JANUARY 13, 2005
JOSEPH J. BORICH
EXECUTIVE DIRECTOR,
WASHINGTON STATE CHINA RELATIONS COUNCIL
BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION
IMPACT OF U.S.-CHINA TRADE AND INVESTMENT ON NORTHWEST INDUSTRIES

Thank you for inviting me to meet with you today. The organization which I represent, the Washington State China Relations Council, takes a keen interest in the work of the Commission and in government policies and legislation in general that could enhance, or detract from, constructive, stable and mutually beneficial relations between the United States and China.

The reason for this is simple: international commerce is absolutely essential to the vitality of this state's economy, and China is our third-largest and fastest growing trade partnership.

International trade has always played a key role in Washington State's economy. In 2003, Washington exports to its top 50 markets were valued at over $34 billion (total income for the state in 2003 was $193.7 billion). Over the past 30 years, Washington exports have contributed to nearly one-half of the state's new jobs. It is estimated that by the end of 2005, one in three jobs in Washington will be directly or indirectly supported by international sales. Already, Washington exports support one job in four; if you add in imports, the proportion of jobs supported by international trade goes to one in three. Washington is the most trade dependent state in the nation.

Washington's leading export industry sectors in 2002 remained key sectors in 2003. After aerospace-related exports which were valued at over $20 billion in 2003, the top performers were oil seeds/fruit/grain ($1.6 billion), electric machinery/sound and TV equipment ($1.4 billion), industrial machinery ($1.4 billion), cereals ($1.1 billion), optic/photo and medical/surgical instruments ($809 million), mineral fuel ($735 million), and wood products ($679 million). Although not counted in merchandise trade statistics, the sale of Washington services to China – from architecture to software – would add tens of millions more to our total exports to China.

Two-way and throughput trade between the State of Washington and China in 2003 totaled over $15 billion, of which sales of Washington products represented $3.2 billion. Leading sectors included aerospace ($1.78 billion), oil seeds/fruit/grain ($878.3 million), iron and steel (61.6 million), industrial machinery ($60.2 million), optic/photo and medical/surgical instruments ($49.8 million), pulp and related products ($45.9 million), seafood ($40.5 million), and wood products ($33.8 million). But, Washington exports to China were spread among more than eighty industries. There is scarcely a sector of this state's economy not involved with China trade. On a per capita basis, Washington trades more with China than any other state; in aggregate terms we would rank number two or three.

That is why China is so important to Washingtonians. That is also why Washington business, agriculture and academic institutions created the Washington State China Relations Council 25 years ago and continue to support this organization today. (I would note here parenthetically that the first executive director of the WSCRC was Dr. Robert A. Kapp.)

The WSCRC is the oldest state-level, non-profit organization promoting commercial, academic and cultural relations with China. Our more than 130 member companies, colleges and universities and cultural organizations range from the largest in the state (in some cases, largest in the world) to some of the smallest. They represent manufacturing, services, agriculture, transportation and high-tech – virtually everything this state has to offer. They support the WSCRC because of China's importance to their overall goals and because the WSCRC assists them in meeting their goals. Beyond supporting our members, the WSCRC is committed to strengthening grass roots ties with China, deepening mutual understanding and developing business, academic and cultural opportunities in China for our state.

How do we accomplish this? Let me cite a few recent examples:

-- October 26-27: "U.S.-China Economic Summit." Together with our partners, China's Development Research Center (its top economic think tank) the National Committee on U.S.-China Relations, and the law firm Dorsey and Whitney LLP, we brought to Seattle American and Chinese economists, government officials and business executives to discuss China's development strategy and Sino-U.S. economic relations. Among the discussion topics were China's current economic situation and future prospects, its reform and development strategy; China's rural development and agricultural trade with the USA; intellectual property protection as it relates to foreign investment and economic cooperation; and further development of rule of law and government transparency.

-- October 19-21: "Market Access Strategies 2004 – China's Environment," held in Seattle, brought 40 Chinese environmental professionals to participate in a special program promoting business in Washington environmental products, equipment and services by giving the Chinese access to cost-effective and practical information on environmental technologies, management, and policy and compliance issues. We expect to follow up this program with an environmental industry study mission to China in the fall of 2005.

In addition, we will be hosting another event later this month, "World Expo 2010: Shanghai's Emergence as a World-Class City," that will provide Washington State companies an opportunity to interact directly with the Shanghai World Expo Organizing Committee, which is responsible for procuring the billions of dollars worth of products, technologies and services Shanghai will need as it prepares to host the 2010 World Expo.

