously a decline in poverty in China based primarily on how many peasants have one dollar a day incomes or two dollar a day incomes. I don't judge poverty that way.

Many of the peasants who I work with actively (I do participatory research so I work with them in the fields), their increased income from a dollar to two dollars a day has meant for them often simultaneously a decline in their living standard, and that doesn't show up in World Bank and in China state statistics, which both trumpets the exit out of poverty of hundreds of millions who I would argue are still in poverty. The reason for that is that simultaneously over the last 25 years, they've lost access to education, public health, and social welfare. The fundamental productive capacity of the land has declined in many of these areas. They're exposed to occupational hazards and environmental pollutants that fundamentally challenge their health and the limited security that did exist (it was limited), no longer is there. So for them, the dollar a day or the two-dollar a day way of judging poverty is not just rather narrow; it's almost meaningless.

So I would argue that there's a much larger group of impoverished people in China, much more desperate than these more glowing, somewhat triumphant, what I consider market triumphalist depictions of the reforms. I've argued that a long time, so that's one different set of assumptions.

A second different set of assumptions is about how we would judge, for instance, migratory labor in China. I remember talking to someone who is probably a colleague of Dr. Keidel's, Justin Lin, who you may have spoken to here. He's a well-known economist in China. And we spoke about the reforms.

This was in the late '80s and then again in the early '90s, and his view of migration was similar to what Dr. Keidel said which is that this is a positive thing. It's good to see people moving to new urban opportunities. There's an assumption in that about how China will follow

a similar linear path in development as Western Europe, the United States and Japan, and there's some fundamental flaws in that assumption.

800 million peasant Chinese cannot become urban. They cannot become urban workers. To somehow assume that and to assume that we will have the same kind of shift in percentages of people from the rural to the urban that has happened in Japan and Western Europe and the United States starts off with an idea that somehow this is the path forward.

And simultaneously with that, these workers--I remember Justin Lin saying something similar to me--I argued with him about some of the difficulties they face in factories in urban areas. Their health is destroyed, they go back to rural areas, and in the rural areas they're having to be supported by other family members. It's a very difficult situation. They send out a new family member.

And he said, look, this is a transitional process. They just have to go through that. They have to suffer. That's part of what we see in our economic development theory. This is a transition. And I looked at him and I said, well, you're talking about a half a billion people. And if in your mind it's okay for half a billion people to suffer in the ways in which I see them suffering, as part of rationalizing during that transition, I think that that's a big assumption on your part. If you care about human suffering in the world and what it might lead to, it's a big assumption about what should be an almost ethical assumption.

So there's a fundamental ethical difference in how I would like to see any kind of transition in China carried out. I'd like to see it carried out in ways that half a billion people don't have to suffer in the ways that I see them suffering.

A third difference is the way in which we judge the global situation. And on the global development question, I chaired the Department of International Development Studies at UCLA for seven years and my cochair was one of the great market triumphalists, Deepak Lal, and we disagreed, similarly probably as Dr. Keidel and I do. But there are many visions of development economics and of development in the world and the vision that was just put forward I think does a great disservice to workers and communities and environments around the world.

There's an assumption about this unique historical event of 800 million peasants--let's take those peasants entering the global economy. This has never happened before in the world. In two decades, 800 million people now are accessible to global business in one form or another. They're accessible.

That is a unique, completely unique historical event. The effect of that in this--Dr. Keidel was against my idea-- ratcheting down and the race to the bottom. I speak of this with very explicit ideas of the impacts on American workers, communities, of environments in Latin America, Southeast Asia, Africa--real evidence of the destruction that has resulted.

I speak of it thinking of what happened in Mexico last year when a half a million workers lost their jobs in the most successful

maquiladora zone, successful zone of economic development that Mexico has. That half a million workers, where did they go? Those jobs were moved to China. What does that do to Mexico and along our borders and how does it impact immigration and a whole series of other issues of China's entrance into the global economy?

So I have a fundamental different set of assumptions about what that unique historic event means. That then leads to some very different ideas about what the World Bank even has done in China. I've independently assessed World Bank projects. So I find a wide variety of ways in which we might disagree, and I hope that I've made that clear.

COMMISSIONER MULLOY: That was very helpful. David, did you want to add anything?

MR. WELKER: Other than to say that I think Indonesia in the 1990s was a darling of many independent economic observers, and then one day it wasn't. There is a possibility of many years to come of economic growth in China that is uneven and great dissatisfaction.

I don't think that the Suharto regime is a legitimate comparison in the sense that I think among the party the access to corruption is much larger, circles of corruption are much larger in China than they were inside of Indonesia where the family in a smaller elite controlled a larger percentage of the economy. Some day China will have to address a need for representative government where if the reforms are dissatisfying too many people, then reforms will be moderated.

If not, I think the protests will continue and, but as Mr. Keidel said, we are talking about many, many years, decades.

HEARING COCHAIR REINSCH: Thank you. We're getting down to the final minutes. I just have one question, and that is to ask the same one I asked in the last panel, which is this question of how or whether small demonstrations turn into big ones, which is not a uniquely Chinese phenomenon but an interesting one.

We've talked a lot about the large number of events of varying sizes. The unanswered question that maybe you could each comment on is what conditions would be necessary for one or more of these becoming nationwide and becoming a large effort that would be no longer localized but would be genuinely a threat to the regime rather than simply something the regime perceives as a threat.

So maybe we can wrap up with that, if any of you would like to comment. Dr. Muldavin, you want to go first?

DR. MULDAVIN: Okay.

HEARING COCHAIR REINSCH: But you will be brief, as will the others.

DR. MULDAVIN: Okay. I think this has to do back with the previous question, which is how do we understand people's vulnerability? And I think if we understand their vulnerability based on fairly simple equations of their income, we miss out on a much broader set of issues that make them vulnerable, make them willing to risk their lives and their livelihoods by demonstrating and even coming together and demonstrating.

I think we see in the growing intensity of the demonstrations and unrest, and in essence in the increased size of many of them, that people are willing to take quite a few chances in that context.

So the potential for them becoming larger, I think, is absolutely there, and I refer you back to one of my comments which is that I believe that Tiananmen in many ways has always been misunderstood because it had quite significant rural roots.

I was in Tiananmen from the first day, lived through it, was there, and for many months after. At the time I came back home after it, and I was quite significantly struck by the fact that here people were talking about democracy. I stayed in China after Tiananmen until the following December.

I came back and I gave speeches about what I saw as the problems, and people were surprised that I wasn't talking about democracy. And it was because the people I spoke to in Tiananmen were talking about four things.

They were talking about social stratification, growing unevenness in the country, which I think is a very serious issue again. They were talking about inflation, which if it were to increase substantially again would cause a real serious problem for the state.

They were talking about nepotism and they were talking about corruption on a wide scale. Now, many of those things have further intensified in the time since then. But very few of the people--it was a very small number of people who were actually talking about democracy despite what we would maybe like to have envisioned.

So our misconceptions of that event I think is one of the reasons why we misunderstood why it was possible for it to be put down. And I think again in trying to understand these events and the potential for them, it does us great harm if we don't look fundamentally at these real issues of vulnerability.

HEARING COCHAIR REINSCH: Thank you. Why don't we just work our way across. Mr. Welker.

MR. WELKER: I'll be very brief. I think that the potential for large-scale interconnected protests is very small. I think that the scale of up to 10,000 in the Chinese context is itself relatively small. I think that the Party leadership will moderate its reforms over long periods of time before the unrest reaches a scale to threaten the national leadership.

HEARING COCHAIR REINSCH: Dr. Keidel, you have the last word, more or less.

DR. KEIDEL: Well, thank you. I'm amazed at the similarity in my experiences with Professor Muldavin. I also was in Beijing in early May through the end of the month doing work for the Ministry of Agriculture and spent every day in the Square interviewing workers and students in my native Chinese, as he also speaks it I'm sure.

And the paper that I wrote but never published because it seemed to be disrespectful of the dead said that this was about not democracy, because when I asked students, I would say if you have

democracy, the peasants will vote away your subsidies, what will you do then?

And the answer was oh, peasants don't vote. It's only us. We need to do something about--and I agree with the list--corruption, inflation, and nepotism. I would say, however, those are not rural issues. Those are urban issues and that it came about because of the inflation the year before. 1988 saw panic, bank runs, stripping of stores of all of their products because of rising prices, and there was some compensation of urban incomes, less for students, for those higher prices, but they were hurt by the inflationary impact of reforms.

My analysis also of what happened at Tiananmen is relevant for your answer, that that set of discontented--issues about discontent, brought on by reforms, in my analysis, was allowed to run wild and capture the city and captured a number of cities because the then premier--actually not the premier, the Premier was Li Pong--the Party Secretary allowed it to.

So I placed a lot of responsibility for the deaths there at his poor management of what was the outcome of economic reforms because of their impact on the urban population's privileges, and so I would say that the real risk of something erupting into a countrywide conflagration would come from a failure of the government to manage what is a difficult situation because of the nature of the success they're having in connecting people to productivity by standards that say your standard of living will depend on it.

Therefore they do not strengthen the rule of law. They do not strengthen the degree to which those that are upset (a) are required to live by the new rules of the market and (b) are not subject to corruption from local officials that so greatly amplifies the threat of this dislocation.

Then, if they don't manage that well, then there is a chance that all of the technology of cell phones, of instant messaging, and so forth will make connections very possible. So they have to handle it well.

HEARING COCHAIR REINSCH: Thank you. A good comprehensive comment, and if no one has anything else, we will adjourn for the day. We reconvene tomorrow morning at 9:30. Thank you very much for a very interesting panel.

DR. KEIDEL: Thank you.

HEARING COCHAIR REINSCH: The hearing is adjourned.

[Whereupon, at 2:50 p.m., the hearing was adjourned, to reconvene at 9:30 a.m., Friday, February 3, 2006.]

MAJOR INTERNAL CHALLENGES FACING THE CHINESE LEADERSHIP

FRIDAY, FEBRUARY 3, 2006

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

The Commission met in Room 1310, Longworth House Office Building, Washington, D.C. at 9:30 a.m., Acting Chairman Carolyn Bartholomew and Commissioners William A. Reinsch and Larry M. Wortzel, (Hearing Cochairs,) presiding.

ACTING CHAIRMAN BARTHOLOMEW: Good morning, everyone. I'm pleased to welcome you today to the second day of our hearing on Internal Challenges Facing the Chinese Leadership. Before we begin, I would just like to thank the staff of the commission who pulled this hearing together. Kevin Lanzit and Scott Bunton in particular did a great job of helping us find panelists, inviting you all along, and getting you to come and speak before us.

So, welcome. I'm going to turn the hearing over to Commissioner Bill Reinsch who is our chair this morning.

OPENING STATEMENT OF COCHAIR WILLIAM A. REINSCH

HEARING CO-CHAIR REINSCH: Thank you. Let me add to those comments, our thanks to the House Administration Committee and its staff, which is our host today, for what has to be some inconvenience to them, but we're very grateful to them making room for us when we know the House is busy.

Carolyn already told you what the title of the hearing is. We had three panels yesterday that I thought were quite enlightening. The final panel will address Chinese control mechanisms and strategies for dealing with public protests.

We're pleased to welcome Dr. Scot Tanner, who is a Senior Political Scientist with the RAND Corporation. Dr. Tanner has written extensively on China and politics, in particular on policing and internal security, political instability and unrest, the dilemmas of building the rule of law, human rights, lawmaking, leadership politics, and China-Taiwan relations.

Dr. Anne Thurston, formerly with the Paul H. Nitze School of Advanced International Studies at the Johns Hopkins University, recently left her teaching post to complete a research project on the social consequences of China's economic reforms and problems of grassroots democratization. She will share her research on grassroots political activities in China.

With that introduction, I'll ask you to proceed. We'll go in the order in which I introduced you. Since we have two of you, we can be slightly more generous with time. So we will welcome oral remarks

up to ten minutes in length, which is surprisingly generous. That may not seem such to those of you that are in academia, but we will also accept for the hearing record prepared statements up to ten pages and 25 additional pages of supporting documentation. As I said yesterday, don't feel that you have to meet that standard. Trees are dying everywhere for these things and so if you can be briefer, that's fine.

Dr. Tanner, why don't we begin with you? We'll do both of you and then we'll have questions for the two of you together.

[The statement follows:]

Prepared Statement of Cochair William A. Reinsch

Good morning and welcome to the continuation of the U.S.-China Economic and Security Review Commission's hearing on Major Internal Challenges Facing the Chinese Leadership. This final panel will address Chinese control mechanisms and strategies for dealing with public protests.

The Commission is pleased to welcome Dr. Scott Tanner who is a Senior Political Scientist with the RAND Corporation. Dr. Tanner has written extensively on China and politics, in particular on policing and internal security, political instability and unrest, the dilemmas of building the rule of law, human rights, lawmaking, leadership politics, and China-Taiwan relations.

Dr. Anne Thurston, formerly with the Paul H. Nitze School of Advanced International Studies at the Johns Hopkins University, recently left her teaching post to complete a research project on "the social consequences of China's economic reforms and problems of grassroots democratization." She will share her research on grassroots political activities in China.

With that introduction I would like to ask Dr. Tanner to begin with his oral testimony. I need to remind all panelists that the Commission welcomes oral remarks up to seven minutes in length, and will accept for the hearing record prepared statements up to 10 pages in length, and up to 25 additional pages of supporting documentation.

