

MAJOR CHALLENGES FACING THE CHINESE LEADERSHIP



**Statement by Senior Advisor James R. Keith
Bureau of East Asian and Pacific Affairs**

U.S.-China Economic and Security Review Commission

February 2, 2006

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, cooperative 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.