We also work closely with the Washington State government and private organizations to promote exchanges with China. Delegations from Washington State co-organized by the WSCRC included those led by Governor Locke in 1997 and 2003; Washington State's Secretary of State in 1999; the Trade Development Alliance of Greater Seattle in 2000; and the Seattle Chamber of Commerce in 2003. In that same vein the WSCRC has also hosted many delegations from China, including one led by China's Minister of Commerce.

We firmly believe that more contact at all levels, not less, serves the overarching interests of both countries and brings benefits – both tangible and intangible – to the residents of this state.

Another service the WSCRC provides (primarily to its members) is a periodic newsletter, the "China Update," which provides reporting on and analysis of current events and trends in China and in U.S.-China relations. I have appended several articles from the "China Update" for your reference.

I apologize if I have gone on at too great a length in describing the WSCRC and some of its activities. I did so to underscore the fact that business and academe in Washington support the WSCRC and its activities precisely because of the importance this state attaches to China. Although I am not at liberty to discuss the activities or business plans of any WSCRC member (or, indeed, any company or organization), I can say that in general for Washington business China is already, or is rapidly becoming, the most important foreign market and key factor to overall success.

A recent study by the Washington State Department of Trade and Economic Development ranked China as the No. 1 future export market by Washington State companies. We believe Washington is well-positioned to see further growth in trade with China, as well as expansion of two-way investment in the coming years. As a center for information technology, biotechnology and medicine, aerospace and environmental technology, Washington has the products, technologies and services being sought by China's producers and consumers. Washington companies have a rich history of business relations with China and are keen to expand commercial ties both here and in China.

The above notwithstanding, the WSCRC and its members recognize that there remain significant challenges to doing business with China. As an organization we believe that China's speedy and full implementation of its WTO commitments offers the best prospect for mitigating those challenges and giving Washington businesses, farmers and workers fair access to the benefits of commercial relations with China.

As the dramatic growth in most categories of our state's exports to China over the past three years indicates, the half of China's WTO glass that has been filled – especially on tariff reductions – has had a salutary effect on our state's economy and underscores for us the desirability of China fulfilling the rest of its commitments in a timely manner. Among our concerns are the sometimes capricious and opaque applications by China of standards-related actions in agricultural and high tech trade that seem designed primarily to interfere with imports of certain products and technologies. We also have considerable interest in China meeting its commitment to grant trading and distribution rights to companies both foreign and domestic licensed to conduct business in China.

I think it is fair to say, though, that our chief concern is, and will likely remain for some time to come, inadequate protection in China of intellectual property. WSCRC members and, more broadly, Washington companies own some of the world's most significant trademarks, patents, copyrights and proprietary technical information. The threat to our companies of having to compete with Chinese knock-off products and of damaged corporate reputations because of inferior products masquerading as originals not only in China, but globally is very costly to WSCRC members and our state.

We applaud the efforts China has made to strengthen the legal framework for protecting intellectual property. We further applaud the detailed plan enunciated in September 2004 by Vice Premier Wu Yi to put teeth in China's legal protections through education programs and tougher enforcement. It is certainly in China's interests to turn this problem around. Unfettered theft of intellectual property risks curtailing not only additional foreign direct investment, but the contributions of domestic creativity that are vital to China's economic development. There is much that remains to be done in this critical area. We trust that this Commission and the administration will continue to focus on the problem.

If I may, I would like to offer a few general observations based on my experiences as a Foreign Service Officer for 25 years – most of that time working in China, or on China issues in the State Department – and as the executive director of the WSCRC.

--For the past twenty five years, China has been embarked on a program of transforming its economy, and with remarkable success. Yet, it remains in many respects a fragile economy with great disparities among various regions and sectors. China's economy will strain to meet the rising demands of a population already more than 1.3 billion and projected to grow to about 1.6 billion by the middle of this century. China's principal concern over most of this century thus will be how to achieve balanced, steady growth and development throughout the country. China's economy still has many structural weaknesses that, in the short run at least, are likely to be exacerbated by its accession to the WTO. So, too, is social and political cohesion fragile in some respects. It may well be that the threat from China — if there ever is one — will result not from the success of its modernization effort, but rather from the failure of that effort.

--A constructive, cooperative partnership between China and the U.S. must be the foremost foreign policy goal for both governments in this century. How well both sides manage that relationship will largely determine whether the 21st Century is remembered as one of peace and prosperity, or one of conflict and suffering. Although there are many areas where our interests are identical or are in parallel, there are and will likely remain fundamental differences in our two systems. Given the importance of each country for the other, we must continue to manage our differences successfully. Therefore, both sides need to keep their list of expectations short and focused on what is truly essential to our respective national interests.