PANEL IV: CHINESE CONTROL MECHANISMS

STATEMENT OF DR. MURRAY SCOTT TANNER
SENIOR POLITICAL SCIENTIST, THE RAND CORPORORATION

DR. TANNER: Thank you, Commissioner. I would warn you against the dangers of offering an academic ten minutes to talk about anything.

Let me begin by expressing my appreciation to the chair and to the other distinguished members of the U.S.-China Economic and Security Review Commission. It's always an honor to have an opportunity to testify before this commission.

My comments today will address challenges to China's internal security strategy. My testimony will briefly examine several points. I'm going to begin by sketching out key points of the Chinese government's evolving strategy to contain and manage the rising levels of protest and unrest in Chinese society.

Next, I'm going to discuss several trends that we're seeing in recent reports of unrest in China, trends which suggest that Beijing is encountering serious challenges, difficulty and failures in carrying out some, but by no means all, of the elements of its internal security strategy, and finally I'm going to briefly address the implications of these challenges for China's future political stability.

Beginning in about 1998-99, Beijing's internal security experts launched a serious search for a more sophisticated strategy to deal with the persistent increases in popular protests that had begun in the early 1990s. They recognized that it was probably no longer possible to force protests back down to the very low rates that China witnessed in the years immediately following the 1989 massacre.

And they explicitly recognized that growing numbers of citizens had legitimate complaints about unemployment, layoffs, illegal taxes and fees, corruptions and almost innumerable other developmental problems that China was facing.

The goal of this strategy was to forge a new way of effectively containing unrest, addressing some of its underlying economic and policy-related causes, and most of all to prevent it from becoming a major threat to the regime stability and its hold on power.

China's internal securities strategy is rooted in a broader political strategy whose goal is to reach out to the vast majority of Chinese citizens who are relatively apolitical. That is in particular the rapidly emerging urban economic elites and try to persuade them that only the Chinese Communist Party can provide them with economic growth, efficient governance, social stability and low crime rates, national unity, and economic respect, to offer them, if you'll forgive the phrasing, a promise of clean responsive autocracy.

At the same time, the Party wants to drive a wedge of prosperity and coercion between the enormous mainstream of average citizens and the minority who might try to organize opposition, promote systemic political change, or who ascribe to religious views that the regime officially considers heterodox.

The internal security strategy nested within this political strategy has several specific elements. I discussed some of these before the commission last year, and so I'll just be brief today and note the major elements would be, number one, trying to contain, manage and defuse political protest incidents.

Number two, to try to professionalize police techniques to avoid turning peaceful protests into sustained mass movements or riots. Police directives and training manuals increasingly urge officers to observe three cautions: to cautiously use coercive tactics, police power and weapons.

Police are urged to focus on suppressing protest organizers, but as long as the protests remain nonviolent protests, police are at least officially encouraged to resist plunging into crowds and instead to attempt to cordon off these crowds to prevent others from joining in, and then wait until later to identify and round up and jail the organizers.

A third element would be to prevent the emergence of any nationwide, regional or ethno-religiously organized opposition movement or politically active civil society group.

In the past two years, in particular, the government has been obsessed with trying to prevent so-called color revolutions, both in China and in its authoritarian neighbors. China has redoubled its efforts to

quash such activist organizations using informants and intimidations to turn organizers against each other.

They also want to keep, number four, they want to keep a firm grip on key point security areas that they believe are vital to the unity or stability of the country, most importantly Beijing, Muslim and Tibetan regions in the west, and Shanghai.

And also recently it appears that the northeast, the Manchurian regions, have become a focus of this, the area bordering North Korea and Russia.

Finally, the fifth point is to try to pressure local Party officials to monitor and to resolve the citizen grievances, which are the fundamental sources of these protests before frustration spills into the streets.

I would add a sixth point. The government also is trying to encourage angry citizens to blame local officials rather than the central government or the system itself for the abuses that drive them to protest. Citizens are urged to believe that the abuses that they encounter from local governments are not typical of other regions or of the system as a whole, and that the center would try to resolve these problems if it learned of them.

The reality, of course, is quite different, and as Human Rights Watch recently documented in its study on repression of legal protesters who attempt to come to Beijing, the government can be quite difficult on people who try to bring these problems to the government, the central government's attention.

The internal security strategy that they've adopted suffers from at least two fundamental dilemmas. First of all, it requires a far higher level of professionalism, training, flexibility and self-discipline from local security forces nationwide.

Secondly, it requires that local Party and government officials who face protests respond as Beijing would have them respond, striking a delicate balance between permissiveness and repression, compromise and firmness.

For this very reason, this strategy plays into some of the key organizational weaknesses of China's law enforcement system, the most important of which is its highly decentralized leadership system that puts primary leadership over regular public security police, that is the first responders in nearly all protests, in the hands of local Party committees and governments rather than in the hands of superior level police departments.

Historically, this has led to significant gaps from region to region in the level of police professionalism, discipline, honesty, budgets, equipment, and personnel levels and quality. Moreover, local police forces are often forced to serve two masters when the guidelines and directives on handling unrest that are issued by superior level police departments come into conflict with the political demands of local Party leaders, their ultimate bosses, and frequently local Party leaders prefer to defy official strategy and suppress petitioners and protesters harshly

rather than deal with their complaints, particularly when these local officials' corruption and abuses are the major cause of these protests.

I see that we're getting short on time. I simply wanted to highlight what I think are some major challenges, shortcomings, and failings in the implementation of this strategy.

First of all, we are seeing increasingly evidence of undisciplined use of deadly force by security forces. Although Tiananmen in 1989 demonstrated that massive use of deadly force can sometimes terrorize protesters into abandoning their demands, Chinese police leaders and analysts are also aware that unprofessional ham-fisted use of violence against demonstrators can often backfire and produce riots and major mass movements, and we have seen several recent cases evidencing that sort of misuse of force.

The most notable in the press lately have been the very unfortunate death of a young woman, a 13 year old in the village of Panlong, allegedly beaten to death by security officials, although the official claim was that this healthy 13 year old somehow succumbed to a heart attack, and also the shooting death in December of approximately 20 protesters in Dongzhou Province.

Other evidences of the failure of the failure of a more professionalized system are the increasingly ubiquitous use of semi-professional and unprofessional forces. I simply label them thugs to enforce security in a lot of localities in China.

Another bit of evidence is that we are seeing increasing signs of prolonged protests, protests lasting three, four months, six months, which it indicates that they are simply unable to prevent them to solve the problems or to intimidate the protesters.

Also, increasing signs of organization among protesters and an increasingly willingness of protesters to resist. I would simply close by saying that the signs suggest that these misuses of police power and that these failures of discipline are meeting increasing resistance from people and that acts of violence such as we saw in these villages I mention here could very easily become rallying cries for larger scale protest against the government in the future.

Thank you for your time.

[The statement follows:]

Prepared Statement of Dr. Murray Scott Tanner
Senior Political Scientist, The Rand Corporation[2]

HEARING CO-CHAIR REINSCH: Thank you very much, Dr. Tanner. Dr. Thurston.

STATEMENT OF DR. ANNE F. THURSTON, INDEPENDENT RESEARCHER

DR. THURSTON: Thank you. I would like to start by thanking the commission for this invitation to speak to you today. I don't usually deal with the big issues that the commission addresses so I was a

[2] Challenges to China's Internal Security Strategy by Murray Scott Tanner

little surprised to get the invitation, but I was assured that you really wanted me and wanted to hear what I had to say about what I do.

Let me start by telling you something of the nature of my research in China and then try to tell you something about why I think what I'm doing is important for this commission as well.

For a number of years, I've been spending as much time as I possibly can at China's grassroots. That means I spend a lot of time in Chinese villages, often in very poor parts of the Chinese countryside. I have spent a lot of time with migrant workers in China's cities and along the coastal areas, and most recently I have been spending a lot of time in the far west of China on the Tibetan plateau working among very poor Tibetans.

I've come over time to call the China that I spend most of my time in the "other China" following a book that a few of you on the commission may remember from 1963 by Michael Harrington, The Other America, where Harrington tried to point out that in the midst of what other people were calling the affluent society, there were still many Americans, some 20 to 50 million Americans, who were still poor.

What I try to point out here in the United States is that in the midst of this China that many people are describing "the rising China," China, the next superpower, the China, the potentially next hegemon, there is still another China where many hundreds of millions of people remain poor and disadvantaged. So I'll start by saying something about this other China, who these people are, what their problems are.

The fundamental reality is that just as China's economy is growing more rapidly than any other economy in the world, so its level of inequality has also grown more rapidly than any other country in the world, which means that there are still hundreds of millions of Chinese people who are still poor.

It also means interestingly enough that the level of inequality, of socialist China, is now greater than the level of inequality of so-called capitalist United States. That's how far the level of inequality has gone.

The largest numbers of these poor people continue to be in the countryside and the figures are quite startling. The average per capita income in urban China where some 36 percent of the Chinese population lives, some 458 million people live, is a bit over $1,000 a year now. China's latest statistics published at the end of 2005 provide figures indicating that in the Chinese countryside, 67 percent of the rural population, which is some 540 million people, earn less than a dollar a day, which, of course, is the World Bank's figure for poverty.

If these 540 million were a country, they would be the third-largest country in the world after China and India, so there is still, as I say, a large number of Chinese people who are still very poor.

This rural "other China" also has tremendous problems. It has too many people and too little land. It has not enough water. Taxes have been very, very high. Officials are often egregiously corrupt. Many parents cannot afford to send their children to school. The health system

has crumbled. Some 80 percent of the people who live in China's rural areas are without medical insurance.

Failing health is a leading cause of poverty. The threat of catastrophic epidemic is ever present. We've heard recently about the potential problem with avian flu. We've also heard recently that China has reduced its estimates for the number of HIV/AIDS cases from 840,000 people to some 650,000, but I think the fact remains that the potential for catastrophe as a result of HIV/AIDS still exists.

The UNAIDS theme group published a number of years ago a study of HIV/AIDS in China saying that China is now witnessing the unfolding of an HIV/AIDS epidemic of proportions beyond belief, and I think despite the reduced numbers, that possibility still exists.

It's also true that this other China that I visit is now no longer just rural. Increasingly urban China, too, has growing numbers of poor and disadvantaged. The largest number of those are not originally from the urban areas. They are people who have fled the countryside for the cities in hope of a better life there.

The number of migrant workers in China's cities now is between 140 and 200 million people. Poverty in China's cities is also now homegrown. State-owned enterprises over the past several years have been laying off workers. Tens of millions of people have been laid off from work in China's cities and some of them have neither found other jobs nor are supported by a social safety net.

Apparently some 25 million people in China's cities are retired people without pensions. Again, another class of this growing number of urban poor. So the basic point that I want to make is that (a) there is an other China, and (b) the problems in this other China are really enormous.

I think that perhaps any one of these or any several of these problems that China is facing would be solvable. The question is how in the world is China going to face this whole set of problems that it's facing at the same time?

Scot and I a couple of weeks ago were at a session where one of our colleagues said that he figured that China had about 15 to 20 years to solve these problems or become a failed state. I don't think that any of us think that China is going to become a failed state, but the fact is that the problems facing this other China are enormous and the Chinese government doesn't always know how to solve them, and therefore there is a sort of rocky road ahead for many millions of Chinese people.

So that's the bad side of the other China. There is a good and very exciting side, I think, also to this other China, and that is that what I find most striking about being in China today is that for every problem China faces, there are people coming forth to try to solve those problems.

These are people that I call social entrepreneurs. They are people who have seen a problem in their own society, they've decided they have their own vision of how to solve that problem, how to go about solving that problem, and they are people who work to solve those problems who can't be stopped and they just have a mission that leads

them to continue working in spite of all sorts of obstacles and I find, as I say, this very promising.

The other thing that's very striking about these new social entrepreneurs is that many of them are forming nongovernmental organizations to address these problems, real nongovernmental organizations. Paul Wolfowitz, the president of the World Bank, was recently in China, and after his visit, the World Bank estimated that China has anywhere between 300 and 700,000 what they call civil society organizations which are essentially NGOs addressing these pressing problems.

I think that these NGOs and these social entrepreneurs are important, first of all, because they are addressing real problems. They're addressing problems of poverty alleviation, education and health care, what to do about laid off workers. They are building water delivery systems in poor rural areas. They're educating people about their legal rights, they're building schools, they're building health clinics, they're educating people about HIV/AIDS.

They are providing training for laid off workers. They're providing education for children of migrant workers. They're just thousands and thousands of marvelous new programs being introduced and carried out by these new social entrepreneurs and these NGOs.

I would argue that they are also important because I think that in the long-term, these NGOs will form the basis for the development of a civil society in China and this is important to me because in my view, the shortest distance between two points in China is not a straight line.

If you want to get from the authoritarian government that China has today to a more open and democratic government, China needs first to develop a civil society and these NGOs are helping to develop that civil society.

These new organizations also, of course, present China with a great conundrum. I won't talk about that now because I know my time is going to run out, but I hope that in the discussion that we have afterwards, we can talk about some of the problems facing these NGOs and some of the Chinese government's concern with them.

I just want to end by saying you have asked in your set of questions that you presented to this panel whether we had any policies or recommendations about how China might be moved in a more open and democratic direction. I just cannot overemphasize the importance of these social entrepreneurs, these NGOs, who are coming forward, most of us don't see them. They're in the other China. They're not along the eastern coast. They're not in the big cities.

I don't have a specific recommendation, but it seems to me that whatever support we can give to these people and these organizations is one way to help China develop towards a more open democratic society.

Thank you.

[The statement follows:]

Prepared statement of Dr. Anne F. Thurston, Independent Researcher

I want to begin by thanking the US-China Economic and Security Review Commission for inviting me here today as part of the series of hearings you are holding on the major challenges currently facing the Chinese leadership.

I do not ordinarily focus my research attention on the big issues generally addressed by this commission—issues having to do with weapons proliferation, China's compliance with the rules of the World Trade Organization, China's national budget, etc. For a number of years I have been spending as much time as I can at China's grass roots—in Chinese villages, sometimes in very poor areas of the Chinese countryside, among migrant workers in Chinese cities, and in remote areas of the Tibetan plateau, i.e. among Chinese people who have not been greatly advantaged by the reforms that began in 1978. I have come to call the places where I spend my time "the other China," following the 1963 book by Michael Harrington called *The Other America*. Harrington's book detailed the plight of the then 20-50 million U.S. citizens who remained poor in the midst of what others, most notably leading economist John Kenneth Galbraith, were describing as the "affluent society." I try to tell the story of the hundreds of millions of Chinese who have yet to become part of "rising China."

I have been assured that your invitation to me today is not a mistake, that you really do want to hear my views on "the other China"--on what challenges the other China poses to the Chinese leadership and how those challenges might influence the political direction of the country.

I am sometimes reminded in talking to Washington audiences of an admonition by the late Michel Oksenberg some years ago on the importance, and challenge, of what he called "getting China right." "Getting China right," he said, "is a deadly serious matter."

And one of the books to which I have returned most frequently in my years as a China specialist is Harold Isaacs' *Scratches on Our Minds*, where Isaacs details the continuing pendulum swings in Americans' views of China. Those swings have persistently ranged from very positive, lauding China's long history and great civilization, its admirably hard-working and intelligent people, to very negative—a view that sees China as a country of great cruelty, barbarism, and inhumanity. And, Isaacs pointed out, not only do our views of China swing back and forth like a pendulum, the negative and positive views often coexist side by side.

I still find "getting China right" to be an enormous challenge. The country is just too big, too diverse, and changing too quickly for us to understand it in all its complexity. But my experience with "the other China" leads me to think that we are in danger of spending too much time looking at "rising China," that too often, when we use China as the subject of a declarative sentence, what we really mean is Beijing, Shanghai, Shenzhen and several other big, prosperous cities along the country's eastern coast.
I find the analysis of leading Chinese economist Hu Angang, who describes China as "one country, four worlds," to be more useful. I will oversimplify Hu's analysis here.

China's great cities such as Shanghai, Beijing and Shenzhen, plus the thriving provinces along the eastern coast generally make up Hu's first and second worlds. This first and second world is what we generally mean when we talk about rising China. This is the China with an economy that has grown at an average rate of more than 9 percent a year since the reforms began in 1978, the China that has probably surpassed France, Italy, and Great Britain to become the world's fourth largest economy, the China of growing military might. This is the China that many see as the next great superpower or, at worst, as a potential hegemon, seeking to dominate Asia and the world. This is the China that some Americans have come to fear. This first and second world China has a population of some 300 million people. It is a little larger than the population of the United States.

That leaves another one billion Chinese people. These people constitute Hu's third and fourth worlds—which is basically (although it is really more complicated than this) my "other China."

So I want to say something about the other China. The fundamental reality of the other China is simply that just as China's economy has been growing more rapidly than any other country in the world, so its rate of inequality has also been growing. The gini coefficient, which economists use to measure inequality and where 0 represents absolute equality and 1 signifies complete inequality, has grown from an estimated .28 when the reform period began to some .45 by 2004. A recent report from the Chinese Academy of

Social Sciences argues that the gap is higher still. The gini coefficient may be as high as .55. In either case, the level of inequality in "socialist" China is greater than that in the capitalist United States, where the gini coefficient is .40.

The other China has many faces. The largest numbers are to be found in the countryside. The fundamental gap between rich and poor is that between urban and rural. China's cities, even in the poorest provinces, are far better off than the rural areas. The figures are startling. Average per capita income in urban China, where 458 million people (some 36 percent of the population) live, is $1033 a year. In rural China, with a population of 807 million people and 64 percent of the population, the average per capita income is $319 a year—less than the dollar a day designated by the World Bank as the benchmark of poverty. China's latest statistics, published at the end of 2005, provide figures indicating that 67 percent of the rural population, some 540 million people, earn less than a dollar a day. The average per capita yearly expenditure of China's farmers is only $236 a year--$.65 a day.

If this "other China" were a country, it would be the third largest in the world—after China and India.

This rural, other, China is a countryside with too many people and too little land and not enough water, where taxes are high and officials corrupt, and many parents cannot afford to send their children to school. The health system has crumbled, and some 80 percent of rural residents are without medical insurance. Failing health is a leading cause of poverty. The threat of catastrophic epidemic is omnipresent. Avian flu is only the most recent fear. We have recently read that China has revised its estimates of the number of people affected with HIV/AIDS downward from an estimated 840,000 people to some 650,000. But everyone still agrees that the problem is nonetheless acute. I assume the warning of the UN theme group on AIDS, still stands. UNAIDS has said that China is "now witnessing the unfolding of an HIV/AIDS epidemic of proportions beyond belief...on the verge of a catastrophe that could result in unimaginable human suffering, economic loss, and social devastation."

China's ethnic minorities are also part of the other China and live mostly in poor rural areas in the country's Far West. China's ethnic minorities constitute only 8.4 percent of the population, but they make up 40 percent of the officially recognized poor and suffer the additional burden of blatant, sometimes nasty, discrimination.

Many women also fall in the category of the other China. As the male-female ratio continues to worsen, with the number of males born every year far outnumbering females, the incidence of trafficking of women and girls is also growing. The women of rural China are particularly vulnerable. The women of China make up some 20 percent of the world's female population but commit, according to the World Health Organization, some 56 percent of the world's female suicides. Most of those suicides take place in the countryside.

But the other China is no longer exclusively rural. Urban China, too, has growing numbers of poor and disadvantaged. The largest number are outsiders, the 140-200 million migrant workers who have left the countryside in search of a better life. Every major Chinese city has its own huge enclave of rural migrants, where tens of thousands of people live crowded together in slums with substandard housing and minimal sanitation, isolated from and ill-treated by the urban residents they serve. Migrant workers perform the *kuli*, the bitter labor (from which the word "coolie" comes) on behalf of urban people. They are the construction workers for the new skyscrapers and apartment buildings where affluent urbanites live and work. They man the assembly lines in the countless factories along the thriving eastern coast, where long hours, low wages, and inattention to safety assure the West an apparently limitless supply of cheap manufactured goods.

Other China also includes a growing number of street children sent to fend for themselves in the city by rural parents too poor to raise them at home.

And poverty in China's cities is now homegrown, too. Tens of millions of urban workers, laid-off from failing state owned factories and often cast adrift without a safety net, have formed a new category of urban poor. So have the approximately 25 million retired people without pensions, living in poverty on less than a dollar a day. Their ranks may grow after 2020 when tens of millions of baby boomers begin to retire. Unless radical reforms are implemented soon, many of China's urban baby boomers will not have pensions or access to health care.

I would also add to this category those millions and millions of people in China's cities whose homes have been torn down to make way for those new skyscrapers and apartment building and whose compensation for the destruction of their homes is by no means adequate to purchase a satisfactory new one. In rural areas, seventy million Chinese farmers have lost their land in recent years. Everywhere in China today, in the cities and the countryside, we are seeing developers and officials colluding to take away land and housing from ordinary Chinese in the interest of "progress." These land and home grabs are a leading cause of the protests we see now in many parts of China.

The problems confronting this, the other China, are enormous. I do not think the extent of those problems can be overemphasized. Taken separately, the problems of the other China might be challenging but ultimately solvable. Faced together, China's is confronting a set of problems on a scale never before seen in human history. For the foreseeable future—the next fifteen to twenty years at least—the focus of the Chinese leadership will, and must be, here. If China does not find the will, the creativity, and the resources to solve those problems, far from being a rising power it will become a failed state—unable to provide the basic goods of life for a significant portion of its people. I do not think this will happen. But China—the people of the other China—have a rocky road ahead.

We all know that China is facing a rising tide of discontent. I defer to Scott Tanner on the question of numbers and their details. Here, however, let me simply note that figures from China's own Public Security Bureau indicate a growing incidence of significant protest. The number of such incidents increased from 74,000 in 2004 to 87,000 in 2005. If the same percentage of the United States population engaged in protests, we would be facing more than 20,000 major protests a year, or 55 major incidents a day. That is a lot of protests. I am not sure how, or how well, we might cope.

I am afraid that if we fail to see and understand this set of problems that both the Chinese government and the Chinese people are facing, we will, to return to Michel Oksenberg, "get China wrong." The Chinese government does, I think, understand its problems, but it does not always know how to solve them. The Chinese government sees the other China. And it sees a rising tide of discontent that could threaten its legitimacy. Increasing numbers of Americans see a strong and rising China and fear the country's potential threat to us. But the Chinese leadership is seeing growing domestic anger and worries about its capacity to remain in power.

I think we would all also agree that one consequence of the growing number of protests in China has been an increase in the incidence of human rights abuse. We are all reading about courageous people with noble ideals and good intentions who continue to suffer arrest, harassment, and persecution. I would cite here just a few.

I think of Chen Guangcheng, the blind, self-educated legal activist who made headlines in the fall of 2005 after leading a judicial campaign against forced abortions and sterilizations in Shandong province—calling local officials to task for disobeying Chinese law against forcing women to undergo such surgeries. Chen was put under house arrest by local authorities and beaten—even after the central government agreed to investigate the very abuses Chen was protesting.

And Lu Banglie, the 34-year old farmer from Hubei province who became a people's hero and was saluted by the communist party-run *China Youth Daily* as "the front runner of peasant grass roots democracy" after having led a successful movement to impeach the elected but allegedly corrupt head of his home village. Lu was beaten unconscious, apparently by hired thugs, after coming to the assistance of villagers in another part of China--Taishi, Guangdong—where peasants were seeking a similar impeachment of their village chief. Today, Lu is still followed by public security thugs wherever he goes.

And lawyer Gao Zhisheng, who achieved fame as one of China's leading human rights lawyers--champion of underground Christians, Falun Gong practitioners, displaced home owners, democracy activists, and exploited coal miners and opponent of corrupt officials, illegal land seizures, medical malpractice and police abuse. His license to practice law was revoked for failing to register his office's change of address on time. Today, he and his family are followed constantly and aggressively.

We need to continue expressing our alarm at the Chinese government's treatment of such courageous activists. But, unfortunately, there is no reason to be surprised that the Chinese government should engage in, permit, or condone the perpetuation of human rights abuses.

The real surprise to me is the growing number of mission-driven people who refuse to be intimidated, who relentlessly continue to work even in the face of the nasty obstacles put before them. What is most striking to me today is that for every problem China faces, people are coming forth to solve those problems. They are people I would call "social entrepreneurs"—people with missions, people with visions of a better China, people who cannot be stopped, who will not give up. They are people who have seen problems in their own society and refused to avert their eyes. They insist, to borrow from Vaclav Havel, on "living in truth." Their mission is to change China. And they are. They are relentless. They will not take "no" for an answer, will not rest until their work is done.

Some of China's earliest social entrepreneurs are government officials, pushing reform from within. Until very recently, government service was both the only route to success and the best possible fulcrum to push for positive change. Some social entrepreneurs are academics. I think of Yu Jianrong a professor in the Rural Development Research Institute at the Chinese Academy of Social Sciences, who has observed widespread rural discontent and called upon his fellow intellectuals to help organize the peasants to represent their interests. Some are lawyers. Some work with people living with AIDS—and with stigmatized groups most vulnerable to contracting the illness. Some new social entrepreneurs are English teachers in remote parts of China. Some are former government officials.

China today is witnessing a veritable explosion of these new social entrepreneurs determined to transform their part of the world, to bring about positive change. The Chinese social entrepreneurs who come to public attention are only the tip of the iceberg. China's social entrepreneurs number in the tens and perhaps hundreds of thousands and span a wide political spectrum. Most work without public fanfare and often with great success. That they exist at all is the real surprise. One of the questions panelists for this session have been asked to address is how the atmosphere in China today compares to that of the Mao, Deng, and Jiang eras. Social entrepreneurs were not possible under Mao and Deng. Most of them would have landed in jail.

These new social entrepreneurs are important for several reasons.

First, for whatever reasons—whether through incompetence, indifference, an inability to innovate, or a failure of will—the Chinese government is not coming up quickly enough with solutions to the country's pressing problems. While the government pays lip service to these problems—persistent poverty and the growing gap between rich and poor, egregious corruption at the basic levels of government, a challenged education system, a failing health delivery system, the potential for catastrophic epidemics, environmental disaster and widespread social agitation—it seems unwilling or unable to solve them. Social entrepreneurs are necessary to finding those solutions. They are essential to China's future.

Second, many of these new social entrepreneurs are forming non-governmental organizations (NGOs) designed to address these pressing problems. One of the most exciting new developments in the other China is the burgeoning number of non-governmental organizations (NGOs) being established by social entrepreneurs. Little more than a decade has passed since Liang Congjie established Friends of Nature, China's first NGO. Now the number of "citizen organizations" (or civil society organizations, or non-governmental organizations, as they are variously called) is in the hundreds of thousands. In a recent attempt to map the full panoply of China's associational life, Hong Kong scholar Wang Shaoguang concludes that the country now has a total of more than 8 million registered and unregistered, non-governmental and quasi-governmental associations. The vast majority of these, more than 5 million, are under the aegis of quasi-governmental mass organizations, such as the All China Federation of Trade Unions, the Communist Youth League, and the Women's Federation.