--Try though we may, we are not going to “fix” China. The threat of sanctions and other coercive actions have simply not worked and always carry the risk of unintended (and unwanted) consequences. We can, perhaps, influence China’s policies and the course of its development – at least on the margins – but only if we remain fully engaged from the head-of-state level on down to the grass roots. While “engagement” may sound like a truism, it is not without obstacles whether intended or not. I am referring here specifically to the policy and practice of U.S. visa processing in China. Long delays and the high rate of refusals for Chinese applying to come to Washington for business or study are seriously impairing our state’s businesses and educational institutions.

--Finally, I must question the wisdom for reconsidering our one-China policy. As then-director of the State Department’s Taiwan Coordination Staff from 1992-1994, I had a role in a full-dress, interagency Taiwan policy review. Although room was found for a few marginal adjustments to that policy, the core principles as embodied in the three Joint Communiqués and the Taiwan Relations Act could simply not be voided or substantially altered without putting at severe risk stability in the Taiwan Strait and indeed, East Asia as a whole. As inelegant and unreflective of the dramatic changes in Taiwan that have occurred as this policy might be, I would posit that for the United States there are still no good alternatives to continuing to encourage both sides to seek a peaceful resolution.

Thank you again for the opportunity to offer my comments today.

APPENDIX
EXCERPTS FROM THE "CHINA UPDATE"

RENMINBI REVALUATION – PROS AND CONS (AUGUST 2003)

Assuming that the U.S. government and not markets should be managing trade with China (an assumption I would not support), persuading Beijing to revalue the RMB vs. the U.S. Dollar is probably the least government-intrusive means of lowering our trade deficit. Increasing the value of the RMB should in theory make Chinese exports to the U.S. more costly, while lowering somewhat the price of U.S.-made products sold in China.

The RMB is currently trading within a very narrow range of 8.276-8.28 to the U.S. Dollar, a peg it has maintained with great consistency (even through the Asian financial crisis of the late 1990s) since it scrapped its dual currency system in 1994. Over the past year or so as a weak economy and burgeoning trade deficits lowered the U.S. Dollar against the Euro (it would also have probably declined against the Japanese Yen except for repeated interventions by Japan's central bank) the pegged RMB has dropped with it, effectively mitigating a price increase for Chinese exports and giving no advantage to U.S. exporters. Some economists estimate that the RMB is currently undervalued by anywhere from 15-40 percent.

But, determining just how undervalued the RMB is (if at all) cannot be easily accomplished. Basing a determination solely on China's current account surplus and foreign exchange reserves is misleading. Since China maintains capital controls, foreign currency cannot move freely in and out of China. If those controls were lifted and Chinese citizens were free to exchange their collective equivalent of over USD1 trillion in savings for Dollars or Euros and invest or spend them abroad, there could be a run on foreign, convertible currencies creating pressure to drive the RMB value even lower than it is now. So, dropping capital account controls and allowing the RMB to float freely against other currencies might have the opposite effect from what Treasury Secretary Snow and others are seeking.

Even if China's government allows a limited revaluing of the RMB and establishes a new peg at a somewhat higher rate the effect on overall trade flows for the U.S. and Europe will probably be very limited to non-existent, even if it lowers marginally the U.S.' bilateral trade deficit with China. Much of what China exports to the U.S. are labor intensive products such as toys, footwear and textiles. As China's share of the U.S. market for such products has grown to over 60 percent in the last decade, so has Taiwan's, South Korea's and Hong Kong's combined share declined by roughly the same amount. Forcing up the import costs of such products from China by revaluing the RMB will not bring manufacturing and jobs back to the U.S.; rather, it will drive production to even lower-cost countries.

High-end products such as computers are for the most part assembled rather than manufactured in China. The sophisticated components that inform high-end products are largely manufactured in the U.S., South Korea and Taiwan, then put together, encased and (somewhat misleadingly) labeled "Made in China" by low-cost Chinese workers. In fact, over half the value of China's imports and exports is accounted for by this kind of export processing.

At the same time that trade with China and other Asian countries continues to grow rapidly and our trade deficit with China is mushrooming into uncharted territory, our overall trade deficit with Asia is declining as a percentage of our global trade deficit. This is so because of trade displacement within Asia (i.e., Japan, South Korea, Taiwan, et al. shifting production of U.S.-bound exports to China), and the growing share of the U.S. market going to the EU, Canada and Mexico. Revaluation of the RMB may slow the trade displacement trend within Asia, but it will do little or nothing to ease our global trade deficit.

But, you may ask, wouldn't RMB revaluation boost sales of U.S. products in China, even if it does next to nothing to reduce U.S. imports? Perhaps somewhat in the short run, but U.S. investment in China is increasingly aimed at China's large and rapidly growing domestic market, and thus is substituting for direct exports of products manufactured in the U.S. A significant lowering of imported goods prices because of a RMB appreciation might create a temporary spike in U.S. exports to China of both producer and consumer products, especially now that both producers and consumers there are ramping up spending. But over time more and more of Chinese demand for U.S. products will be supplied by U.S. manufacturing in China.