But China now has hundreds of thousands of genuine non-governmental organizations. Following a visit to China by World Bank President Paul Wolfowitz in October 2005, the World Bank estimated that China currently has anywhere between 300,000 and 700,000 civil society organizations "delivering services from legal aid to environmental protection and at the village-level, building playgrounds for children and sharing technologies in smallholder agriculture." China, however haltingly and belatedly, is joining in the "associational revolution" first lauded by Lester Salamon in 1994.

Third, these new NGOs are providing the basis for the development of a civil society in China. The development of civil society is important because, in my view, a solid civil society is essential if China is to begin moving successfully in a more open, democratic direction. I am struck repeatedly in China that the shortest distance between two points is rarely a straight line. The shortest distance between China's current authoritarian government and a more democratic future requires the development of a civil society.

Many of these new social entrepreneurs and these new NGOs are a thorn in the side of the Chinese government. They have to be. They are demanding that officials abide by the law. They are advising citizens on their legal rights. They are demanding greater transparency and accountability on the part of the Chinese government. And as representatives and champions of the disadvantaged, they are also offering alternative models of leadership, particularly at the local level. Local officials, in my own experience, are almost universally assumed to be both corrupt and uninterested in either the plight of the poor or the problems of ordinary people. No one can quite trust the local government, people say. Many of China's new social entrepreneurs are examples of what good local leaders could be.

Fourth, China's new social entrepreneurs and the organizations they run are beginning to act in concert, crossing barriers that have been difficult to breach. Some urban-based intellectuals have come to the assistance of disaffected rural communities. Human rights lawyers represent clients from increasingly diverse parts of the country. Lu Banglie tried to carry his successes from one part of the country to another.

And, increasingly, groups with common goals are coming together to petition the government. In August 2005, 61 NGOs and 99 individuals signed a letter requesting the Chinese government to follow its own laws by releasing its environmental impact studies of the proposed Nu River dam. The proposed dam would be massive, and many are worried about its technical feasibility, its effects on the richly biodiverse areas where it would be located, and its impact on the lives of the ethnic minorities who live there. Forty-nine people have signed a letter criticizing government behavior in Dongzhou village, Guangdong, where villager had spent months protesting the construction of a wind power plant and police opening fire on a crowd of protesters, leaving some twenty people dead. Thirty people have signed letters of protests over events in Taishi village, where one legal activist, Yang Maodong (Guo Feixiong), was arrested and Lu Banglie was badly beaten. Journalists have signed petitions protesting the firing of editors.

Both China's new social entrepreneurs and the growing number of NGOs present the Chinese government with a conundrum. These people and these organizations are addressing genuine problems, and they are using legal means to call upon the government to implement its own laws. The Chinese leadership no longer insists that the vast array of problems currently facing the country do not exist. Nor does the government pretend any longer that it alone can solve these problems. This is why non-governmental organizations are allowed to exist.

I think one cause of the conundrum is this. The Chinese government is obsessively concerned with the possibility of the country descending into chaos. And certainly they see this rising social unrest as a manifestation that the stability of the country is being challenged. China's new social entrepreneurs and new non-governmental organizations are both potential solutions and potential contributors to that social unrest. On the one hand by helping to deal with problems the government alone cannot solve, they may be lessening the tendency to social unrest. On the other, some of those problems are systemic and necessarily bring some NGOs in conflict with local governments.

There is in China today a huge disconnect between leaders at the highest levels of Chinese society and those at the lowest. There is massive corruption at the bottom levels of Chinese society where these conflicts are occurring. The causes of this corruption certainly are many, but I would cite two here.

The first is unfunded mandates, particularly in the country's poorest areas. Governments in poor areas are responsible for such public goods as schools, roads, and local salaries. When governments do not have money, they tax the peasants, or impose fees on every imaginable activity and possession. In many cases these fees and taxes have become rapacious.

The second cause of corruption is the nature of property rights. Chinese farmers do not own their own land. It is contracted to them for their use. All village land is ostensibly collectively owned. Who

controls decisions about the land, how those decisions are to be made, how sales of land rights are to be handled, and who gets the profits is very ambiguous. The ambiguities allow almost unlimited opportunity for collusion between greedy local officials and greedy developers.

Social entrepreneurs representing the disaffected are necessarily putting themselves into conflict with local authorities. And when negotiated attempts at solution fail, and villagers turn to outright protest, their leaders run the risk of being accused of "creating turmoil," which is what the students were accused of when they protested in 1989.

International involvement is an additional complication. Numerous international non-governmental organizations are working in China today, on such issues as poverty alleviation, education, health and HIV/AIDS, the environment, and legal reform. Many local Chinese NGOs receive international support. Many could not function without it. Many foreign NGOs work closely with some of China's NGOs. The Chinese government is not entirely comfortable with these relationships, and that level of discomfort apparently increased sometime last spring.

As I understand it, the problem began with a perception in Russia that a number of the recent so-called "color revolutions," particularly those in Georgia and Ukraine, had significant support from international NGOs. China apparently also became concerned that some of the international, including American, NGOs working in China might somehow be trying to promote a color revolution there. Thus, the government began, over a series of several months, an investigation of all the international NGOs working inside China. As I understand it, those investigations are now complete. I do not know of any foreign NGO that has been denied permission to continue working in China. But a pall was cast on many organizations there, and new rules and regulations concerning foreign NGOs are still being discussed.

If we are to take the Chinese government at its word, there is really no great conflict between its goals and the goals of most international NGOs working in China. The Chinese government has taken rural reform as a major goal of its latest five-year plan. Agricultural taxes on peasants are slated to be abolished. Rural education is to be free. A new system of health insurance is to be introduced to the countryside. Efforts to eliminate corruption of local officials will be stepped up. The rule of law is to be emphasized. And in its recent white paper on democracy, the Chinese government declared democracy to be the common desire of people all over the world and promised to continue improving "socialist democracy with Chinese characteristics." The major caveat was simply that democracy be generated internally and not imposed by external forces.

But the disconnect between China's central and local governments has long been vast. Policy articulated at the national level does not always get implemented at the local ones. Without continual pushing and prodding from disaffected citizens, represented by social entrepreneurs and non-governmental organizations, inertia sets in.

It would be difficult to exaggerate how important China's NGOs are to the country's future. China's new social entrepreneurs and the organizations they run are the hope of China, the impetus for economic, social, and political reform. Grass roots change is coming from them. If democracy is to be introduced there, its success will depend in large measure on the social entrepreneurs, the organizations they run, and the constituents they serve. Between China today and a possibly democratic China of tomorrow is necessarily the development of a something most people would call a civil society. Many of China's new social entrepreneurs, often intentionally and sometimes unwittingly, are contributing to the development of civil society in their country. Some are even consciously promoting democracy.

I do not end with any specific policy recommendation. But this panel has been asked what initiatives or policies the U.S. government could pursue to help the Chinese people foster a freer and more open political arena. Domestically induced reform is going to come from these new NGOs and the social entrepreneurs who lead them. These new purveyors of change in China deserve our support.

PANEL IV: Discussion, Questions and Answers

HEARING CO-CHAIR REINSCH: Thank you very much to both of you for some very interesting comments. In retrospect, we

probably should have gone in reverse order because Dr. Thurston, you did such a good job of laying out the problems and then you both talked about how the problems are being dealt with.

In any event, I've got questions, but I think I'm going to go in order here, and yield to my co-chair, Mr. Wortzel.

HEARING CO-CHAIR WORTZEL: Scot, Anne, thank you both very much for being here. It was great testimony and it reflects amazing research and being at the head of your field. It really informs public policy when people do the things that you do.

I have a question for both of you. For Dr. Tanner, you talked about the wedge of prosperity and coercion. I thought it was a great term. The concept of driving this wedge of prosperity and coercion among residents of China implies to me that there is some relationship or some coordination of the actions among local grassroots Communist Party cells, perhaps public security officials, and even offices or regional offices of the State Security Bureaus.

So if you've been able to glean anything on that, how that may work, and if it's effective. Please discuss this.

For you, Dr. Thurston, if 67 percent of the rural population is earning so little, as you say in your paper, as little as 65 cents a day, are provincial governments or is the central government working to build an infrastructure out in rural areas that would allow these entrepreneurs to either develop businesses or to get intra-provincial trade going or even inter-village grade in ways that would raise up that economy?

Second, one of the hypotheses that inform this whole idea of an opening to China, continuing trade, permanent normal trade relations and WTO membership, was perhaps a direct relationship between this trade and democracy. Now, a lot of us aren't as happy about the speed of democratic development and question whether that hypothesis might be true. However, you certainly have painted the development a civil society, where people are beginning to take control, not only of their own lives, but of the lives of their villages and the economic life and commerce in their villages.

So I'd be interested in hearing you talk a little bit more about that aspect of permanent normal trade relations and WTO membership.

DR. TANNER: First of all, I want to thank Commissioner Wortzel for his extremely kind words to Dr. Thurston and me. It is always an honor to do this sort of research, particularly if a commission such as yours finds it of any value at all.

We, I think a good deal can be said about a strategy that is used here, and I chose those words about driving a wedge of prosperity and coercion very carefully. I think this is an extremely deliberate strategy to try to offer to the vast majority of Chinese citizens the possibility of--this is sort of a classic shift from a totalitarian system to a tough authoritarian system.

You start to offer people, you know if you stay out of--the deal becomes if you stay out of politics, if you leave the driving to us, we're willing to offer you a better, more prosperous life, but there is also

behind this the not very well-veiled threat of what can happen if you get involved in organizing political dissent.

This is sketched out in training manuals that you find for political security work in China or it's now called domestic state security work, that in protests that police are supposed to identify the leaders, that they are supposed to, if possible if the low level of violence permits, if possible, to wait until afterward when they are separate and people can't respond to their detention, and to focus on rounding these people up quietly afterward or to sow dissention among their ranks.

They constantly talk about involvement in the neixian, the internal line, which is of course the Chinese phrase for infiltration of a group. And these are the rules. This is how this is supposed to be done. I'm sure the commissioner have all seen this. About three years ago, the excellent correspondent of the Washington Post Philip Pan wrote an article called "Three Workers,"[3] which is as eloquent a description of the state security and public security tactics for sowing dissent among a group like this as I think I've ever seen in the English language.

HEARING CO-CHAIR WORTZEL: Would you consider just appending that to your written statement?

DR. TANNER: I'd be happy to--

HEARING CO-CHAIR WORTZEL: Then we'll include it into the record.

DR. TANNER: Yes. It's an eloquently done job of describing this, and if you look at the directives given to security officials, it reads exactly like the tactics that Mr. Pan describes in there.

So, yes, that's a very deliberate strategy to isolate these people and in the process to offer to the vast majority of citizens an opportunity for that. I don't want to go too long. I want to say just one last thing though.

As far as we can tell, the majority of people who take part in small-scale peaceful protests in China in recent years don't suffer any significant penalty as a result. If you take the Chinese police statistics at their word on how many people are taking part of this thing, it is probably now the case that there are at least ten million people in China who have taken part at some time in the last decade in a public protest with no significant consequences as a result.

The long-term implications of having a group like that in Chinese society are fascinating to contemplate.

DR. THURSTON: Thank you. your questions are very interesting and let me see if I can try AND answer them. The first thing to say, and I do say this in my longer paper, is that if you read what the Chinese government is saying right now, they are very, very concerned about the other China.

They have a set of policies to try to address these issues. I think one of the things that anybody who studies China learns very, very quickly, is that there is always a huge disconnect between policy as it's

[3] Three Chinese Workers: Jail, Betrayal and Fear. Government Stifles Labor Movement by Philip P. Pan, Washington Post Foreign Service, December 28, 2002

articulated from the center and what actually happens on the ground, and I think it's true that everywhere I go in China, what I hear is that the local level officials don't care about us and that they're corrupt.

So at best it takes a long time for these policies articulated at the center to start being implemented at the local levels. Infrastructure is a big concern. If you look at this develop the West policy, infrastructure is a huge concern in that policy, and what's happening now is that infrastructure is focused on railways and trains in particular, so you're getting big highways connecting the major cities.

Then the question, though, is it takes a long time to get roads at the village level. The villages that I visit in the mountains have roads, but they're dirt roads, they're just rutted roads. They're very difficult to travel.

We talked a little bit before the session started about my work on village democracy. The best predictor of A candidate being elected to the position of village leader is if he promises to build a road because the roads do get opened up. They make the market available to the villagers.

You also raised the question of the relationship between trade and democracy. I will say that I was certainly one of those people when we were having these discussions here in Washington who was in favor of continuing most favored status, permanent normal trade relations with China, on the basis that the contact is good in the long term for both human rights and for democracy.

I would also say again the shortest distance between two points in China is not a straight line. It's very unclear how, what this relationship is. But it is certainly clear and it's clear from what Scot says, too--I'm not sure if he would say it the same way--but people are becoming aware of their rights.

If you take the Chinese government at its word and read that white paper on democracy that they've recently written, a lot of it is very formulaic, but the Chinese government has committed itself to socialist democracy with Chinese characteristics, and, if we can keep pushing them along those lines, then I think that we've got something to work with.

I guess I'll stop there. If you want to follow up, please do.

HEARING CO-CHAIR WORTZEL: Thank you very much, both of you.

HEARING CO-CHAIR REINSCH: Thank you. Mr. Wessel.

COMMISSIONER WESSEL: Thank you both for being here. It's very impressive testimony, and Dr. Thurston, it's good seeing you again. We were together I guess some weeks ago.

Your last comment or second to last comment reminds me of Tip O'Neill--

DR. THURSTON: That's right. That's true.

COMMISSIONER WESSEL: --who commented on how all politics is local. It seems it doesn't matter whether it's here in the U.S. or there in the other China that--

ACTING CHAIRMAN BARTHOLOMEW: We might append that to all politics is roads, by the sound--

COMMISSIONER WESSEL: Is roads. Well, ask governor, newly elected Governor Kaine of Virginia.

DR. THURSTON: All politics is what?

DR. TANNER: Roads.

DR. THURSTON: Oh, roads. That's true.

COMMISSIONER WESSEL: I was also struck as Dr. Wortzel was, Dr. Tanner, with your comments about the driving a wedge of prosperity because your comments seem to say that the promotion of individual economic rights in China, in fact, is being used as a wedge to thwart greater liberty.

Dr. Thurston, do you agree with that in terms of that the promotion of rights to not a select few, since it's broadly being done, is also being used as a strategy to limit further inroads on democracy and freedom?

DR. THURSTON: I'm not quite sure what you mean.

COMMISSIONER WESSEL: As I understood Dr. Tanner's comments, he said the Party wants to drive a wedge of prosperity and coercion between the--not as I understand it, as he said--this economic mainstream of average citizens and the minority. That there is a defined strategy of promoting individual economic rights, the entrepreneurial class, not the social entrepreneurs, in their ability to provide growth and jobs to that, if you will, sector, but at the same time limit broader freedom and democracy movements.

DR. THURSTON: Well, I think that's a very hard question. I'm struck so much in China by on the one hand/on the other hand. There is now a pushing from the lower levels from these social entrepreneurs as a result of introducing things like village elections. There's a lot of pushing for greater recognition of rights. I think that the tremendous problem is that China has so many problems and it can't solve all those problems, and it can't even abide by its own laws, its own rules, its own policies.

When people get upset with that and they push and they protest, then the government has to push back. So I think it is a very, very complex interplay, and I think that the Chinese government faces a tremendous dilemma about implementing its own policies and the fact that it can't implement those own policies and people get upset.

So I think it's going to be a very, very rocky road ahead. I do think that the direction is basically positive, but there are just too many problems.

COMMISSIONER WESSEL: What hopes do both of you have for the 11th Five Year Program that is in the final formative stages and its recognition of the other China, or stated recognition? What hopes and what have you seen anything on the ground yet to indicate that there is a commitment to that?

DR. TANNER: I'm sorry, Commissioner. Would you be more specific on--

COMMISSIONER WESSEL: The 11th Five Year Program has talked about the inequities, has talked about income gaps, has talked about health care, the educational system.

What are your hopes for that? How deep are the programs that will come from that? Have you seen any evidence that there is already some infrastructure being laid to address those inequities?

DR. TANNER: I'll be quite honest. A number of the questions that you're talking about of whether or not this strategy is likely to be effective in dealing with the long-term problems of inequality, these are really issues for an economist. I would not care to venture a guess on how successful they're likely to be.

I will say this. Even China's security officials are very frank in their claims that the dramatic increase in inequality that Dr. Thurston reminded us of, they believe is a major source of unrest, and that they don't expect to be successful in containing unrest without progress on that front. One of the striking things you see in police journals these days is discussion of, of all things, something called a Gini index, which is, of course, the most widely used economic indicator of income inequality in a society, something one would never expect to see police officers talking about.

But they are well aware of the increase, the dramatic increase in inequality and society and they know that if they can't make progress on that, they should not expect to be able to get a handle on unrest.

DR. THURSTON: Yes. I think what's happened, what the Chinese have done with respect to this plan is to lay out big goals without saying how they're going to implement those goals, and I think I mentioned some of those goals in my piece.

Rural education is supposed to be free. The agricultural tax is to be stopped and there is to be development in the poorest areas of China. The question then is--in health care--they are supposed to be introducing a health care system in the rural areas. Again, the question is always how those policies get implemented and where is the money going to come from.

If you look at all of the promises that the government has made, and then try to ask how they're going to fund this and how the funds are going to get down to the local levels, that's a problem.

A lot of the problems of the local levels are unfunded mandates. The local level is required to build schools and roads and hospitals and that sort of thing, but in poor areas, they don't have the money to do that.

I have seen changes in recent years as a result of these central level policies. The biggest change I've seen is that education is now free in the country's--like in the Tibetan plateau that I visit now.. It was not when I first started going there.

Now, it's hard to build schools, it's hard to pay teachers and that sort of thing, but children don't have to pay for their education anymore.

The other big change I've seen is that the social entrepreneurs and the NGOs in these areas hear what the national government is saying, and they use those policies to make their arguments to the local government.

So the local government can't say, yes, but this isn't our policy, it is the policy, and so the question is how do you begin to find the means to implement that policy at the local level?

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR REINSCH: Thank you. Let me say I think we're probably going to have time for another round of questions, so, Commissioners, don't feel that you need to exhaust everything in the first round. We have time.

Mr. Mulloy.

COMMISSIONER MULLOY: Thank you. I want to thank both Commissioners Reinsch and Wortzel for putting on this hearing and pushing that we look into these issues. I've found the two days of testimony quite interesting in helping me get a better sense of what is happening out there.

Scot, I want to also commend you for your article that appeared in The Wall Street Journal yesterday your op ed, which was quite good.

Dr. Thurston, in your testimony, you talk about this gini coefficient that has moved from .28 to .55 in China over this period.

DR. THURSTON: The highest estimate.

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COMMISSIONER MULLOY: Yes. Now that means inequality is increasing in China.

DR. THURSTON: Right.

COMMISSIONER MULLOY: And you note that the gini coefficient in the United States is .40.

DR. THURSTON: Right.

COMMISSIONER MULLOY: Do you know what it was 20 years ago or 30 years ago in the United States?

DR. THURSTON: No. I'm sorry I don't.

COMMISSIONER MULLOY: I expect income inequality is increasing in the United States as well.

DR. TANNER: I believe that's true, sir.

I believe it was lower 20 years ago.

COMMISSIONER MULLOY: Yes, that’s my understanding. Now, here's what I want to throw out and get your comments on. Sir James Goldsmith, who was an economist and investment banker, warned people in 1993 not to get into the WTO, because he said with capital and technology so mobile, that they would move to these other countries, create goods, and ship them back here.

He said that you're going to have downward pressure on your pensions, your health care, your own standard of living, and if you watch what's happening in this country with our pensions, you say maybe he was on to something.

Now, he was saying this isn't going to be good for us. Joshua Muldavin, who was in here yesterday, talked about, as the world's companies rush to China to set up factories to avoid environmental, pensions health care costs, unionized labor, they are dragging communities worldwide on a downward race to the bottom.

That was his testimony. He said it isn't good for China because you're creating all kinds of stress and problems in China. And you talked about the growing unrest in China as a sign that things aren't what they were there 20 years ago.

So, I think it's too late to turn the clock back. What policies should the U.S. government be pursuing? For example, people criticize us for saying China's got to change its exchange rate policy because it's giving them an unfair advantage in terms of shipping goods here and they say China has got a lot of domestic problems, they need to grow their economy, leave them alone.

But the testimony I get is that this isn't necessarily good for them, an export-led growth strategy. They've got to moderate this export-led growth strategy and try and so some more domestic growth in China, which I think would be good for them and maybe good for us. That's my initial read on what I've heard these last two days and I just wanted to run that by you and ask you both is this anything that you would agree with. Dr. Thurston and then Dr. Tanner?

DR. THURSTON: Well, I think that the questions that you're raising are very important and very interesting. I also think that I'm not the person to answer them. I think that we have some very, very good economists here in Washington and I'd be happy to suggest that you all meet with some of them.

COMMISSIONER MULLOY: I think this is too important to leave to economists because I think economists, as Dr. Muldavin told us yesterday, don't really capture the larger issues of what is happening here. They get focused on economic man and remove him from the largest social context.

DR. THURSTON: No, I think that's true.

COMMISSIONER MULLOY: That's why I wanted to get you folks who really understand what is happening on the ground in China to give me your views.

DR. THURSTON: But I think you're also asking about the role of WTO and how--

COMMISSIONER MULLOY: No, I think that's done now.

DR. THURSTON: Okay.

COMMISSIONER MULLOY: That's done. So the world we're in today, should China be focusing more on domestic-led growth rather than export-led growth?

DR. THURSTON: Oh, absolutely. Yes, certainly, absolutely. I do, by the way, think the Chinese government at the national level knows that. Then the question is how?

COMMISSIONER MULLOY: We should be pushing them in that direction?

DR. THURSTON: I don't know if we should be--I'm not qualified to push China.

COMMISSIONER MULLOY: Okay.

DR. THURSTON: I try to work with Chinese who are trying to solve problems in their own society. I would hesitate to push them because, well, I guess maybe not in this paper, but somewhere in something I've written I describe China as like a beanbag. You push it here and something pops out over there.

COMMISSIONER MULLOY: Yes.

DR. THURSTON: So you want to be very, very careful about pushing China. What I try to do is find ways and places and people to work with to solve problems generally at a more local level.

COMMISSIONER MULLOY: Thank you. Dr. Tanner, do you have anything else?

DR. TANNER: Commissioner Mulloy, I have felt that one of the problems with the way that we've looked at the problem of unrest in China has been focused, and I have not yet read yesterday's testimony so I don't want to comment directly on that. But I think that we have focused a little too narrowly sometimes on some of the economic causes of this.

It is true that a lot of the complaints that people have that spark unrest are economic -- loss of jobs, withheld pensions, withheld health benefits, property being taken away, fees and things like that.

My problem with what I read for some of these analyses of this unrest is that there is such a long list of both economic and noneconomic complaints over which people are protesting in China today that that fact itself should scream to us that it's something more fundamental in the political system that is getting people out in the streets.

This is a government that over the last 55 years has undertaken some brutal economic policies and yet it's only been in the last decade or so that we're starting to see the social response reflected in widespread protest.

I think the focus on the sources of this needs to be at least as much on the political source. This is a system that does not offer people peaceful, legal, useful channels for dealing with these economic and noneconomic complaints that they have with the system.

Getting back to the question you specifically asked about policy, I think that U.S. policy needs to be focused in addition to a number of these economic issues, and I agree with you on several of them, needs to be focused on continuing to encourage China to undertake political, legal reforms in their system and that these are the sorts of things that unfortunately we can't say by the end of next year, these will have a major change.

But as I was mentioning to a couple of the Commissioners beforehand, we had no idea 25 years ago that when China started encouraging the use of contracts to reform its agricultural system, that this would end up giving the Chinese people a sense of contract and right and entitlement that would cause protesters in 2006 to be waving

contracts and legal documents in the face of local officials saying you can't do what you're doing, I know my rights.

So the long-term effect of encouraging these sorts of legal and political changes are things we can't predict right now, but I really do think this is something we need to continue to focus on.

DR. THURSTON: Is it okay if I add something to that?

HEARING CO-CHAIR REINSCH: Go ahead, briefly.

DR. THURSTON: If you look at these, what appear to be economic disputes that cause protests, it's not just that it's, the issues aren't just economic. It's there's a perception of grave unfairness on the part of these people who protest.

You think, for instance, of people in the northeast who a number of years ago were protesting as their factories were shutting down, what was happening is that the managers of the factory were driving into the offices in their Mercedes and stripping the factories--they were making money off this as all the workers were being laid off and they weren't--the promises that had been made to them were not being fulfilled.

If you look at the land disputes that are going on right now, the problem is that the local level officials are in collusion with the developers, the local level officials and developers are making a lot of money by buying and selling this land, and the villagers who are part of this collective aren't getting their fair share. So there is a perceived sense of unfairness and corruption that leads to most of these protests, I think.

DR. TANNER: I completely agree with Dr. Thurston on those points.

HEARING CO-CHAIR REINSCH: Thank you. Ms. Bartholomew.

ACTING CHAIRMAN BARTHOLOMEW: Thank you very much, Mr. Chairman, and thank you to our witnesses. This is really interesting and we get so much benefit out of being able to tap your expertise and your brainpower on all of these things.

One point of clarification, and then I've got a specific question and then broader questions. Dr. Thurston, I always think it's important to note, whenever the issue of MFN comes up, that for the vast majority of the people who were in the opposite side of the MFN debate for you, it was not about cutting off engagement and it was never about cutting off engagement. It was, of course, about using U.S. leverage in the terms of the engagement. And there has always been a tendency in that debate still to characterize people as you're trying to cut off contact with China and--

DR. THURSTON: I once shared the podium with Nancy Pelosi.

ACTING CHAIRMAN BARTHOLOMEW: There you go, someone I know quite well. I was particularly interested in your comment about education in the Tibetan plateau. In my day job, I run an NGO that focuses on the goal of education for all and getting all children in the world access to education.

I don't usually bring it into this room, but it's interesting to me that you mention education in the Tibetan plateau being free, but I'm wondering what language that education is in?

DR. THURSTON: Well, it's actually in the places that I visit, it starts in Tibetan because one of the problems is even if teachers wanted to teach in Chinese, they don't know Chinese because the area that I visit is the most Tibetan place in the world, 96 to 98 percent Tibetan. This is in primary school.

By the time children get to middle school they are being introduced to Chinese and the method of instruction is in Chinese. So I think your question is probably also directed to the issue of the survival of the Tibetan language, and yes, I think the problem is that the Chinese government requires that teaching, at least at the level of middle school and above, is in Chinese, that children are allowed to take only one other foreign language, which for a Tibetan would be Tibetan, but English right now is the foreign language that people want to learn.

So what some people who are trying to work with the Tibetan educational system are trying to do is to allow students to study both Tibetan and English in order to maintain their Tibetan language.

ACTING CHAIRMAN BARTHOLOMEW: That's particularly interesting and the point, of course, was about the Chinese policy of making Tibetans more Chinese and so the language that people are being taught in is very important.

If they don't have access to teaching in the Tibetan language, not only do they fall behind education-wise, but it also is taking them away from their own cultural heritage and who they are.

I'm interested in the conundra of dilemmas--we were just discussing up here whether the plural of conundrum was conundra, which I think it is--of these NGOs, and I presume that there are two, which I'll identify, but want to know if I've gotten them right or if they're different.

One, of course, is the aspect of when you turn over to an NGO community, either actively or by default, the provision of social services. You set up a situation where you are creating a possible organizational structure that is outside the government, that you then have to control and in that sense I'm actually thinking of Hamas and organizations like that that have provided social services along the way and then the challenge it becomes when the government cannot.

That's one. And then the second, and Dr. Tanner, I'm interested in your comments on this too, is that fine line between what is acceptable in activities that are NGOs are doing, what is not acceptable, how people identify that line, how much they are self-censoring in their own activities and also for a number of people who get involved in service provision. You reach a point in service provision when you realize you can only do so much and there are systemic issues and it sometimes turns over into advocacy.

Are there other dilemmas that are being faced and how do you see these balances being played out?

DR. TANNER: Your question about the dilemmas of allowing the rise of these sorts of civil society organizations is extremely well placed and the Chinese government is very frightened about this.

This has become really a major focus of their concern in the last couple of years, particularly the constant references to the danger of the Yanse Geming, the color revolutions.

What we are increasingly seeing, I think, and I do want to be careful about characterizing these things, is protesters piggybacking on a wide variety of existing social networks, and it's not simply organizations that you might see as, oh, more or less overtly political or close to being political.

You even see references to people using sports organizations, for example, as the organizational base, the network for putting together protests. I don't want to say that's very widespread and I certainly don't want to say that going into the Olympics, but the increasing existence and widespread use of these organizations simply provides people with networks that are freely available ways of contacting people and easy efficient ways of mobilizing dissent.

I think it would be very, very difficult for the Chinese government to crack down on that without undertaking a very serious major recertification of a large number of social organizations, something that could easily backfire because they are providing pivotal services right now

ACTING CHAIRMAN BARTHOLOMEW: Dr. Thurston.

DR. THURSTON: I appreciate what both of you have said, and I think my comments would simply repeat in one way or another what you've both said.

It seems to me that the essential conundrum is that the Chinese government has come to recognize that it can't alone solve all of the country's problems, and it has therefore allowed other organizations to come into being to address some of these problems.

But there is a tendency then for these organizations to become, I want to say advocacy organizations, but I think that's really scary to the Chinese. The fact is when these organizations try to hold the government to its own rules and regulations, when they educate people about these rules and regulations in Chinese law, and the government can't meet those demands, meet those requests, then, you have some of the protest that we're seeing right now.

So the question for the Chinese government is how to allow these to exist without causing themselves more trouble. I think the fact is they are going to have more trouble. That's all there is to it.

One of the things I did want to say is that this concern in recent months has been reflected in--Scot mentioned the fear of these color revolutions. There's a sense that the Chinese apparently have gotten from the Russians that these color revolutions were in some way fostered by international non-governmental organizations.— There are a number of marvelous international organizations working in China, and there has recently been a review of all of these organizations and a reregistration. As I understand what's happening now is that the review

is over. So far as I know no foreign NGO has been denied its registration in China. There is now a discussion about new rules and new regulations governing these non-governmental organizations that are working inside China.

ACTING CHAIRMAN BARTHOLOMEW: I have just one quick follow-up question, and that is obviously in Russia there's been this law that they've been trying to promulgate which would cut off NGOs that are any getting any sort of foreign money. Do we have any sense that the Chinese government is watching the world reaction to that to see if this is something that they're going to be able to follow down that path? If we don't speak out loudly enough against what the Russians are trying to do, the Chinese can feel like it's an okay thing to do themselves?

DR. THURSTON: Good question. Very, very good question. Certainly the Chinese are looking at what Russia is doing. My sense, though, is that the Chinese themselves know these organizations are very important and they're doing very good work in China, and they're there. It would be a huge, huge problem if China were to begin denying these international organizations the ability to work there. And I have not heard that suggestion.

ACTING CHAIRMAN BARTHOLOMEW: Dr. Tanner, any?

DR. TANNER: I'm a bit more cynical on a lot of things, Dr. Thurston.

DR. THURSTON: That's why we're here together.

DR. TANNER: The incentives that Dr. Thurston has just pointed out are absolutely correct. There are an enormous number of problems that the Chinese state simply can't solve by itself and needs these organizations to help them solve.

That said, I think that if they decide that what happens to these organizations is absolutely pivotal to their continuing--to the Chinese Communist Party continuing to remain in power to avoid becoming an unemployed Communist Party, that they're not going to allow world reaction to what the Russians do to stop them from taking a policy that they think this is vital to their continued survival.

I think they will probably watch for international reaction, try to see ways that they can make this, make anything that they do more palatable internationally. But I think in the end, this government will take the measures it thinks it absolutely has to take to ensure its survival.

ACTING CHAIRMAN BARTHOLOMEW: Thank you.

HEARING CO-CHAIR REINSCH: Thank you. Ms. Houston.

COMMISSIONER HOUSTON: Thank you, Commissioner, and thank both of you for being here today. This has just been remarkably enlightening.

I have a question for each of you and, of course, you are both welcome to jump in at any time. Dr. Thurston, I just love your phrase "social entrepreneurs." I think that is absolutely wonderful and I plan to plagiarize it.

DR. THURSTON: No, I plagiarized it. So let me tell you how to plagiarize it.

COMMISSIONER HOUSTON: I hope that at the end when your social entrepreneurs have in an ideal world discovered civil society in China that again they are matched with business entrepreneurs because certainly those folks need to have a job to go to when they're done reforming. And the in and outgo of capital is going to be very important to that end. We don't want a closed financial system there.

My question is more about the nature at the fundamental level of some of these protests. Here in America we have, thankfully, people protesting and supporting all kinds of things all day long. There is usually one thing that brings them to protest just as there's one thing that brings everyone to vote. People have a lot of interest, but it may be taxes. It might be life issues. It might be national defense issues.

There are a number of things that interest everyone, but one thing that really motivates people to get out there and protest. However, no one is walking around Capitol Hill protesting the government; no one is trying to overthrow the government of the United States. The first step, I suppose, before any kind of unrest or protest activity is recognition and distress, recognition of a problem and then realizing that you're distressed about it.

My question is the folks who are either in an NGO or having more or less ad hoc protests, are they protesting the one thing like we do here America, or is there, do you have the sense that they are also protesting the regime itself and the fundamental quality and construct of their government?

Dr. Tanner, my question for you, I asked this yesterday as well of someone and I'd love to hear your answer. We have the Olympics coming to China and that certainly shines a spotlight on Beijing, in particular, and I'm sure as I mentioned yesterday it will be all clean and tidy and look very nice.

I have two questions having to do with the unrest factor in the Olympics. Number one is what is your sense or prognostication perhaps on what we will see or not see going on in Beijing? Do you think there will be a concerted level of activity there to protest as we saw in 1999?

The second part of my question has to do with Dr. Thurston's "other China." Do you think that there will be any dissemination of information about what's going on around the Olympics and there will be any kind of envy out there that spurs further dissatisfaction in the villages when they see what's going on and they see what they're missing as far as economic activity and quality of life?

I'm unclear on how much information goes out to those villages and how much those folks actually see. I wondered if this will spur any kind of further unrest when they see what happens in the capital city where they are not?

DR. TANNER: Historically, the two times that I can think of in my life when the Olympic games were held in an authoritarian developing country and the two that pop immediately to mind are Mexico City in 1968 and Seoul in 1988--am I right about that--these proved irresistible opportunities for a wide variety of protesters.

I am completely confident that a number of groups of people will try to do the same in Beijing in 2008. But as to whether or not their being able to get past what will be, I'm sure, an enormous security presence, both overt and plain clothes, that's simply impossible to forecast.

This is part of the elaborate cat and mouse game that already goes on between police and protesters. I think that what the Chinese will probably do is to move, is just physically move out of the city anybody that they're even remotely concerned about. So I think that diminishes the likelihood of this.

There is another thing that needs to be considered which is that the government will be so testy about this that while you can attract attention for a protest by protesting at that time, you're also almost certainly going to be dealt with far more harshly than you would at other times. This will be regarded as a national insult to China on international TV. Some people may calculate that that's not the best way to advance their goals.

COMMISSIONER HOUSTON: What about the issue of the dissemination of visuals of what's going on in Beijing out to the villages and the possibility of unrest there based on what they see?

DR. TANNER: Even with the elaborate efforts to police and control the Internet, we do manage to see a lot of things very cleverly getting circulated on there, whether it was the footage this past year of police beating protesters in I believe it was a village in Hunan, if I recall correctly, or these infinitely subtle things that people are able to do. For example, carrying out discussions of an old story by LuXun about the death of a young girl at the hands of Kuomintang soldiers, as a way of making reference to the killing of that 13-year old girl that I mentioned earlier.

Or people simply logging on and saying "I know" to indicate that they knew about the killings in Dongzhou. There's almost infinite cleverness in this and I'm sure they will find ways to disseminate a lot of these things and it will be, as I said, an ongoing cat and mouse game between the security officials and the citizens. My long-term money is on the citizens.

DR. THURSTON: Those were marvelous questions. I like them both a lot. If I could just add to Scot's answer. I've certainly heard from Chinese friends that the Olympics are going to provide an opportunity for people to at least try to protest and I've had people draw pictures of petitioners from the countryside coming in and essentially surrounding the city.

I think the Chinese government also knows this, and I think the city will be cordoned off. So I also hear people say that there will be no big protest in China until after the Olympics because the Chinese government is so concerned about what happens.

I think it's true that television already provides people in the countryside with a view of what the other China – the rising China is like. It would be interesting to see how people respond to the Olympics because I think it would be a mixture of great pride, on the one hand, to

have these international Olympics being held in China's capital city. I think people are very proud of their country.

On the other hand, it also would give them an opportunity to see a life that they don't have and don't have access to.

With respect to how people protest and what their recognition of the problem is, I think many people including I assume Scot, but I'm not sure, who have looked at the nature of these protests in China have been struck by how local they are and how the focus of the anger is on the local official, and Scot did mention--there are so many people who believe if only Beijing knew. If only they knew what was going on here, then they would come down and help us. That's very traditional in terms of protest in China. During the Cultural Revolution, too, when people were being persecuted, people would say if only Chairman Mao knew, he would come and help me.

So the real jump is going to be when people begin to make that connection between what's happening at their local areas and the fact that this is systemic rather than just their local, one local corrupt, or two local corrupt padres.

HEARING CO-CHAIR REINSCH: Thank you. Mr. D'Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman, and thank you both for coming. This has been very interesting testimony. It's different from what we heard yesterday from traditional political scientists and economists in terms of the question of the scope and scale of what you call "social entrepreneurs" and NGOs. If you draw the logical conclusion, they become the political movement in the long run in the absence of the central government and provincial government solving the problems that they're trying to address, which is, of course, the major question.

It's hard to evaluate the scale and scope of this movement, but I think it's very interesting to look at it, and I don't think it's been evaluated very carefully. There are two parts of it that I find interesting. The first is the question of land. Obviously a lot of this discontent is over land, taking away land that is, quote, "collectively owned" already. The first part of my question is to what extent is there a social entrepreneur movement or NGO movement to privatize land?

After all, the Chinese society is engaging in the substantial privatization--that's the name of the game, I think, isn't it--privatization to try and bring economic growth, bring outside entrepreneurs in and grow Chinese entrepreneurs.

The second question I have is to what extent are there NGOs or social entrepreneurs for bringing better rural health care back into China? And is there a growing relationship between NGOs dealing with rural health care and international organization, international NGOs, American NGOs, European NGOs and so on? China is going backwards fast on rural health care quite clearly, and it is I think a genesis of some of the discontent.

So the question is are there NGOs that are dealing with the question, the central question of privatization of land, to go along with the other policies of privatization the Chinese government is doing?

Secondly, what about rural health care? Are we seeing an attempt to reverse that flow to the cities of health care and leaving the rural countryside really destitute?

DR. THURSTON: All of those questions are very important. I want to backtrack and say something about the nature of social entrepreneurs and NGOs and why they might be more controllable from the Chinese perspective than they appear to be in terms of sheer numbers.

The Chinese only allow one NGO with the same goal at any given level of government, which means at the county level, you can only have one environmental NGO or one health care NGO, that kind of thing, and that keeps them isolated from each other and makes it much more difficult to have this sort of cross-fertilization that you're referring to. I think it's been a fairly effective strategy so far.

Your question about the privatization of land. It seems so obvious to me that the answer to these problems in the Chinese countryside is to privatize land. I have not heard ever in China people saying that this is what we need to do. What worries me is that if China were to try to undertake privatization of village land right now, the level of corruption in the villages is so great that it would be a very, very, very difficult process, and you really would need outsiders coming in and spending long periods of time in the villages to try to of straighten this out and make sure that it was done correctly without corruption.

But in the long term, it seems to me that privatization of land is the only solution to this land problem that China faces.

With respect to NGOs and rural health care, yes, NGOs are decidedly worried about and interested in rural health care. I think it's also true that there are many international NGOs that would be delighted to work with China on issues of health care.

The problem is, is that the way this issue gets addressed at the local level is, we need a clinic, we need doctors, it's very specific and concrete when, in fact, the issue is a much, much bigger issue. The issue is how do you introduce medical insurance for poor people who can't afford health care?

It's an issue that is, in fact, I think ultimately is something that the government does have to step in and help to solve. Now, this is part of the new Five Year Plan to begin to introduce health insurance to the countryside. Again, it is such a complicated problem because it's also an issue of cost in the countryside, and they can't afford health care, but so far there has been no insurance that people can afford that would give them the level of health care that they need.

So again, it's an issue where the government is going to have to come in. I think one of the problems is always how people at the local level understand their very local problem, but they don't understand that it's part of a much bigger problem and how do you leap upwards to see it as a bigger issue rather than just your local issue. That's where I think

some of these social entrepreneurs are coming in. They do have a much broader vision.

DR. TANNER: I agree with Dr. Thurston about long-term solutions to this problem, but she's made I think also an extremely important point, that with an enormous number of reforms and problems going on in China, one can imagine the long-term situation that might make things better.

But the real political challenge is how you get from where we are now to the long-term solution without destroying your government in the interim period? I think Dr. Thurston is absolutely right. The levels of corruption in Chinese society now are such that that initial move to make land freely available for sale. We all watched what happened in Russia in the early 1990s with the privatization of state assets, and I see no reason to expect that China wouldn't see something at least as bad when land that is now under the control of local officials can be made available for sale. I'm sure you will see kickbacks and things like that.

The other thing is I just don't simply think that economics by itself is the solution to the unrest problem. You make the land freely available for sale. A factory buys it. It sets up a chemical factory and pollutes the local streams and people get sick as a result and now you've got protests over pollution and the enforcement of environmental laws.

I don't think that there is a single, simply economic answer to this. I think that the problems of protest and this problem are rooted fundamentally in its political failings.

COMMISSIONER D'AMATO: Thank you.

HEARING CO-CHAIR REINSCH: Thank you. Commissioner Bartholomew preempted one of my really good question so I have to go to Plan B here. Let me pursue for a minute the question of the failed state analogy you made although I think some of this question is going to be as much to Dr. Thurston as it is Dr. Tanner.

I'm not sure that's an apt term in this case. To me failed states are countries that linger on through a combination of repression, social disorganization internally, perhaps as a consequence of the repression, isolation and irrelevance. That means, among other things, frankly there aren't that many people outside the country who think it's important enough to intervene.

Most of these criteria I'm not sure apply to China. In fact, what both of you have talked about is really a situation in which the citizens are becoming progressively more demanding for a variety of reasons and in a variety of venues, both economically and politically and becoming marginally better organized to do that, and yet you've both drawn a picture I think of a state that is progressively less able to deliver on the increased demands.

So I'm not sure that leaves me very optimistic about an outcome, and I don't think that conditions there are such that the problem is simply going to linger on for a long time and people are just sort of content.

Now, you Dr. Tanner profess some optimism at the end, putting your money on the citizens. Maybe you can both elaborate on that, on the hypothesis I just articulated, and talk about your level of optimism and how you think things are going to play out given the scenarios that you've drawn?

DR. TANNER: Well, first of all, let me make two quick clarifications. When I talked about putting my money on the citizens, I meant in the battle, in the two-way race between the security officials who are monitoring control of the Internet and media and things like that, and citizens who constantly dream up these really brilliantly clever ways of avoiding these things, that my money is on the cleverness of the citizens to be able to keep ahead of the censors.

I agree with you. I have never used the phrase "failed state" to describe China, although I'm perfectly happy to talk about the failures of their political system, and that's what I was discussing there.

The two principal failures are the inability of this system to effectively monitor corruption and abuse by local officials, and it's not just inability. It is to a certain extent unwillingness.

Secondly, the inability of this system and unwillingness to offer its people effective accessible legal avenues for dealing with this wide array of problems and getting a proper, fair, legal solution to them. That's what the system is not set up to do and I am very pessimistic that they are going to take the steps necessary to do that, because that would involve taking control of the legal system out of the control of local Communist Party committees and Communist Party officials and they believe that is a fundamental cornerstone of their control on power.

My concern over the long run is that we could find ourselves before too awfully much longer with China being a political system that its greatest capacity might be simply its ability to continue to cling to power, but to provide public goods to society, to provide any sort of legal avenues for people to solve their problems, to provide effective control on corruption, I don't see this system making the types of changes necessary to be able to make progress in that direction. That's my long-term concern.

HEARING CO-CHAIR REINSCH: Dr. Thurston, do you want to comment?

DR. THURSTON: Again, very big questions. I guess my definition of a failed state, I think I was the one who used the word "failed state," and it wasn't to say that China is a failed state. It is to say that unless China finds a way to solve all of these problems, it's in danger of becoming a failed state.

My definition of a failed state would be as Scot just said--the inability to provide the basic services and goods to its population or to a substantial part of its population.

I also I think I agree with Scot here, which is to say I think I understand him correctly. In the end these problems are so big and so complex, but I agree that they are in the end political problems and my fundamental belief is that the best and only way to solve them in the end is through major changes in the Chinese political system.

They are political problems, and people don't have the right to legal redress. They don't have the right to free expression. They don't have the right to their own property and these are big, big problems, the essential problems.

HEARING CO-CHAIR REINSCH: Yes. I wouldn't think anybody here would disagree with that, and this is very enlightening. I appreciate it. I guess where I was going was whether the status quo is sustainable for the long term. It seems to me the states where this kind of thing lingers on, if you will, are states that, among other things, are not very well integrated into the world system, where there is limited foreign investment, limited foreign interest, limited trade.

China is none of those, and China is an economy and a society that is rapidly becoming part of the global trading system, and I'm not sure the situation that you've described is one that is going to able to linger on, simply because there are too many outside connections. If the regime begins to take more repressive steps to sustain itself in the face of some of the pressures that you're talking about, then they're going to run into a whole bunch of problems from the outside as well as from the inside that would not be the case in some other countries.

I won't ask you to comment on that. That was just a reflection. We have a phone ringing.

DR. TANNER: Not mine. I'm just taking the hint and turning my off.

HEARING CO-CHAIR REINSCH: Oh, I see. Well, I have some sympathy for that. Exactly that happened at my son's wedding in the middle of the ceremony, the phone rang. It turned out to be the priest's, which was a novel development, but in any event, we--

COMMISSIONER MULLOY: You mean his phone rang?

HEARING CO-CHAIR REINSCH: Yes. To his great credit, he didn't answer it. In any event, we have at least two commissioners who indicated that they have an additional question, now three. So I'll turn the platform over to Mr. Wortzel.

HEARING CO-CHAIR WORTZEL: Having observed in Beijing the way the police and the military handled the Asian games, the 1995 U.N. Women's Conference and from a distance what happened at the WTO meetings in Hong Kong, I agree with you completely. Beijing will be a very quiet and controlled place, leading up and during the Olympics. I think it will spurn a lot of great economic development, and an awful lot of Beijing and Huairou and the areas outside town benefit from it economically and there are a lot of jobs created and infrastructure built, but there weren't any protests and they'll continue to be able to exercise that.

When you do see demonstrations, whether they're over land rights, whether they're over corruption, even whether they're over a bicycle accident, regardless of the size of the demonstration, the propensity towards violence is almost parabolic. Violence just rises really quickly. And I wonder if that might be because there's simply a high level of frustration and alienation among the populace?

You can't vote somebody out of office because they're corrupt or they're not providing services in China. It seems to me that the volatility of these demonstrations is getting worse, which only brings a stronger response from the security forces.

So I would like to hear your thoughts on the relationship between a propensity toward more violence and demonstrations and this frustration over political outlets?

DR. TANNER: Commissioner Wortzel, you and I have talked about this privately in the past, and I completely agree with you that this is a very important point for us to focus on, that while, assuming we take the Chinese law enforcement statistics to be reasonably indicative of what's going on, we have a long-term steady upward flow in the level of protests, but you're absolutely right. The danger here is that in systems like this that suffer collapse, there is a tendency for these things to spike very suddenly, and there is no guessing, no sociologists, no political scientist is good enough to forecast will be the cause of that sort of thing.

Dr. Wortzel and I had the great misfortune of both being in Beijing during the spring of 1989, during the demonstrations and the massacre there, and I think we would both agree that going into January and February of 1989, Beijing was a pretty apathetic, dull place in a lot of ways, particularly around the campuses.

There were some activities going on, but this was a pretty apathetic place. Who would have forecast the death of Hu Yaobang on April 15 would suddenly galvanize this protest, and so that is a real concern.

But you're also absolutely right that the evidence is that this is becoming an increasingly violent society. Group violence is on the rise. There's a number that's been floating in the press and for about the last two to three weeks of 87,000 social order incidents, and a lot of people have mistakenly--I've double checked the police figures--a lot of people have mistakenly thought that this is the annual update of the number of mass incidents, of protests. It's not. It's a different statistics.

What it is, however, is the number of incidents of group social order violence, brawling, bar fighting, things like that, and it should be no source of reassurance to the Chinese government that this is on the rise, particularly in a year when they otherwise had reasonably good success in dealing with a number of violent crimes.

This is, you're quite correct, a society in which small matters can turn to fisticuffs, beatings, knifings, violence, increasingly quickly. I don't want to compare it to a Sudan or a failed state or something like that, where the state has lost control over the monopoly on violence. But these sorts of things can get out of control much more quickly than they used to, and I'm quite sure that the security services know this, and responding to this and containing it quickly therefore becomes a major challenge for them.

I would simply note that in my written testimony, I highlighted the fact that the number of police officers who are dying in the line of duty and indeed dying as a result of attack--we now have

indications of how many are being attacked, not just dying in car accidents--are far higher than they used to be in the past, far higher than during the Mao era. This is an increasingly restive society.

DR. THURSTON: I would love to come in on this one? First of all, I was living in China throughout the 1980s. I spent half of my time in China, and in late August, early September of 1988, I wrote an article that was not published for several months saying that something is very, very wrong in this country, that people are very unhappy and very upset and something is going to happen.

So living there at the time, and taxi drivers, thank heavens for taxi drivers -- people were very upset. There was a lot of talk about political reform. So to my mind, the death of Hu Yaobang simply caused those protests to happen earlier. I thought certainly that something was going to happen on the anniversary of May 4, which is why I was there, because I wanted to be there for that demonstration, but it happened earlier.

So I was glad to be there. What do you mean you had the misfortune not to be there--and as you were asking your question, I was thinking of the spring of 1989. You're talking about this propensity to violence and for things to get out of hand so quickly. I have to say often in the streets of Beijing, late at night when I'm walking the streets and looking up and to see all these people in these buildings so crowded and so close together, why isn't there more violence?

But we had six weeks of utterly peaceful administrations in the city of Beijing with millions and millions and millions of people. I think that we shouldn't forget that. So the question then is why are these demonstrations that we're seeing now going so quickly to violence?

I think one of them is that the students were committed to nonviolence and one of the reasons that students were very, very reluctant to see worker participation is because they believed that the workers were not committed to the same level of nonviolence.

I haven't thought this through at all--I'm just thinking out of loud here--is that the students demands were very amorphous. They wanted democracy and goodness and that sort of thing. They were just there. But the demands in the countryside are very, very specific.

They know when their demands aren't going to be met and they know that they can't be met, and they are angry. The Chinese have this expression that they call "chiku," they can eat bitterness for a long period of time, but then something happens, some incident happens, and people snap, and then it just -- all hell breaks lose, and I guess that's what we're seeing in the countryside.

But don't forget that we had six weeks of peaceful demonstrations with millions of people participating.

DR. TANNER: And as I recall, the best downtown traffic management I ever saw in the city of Beijing was by the students.

HEARING CO-CHAIR REINSCH: Thank you. Ms. Bartholomew.

ACTING CHAIRMAN BARTHOLOMEW: Thank you. One comment and then a question. The comment actually directed toward

you, Commissioner Reinsch, on the issue of failed states. One of the reasons we're all concerned about failed states of course is because of the consequences when they become havens for non-party, non-state terrorist organizations. I'm not sure that economic investment is necessarily going to prevent that, and we look to Indonesia as a case of the possible teetering on the version of failed state status despite the fact that we had massive U.S. corporate investment and interest in it. So I'm just not quite sure that your example holds and I think that it is something that we should be thinking about 15, 20 years down the road as we adjust our policies Again, not implying that it's going to happen, but we don't know what's going to happen and some of these things are always possibilities.

Dr. Tanner, I'm going to introduce the topic, the topic of these mechanisms of control of information because in addition to people finding out what's going on, for any of these individual events or people involved in these individual events, to become some sort of movement, they need to be able to organize and organizing through the Internet or organizing through telecommunications is a pretty significant way to do it. And of course, there's been a lot of attention lately in this country on some of the complicity on the part of U.S. companies in helping with censorship and helping with control of information. I wonder if you could talk about that a little bit?

DR. TANNER: I'll choose my words carefully. First of all, the standard disclaimer always applies that my comments today are my own and do not represent those of the RAND Corporation or any of its sponsors. That said, I was profoundly dismayed by the reports about Google and Yahoo and I'll simply leave that editorial comment at that.

The rise of rapid telecommunications, of the Internet, of text messaging, cell phones, things like that in China, are a terrific factor facilitating the organization of protest. Law enforcement sources are absolutely unambiguous about this. That this is a problem for them.

They complain about, for example, increasingly suddenly arising protests or even ones that are coordinated to the point where two groups of people with essentially the same demand will arrange for protest to start in different parts of the city at the same time.

And that's clearly a challenge for them. At the same time, just a disclaimer or a qualification. That, in 1989, they did an astonishing job of organizing student protests with bicycle runners going from campus to campus, going all over town and giving messages. The darn telephones were useless back then.

You had to make three calls to get one through, and faxes were not widely available. So you can organize protests reasonably well by good old-fashioned word of mouth and foot traffic and a bicycle. But you're absolutely right. The rise in the telecommunications systems is still facilitating the speed with which these things can be brought to bear.

ACTING CHAIRMAN BARTHOLOMEW: Dr. Thurston, anything to add?

DR. THURSTON: No. One of the things I was certainly thinking about as Scot was talking is Falun Gong. The fact that they used the Internet, I gather, and faxes and phones and whatever to orchestrate a

demonstration of 10,000 people around Zhongnanhai, the seat of Communist Party power, suggests both the power of telecommunications to organize and also the reason that the Chinese government is so worried about it.

ACTING CHAIRMAN BARTHOLOMEW: Okay. One more quick question. Dr. Tanner, you mentioned these 10 million people who had participated in protests and hadn't had adverse consequences or hadn't been arrested and what does that ultimately mean. But, I'm wondering about this concept of kill a chicken to scare the monkeys. I presume that a number of the leaders of the events that they were involved in indeed have been imprisoned or have seen other consequences in their lives, and how--I know it's an amorphous question--but how free are people going to feel to be able to take from the lesson, that, well, I did it, and I got away with it when they see that other people didn't?

DR. TANNER: All I'm talking about is a historical change in the way that the state has dealt with people. I've been studying China for about 25 years now--astonishing to contemplate--distressing to contemplate--Dr. Wortzel has been at this at least five years longer than I have. If a group of people organized a protest to block the front of a local government building back in the 1950s or '60s, the consequences for every member of that group would have been severe.

I'm simply pointing out that while they are focusing on and being very tough on, as you say, the chickens, the leaders of the group, nevertheless, we don't see evidence that people who take part in protests are being rounded up in these sorts of numbers. If you read, it's instructive to read the extensive reporting that was done on the protests in Dongzhou, the ones that culminated in the shooting of the people on December 6, as I recall.

Those had been going on between six months to a year and leaders of the protest had been picked up, detained, roughed up, there had been tear gassings, things like that. People kept coming back, and so I would just simply point out, if you take their reports, their statistics and things semi-seriously, you have to reach the conclusion that there is now in Chinese society a significant number of people--I just make a guesstimate of about 10 million--who have probably taken part in some sort of a protest like this without suffering any major consequences, and that has got to send a message.

That's got to send a message.

HEARING CO-CHAIR REINSCH: Thank you. Mr. Wessel.

COMMISSIONER WESSEL: Dr. Thurston, I'd like to ask you a couple of operational questions, and if there are articles or information that we could read, that would be fine as well, if you want to respond in that way.

As it relates to these NGOs, understanding there is not one model, are they similar to many of our NGOs? The ACORNs, the Public Citizens, if you will, in terms of how they may organize at a local level? Do they become organic groups that gain great adherence? Do they organize in any way as we hear about all these protests?

Are the NGOs in any way leaders of some of those protests or are they really, if you will, sort of delivery organizations of health care, environmental access, et cetera? How do they, how do they operate?

DR. THURSTON: Thank you. That was an excellent question. I think they operate very differently. For instance, the ones that I am associated with in China's far west are essentially operated as voluntary associations. People are members of the NGOs and they serve as volunteers. Well, there is a paid staff within the NGO, but everybody works as volunteers to implement programs, to decide what programs they will sponsor and that sort of thing.

I would argue that they're quite democratic in the sense that decisions within the organization are made democratically by association members, and in terms of deciding what, well, after a decision has been made about which programs to support, they're implemented very democratically, and there is a thing in the development world called "Participatory Rural Assessment," and these organizations do try to go down into the countryside, into villages, and discuss with villagers what their needs are, and they work with them to decide what program makes sense or what programs make sense and then to have that carried out, those programs carried out by the people who will be the beneficiaries of the program.

These organizations serve to represent the interest of poor people, poor villagers, disadvantaged, to the local government, and I think that they probably conceive of themselves that way, but their larger goal is poverty alleviation, education, and I think that they would avoid like the plague being involved in any demonstrations because the price of that would have to be the end of the organization and certainly end of the leaders of the organization.

COMMISSIONER WESSEL: Does the government where they're doing this gap filling I guess you're indicating in some ways, meaning the development and the other issues or health care or anything else, are they therefore embraced by some of the local government as being able to do things that it cannot because of resources or anything else?

DR. THURSTON: It's a difficult relationship. It's not an easy relationship. But I think that there is a sense, again in the areas that I work with in the far west, that you can't really get anything done without government support.

For instance, you can build a school, but you need teachers for the school, and the county level government is responsible essentially for supplying the teachers. There are so many permissions you have to get to do anything in China that you always have to work with the local government.

So it's always this pushing and pulling between the NGOs and the local governments. But it's a mistake to assume that nobody in China and none of the government officials at the local level want education or health care. Everybody knows that there's a problem and the

question is how to work together cooperatively to solve the problem, and then when it can't be solved, what do you do then?

COMMISSIONER WESSEL: Thank you. If you have writings or other articles, at some point I would appreciate seeing any of those, and any advice as we look at possible travel there of what's good models to look at would be appreciated.

DR. THURSTON: Are you willing to go out into the far west and to see "other China," I would be delighted to try to--

COMMISSIONER WESSEL: If we're allowed to, yes.

DR. THURSTON: --to try to help you get there and I could. I would be delighted. Certainly one of my mantras in Washington is that we're not seeing this other part of China.

COMMISSIONER WESSEL: Great.

DR. THURSTON: And we need to.

HEARING CO-CHAIR REINSCH: Thank you.

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR REINSCH: Mr. D'Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman. This discussion about the unpredictability of events I think is very, very interesting and quite important in the Chinese case. Certainly one could hypothesize a confluence of events that would lead to some kind of a major disorder. When you're talking about 87,000 incidents, the scale of that, I can't really comprehend how the leadership sleeps at night knowing that 240 incidents are going to occur that by the next noontime.

Our ability to predict what will happen in a society like China is pretty limited. I can remember visiting Iran six months before the shah fled and the revolution there and it was sleepy hollow. No one was predicting that, and everybody said everything is fine here, this is a very stable society, Sadaq runs the place and you know nothing is ever going to happen here.

Within a year, it was all over. I think it's also quite important to understand the Chinese regime, the kind of attention they're giving the Internet, putting 30,000 police in place to monitor the Internet, forcing Google and Yahoo and Microsoft and Cisco to come their way, it shows the Chinese understand the power of ideas.

The power of ideas is formidable to shaping society, and I think that's certainly a lesson that we should take here. The pen in China, even in China, may be more powerful than the sword. Ideas count.

My question is this: do you think that it's important and prudent, given the unpredictability and confluence of events that could occur, and the power of ideas and their force, that the U.S. put into place at least some kind of contingency plan, some kind of contingency policies, what actions and initiatives we would take as a country given our role in China, investments in China, and growing relationship with China in the event of chaos or the rebellion or whatever you call it, disorder?

Do you see any indication at all that we understand what we would do in that event?

DR. TANNER: I feel that it's a superb question, Commissioner D'Amato. I feel the greatest sympathy for the people in our government who are responsible for monitoring events in China and advising our top leaders on what happens next, and that is the problem that they face that academics are freed of; right? They have to make their best guess what happens in the next couple of days, the next couple of months, ten, 20 years down the road.

The inherent unpredictability of something like this, the advice, the exact forecast, you should be giving someone is we don't see signs on the horizon right now that things are likely to go really bad very soon, but there are a number of social problems in China that could turn very serious very suddenly.

That's, of course, a terrible bit of advice to have to give to a leader because a leader will shoot back at you, well, yes, but what's going to happen in the next week, and you can't give a good response to that sort of thing.

We need to be thinking about this. We need to be thinking seriously and systematically about this, and, yes, I actually get the feeling that there are an awful lot of people, hardworking, responsible people in the U.S. government who are devoting a good deal of time to thinking about these things.

We've never seen anything like this before--the interaction of a country whose economy is growing at nine percent a year, continental-sized, whose military is growing at terrific pace and yet is being presided over and led by a government that is very good at repressing people, but is also internally very corrupt and increasingly subject to social unrest, that combination of those three things, state with serious problems, a rapidly growing military, a rapidly growing economy, how those three interact with one another is the major intelligence challenge for the United States for the next 20 years in dealing with China because there is no historical precedent I can think of for how you would deal with that.

DR. THURSTON: If I could just say a couple words. I know that the U.S. government is thinking about this because a number of years ago I participated in a simulation organized by the U.S. government. The scenario was that chaos had broken out in China, and we had in the simulation both Chinese leaders. I remember that I was the mayor of Shanghai, and we had--

ACTING CHAIRMAN BARTHOLOMEW: That's a distinguished position you have, a great future ahead of you.

DR. THURSTON: That's right. Exactly. That's right. I'm on my way up.

DR. TANNER: And a great chance for corruption.

DR. THURSTON: We had the U.S. government there deciding what to do, and I remember as the mayor of Shanghai, what I wanted was to get those migrant workers out. I did not, they had to leave this city no matter what, period. But I don't remember it that clearly right now, but the people who are representing the U.S. government were just stymied. They did not know what to do. What can we do?

HEARING CO-CHAIR REINSCH: Thank you. Mr. Mulloy.

COMMISSIONER MULLOY: Thank you, Commissioner Reinsch. Dr. Thurston, I just wanted to throw out one more problem. You cited on page four of your testimony that the women of China make up 20 percent of the world's female population, but they account for 56 percent of the world's female suicides.

I don't know whether you mean to link the two, but prior to that, you talk about the fact that there is an imbalance in China because of the one child policy. There are a lot more men than women because I guess when a family would prefer to have a male child than a female child, and if they have to, they'll abort the female and have the male.

Do you tie the female suicide high rate to the former problem of that there are males than females? Secondly, if you could both comment on what it means to have more males in a society than females in terms of social stability? I think that would be another issue we'd like to just get your opinions on.

Thank you.

DR. THURSTON: Thank you. Yes, excellent question and very sad, I think. Let me start with the last question, which is the issue of social stability. Well, let me just start with the whole general problem. First of all, there has always been a sex imbalance in China, by the way. There have always been more males than females in China.

The ratio has become much worse in recent years, and not just because of the one child per family policy. What's happened also is that we've talked about the health system, but one thing that has happened in rural China is that many areas have been able to buy sonograms and it happens generally in the countryside, almost everywhere in the Chinese countryside, two children are okay, and in many parts of the countryside, three and four are okay.

But it's usually at the second pregnancy, if the first child has been a girl, if the sonogram shows that the second one is also a girl, there is a high tendency to abort that child. And the ratio has gotten much worse in recent years. It's now at birth the ratio is something like 117 or 18 boys for every hundred girls.

In China, it's about 104- 106 males to females. And yes, what this means is that a significant--however long this goes on, you don't know how long this is going to happen because there is a self-correction that could come about when people realize that, hey, we don't have enough girls.

But the projection is that "x" number of Chinese men will not be able to marry. There is essentially universal marriage in China, and then what happens? And, there are a lot of people who believe that one of the best predictors of social instability is the number of unmarried young men in that society. So in terms of predicting social instability, this is a good predictor of social instability.

Now, is there a relationship between the level of suicide among women and--first of all, I think that unfortunately there have not been that many studies done of female suicide in China. My personal take on this is that it has a lot to do with the status of women in China.

What's happening now is that many of the men in the villages are going off to work in the cities and so you have whole villages that are just made up of women and old people.

But, most women in China are not native to the village. They come from outside the village so they're coming as strangers into the village. The social support system for women in Chinese villages is very small.

You have to make an effort to make friends because you don't know anybody there when you get there. People live in houses where there is a courtyard that has a wall around it, so you have to get outside of that in order to get the social support that's necessary. So it's a very tragic situation, but I'm not sure what the link is.

HEARING CO-CHAIR REINSCH: Thank you. I think we've reached the end unless there is someone with another comment. This has been very enlightening and we appreciate your contribution, also your patience in staying with us this long. It's been great.

Perhaps we can have you back on another occasion. If there is nothing further, with our thanks--there is something further.

ACTING CHAIRMAN BARTHOLOMEW: Just one comment which is these two days of hearings, as we said yesterday, were at Commissioner Reinsch's suggestion, and I really want to commend him. I think it's been a very interesting and enlightening two days. So thank you.

HEARING CO-CHAIR REINSCH: Thank you. The hearing is adjourned.

[Whereupon, at 11:30 a.m., Friday, February 3, 2006, the hearing was adjourned.]

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