In any event, the arguments for and against RMB revaluation may be moot, at least for the time being. Despite some indications in July 2003 that Beijing was contemplating both a wider trading band for the RMB and eventual relaxation of capital account controls, China's Premier Wen Jiabao in early August 2003 said that "To keep the stable RMB will not only benefit the stability and development of the economic and financial order in China, but also the economic and financial order of surrounding countries, and the international economic and financial order." In other words, relaxing currency controls and allowing the RMB to float would, in the opinion of China's government, put the future development of China's burgeoning but still relatively underdeveloped economy and the global financial system at considerable uncertainty if not outright risk. In that, Premier Wen is probably right, although not for reasons that redound to China's glory. The possibility of unobstructed capital flight and the impact on China's state banking system of suddenly exposed $500 billion in bad (and mostly unrecoverable) loans should give pause to China's Premier, and the heads of central banks everywhere.

SUMMER OF OUR DISCONTENT (JULY 2004)

Although the threat of imminent conflict in the Taiwan Strait remains relatively low, tensions there have risen steadily over the past five months since the re-election of Taiwan’s president Chen Shui-bian. Despite the close margin of victory (Chen won by about 30,000 votes of the 13 million cast and the two referenda he placed on the ballot were both defeated under Taiwan’s referendum rules), the widespread view is that Chen will not be deterred from pursuing his pro-Taiwan independence agenda, especially if the DPP and its coalition partners win a victory in the legislative elections coming later this year.

The expectation that there will be four more years of Taiwan independence salami-slicing by Chen has raised alarm in Beijing, led to rancorous debate over the PRC's recent "soft" policy toward Taiwan, and created a fair amount consternation for U.S. policy makers. And, although Chen sought to assuage in his second inaugural address the most extreme concerns over his quest for Taiwan independence (as he did in his first inaugural in 2000), he nevertheless left the door wide open for future referenda, as well as a "re-engineering" of the ROC constitution during his second term. While "re-engineering" apparently does not include such explosive issues as a name change for Taiwan or a declaration of independence, it probably does include, at minimum, the Taiwan indigenization of the ROC constitution which, inter alia, would almost certainly embed in it the concept of Taiwan sovereignty.

Relations across the Taiwan Strait remain essentially frozen with no prospect in the near term, at least, for a resumption of cross-Strait dialog. Beijing will not drop its insistence that Taiwan accept the "one-China" precondition for the resumption of dialog, nor will Chen accept that precondition. The political impasse weighs more heavily on Beijing than it does on Taiwan, or at least on Chen Shui-bian. With no apparent prospect that Chen will ever yield to Beijing's "one-China" precondition, or even treat with the PRC under any conditions save Beijing's acceptance of Taiwan sovereignty, the long simmering debate in the PRC over how to deal with Taiwan is reaching full boil again.

In the 1996 and 2000 Taiwan elections, the PRC sought to influence the outcome by adopting hard line tactics. In 1996, the PRC launched massive joint force military exercises near the Taiwan Strait that included test missile firings over the northern and southern tips of Taiwan. In 2000, China's top leadership warned of "dire consequences" if Chen were elected. In both cases, the hard line approach failed to achieve Beijing's desired result. Mindful of that fact and aware of the growing economic integration between Taiwan and the PRC, China's leadership opted more recently to foreswear cruder attempts to influence political outcomes in Taiwan and focus instead on maintaining Taiwan's international isolation while playing the economic integration card for all it was worth. The judgment behind this policy shift was that as time went on, frustration in Taiwan over diplomatic isolation plus the growing attraction of the PRC's increasingly powerful economy would make some kind of cross-Strait accommodation a plausible alternative for the majority of Taiwanese.

This policy and the judgment behind it failed its first test in the 2004 Taiwan elections, though not by much. Although Beijing might take some solace from the whisker-thin majority that Chen received, they could do so only by choosing to ignore the fundamental political and socio-cultural shift that has taken place in Taiwan over the past four years. That shift does not auger well for a Taiwan embrace of the Mainland. The process of "indigenization" is now well underway and with it, the increasingly widespread acknowledgement among Taiwanese that they are politically, culturally and historically distinct from their cousins on the Mainland. This tectonic shift toward a distinct self-identity has been accompanied by a similar shift in the political center of gravity in Taiwan. As recently as the 2000 election the KMT was able to include in its platform a call for eventual reunification. By 2004, the coalition “Pan-Blue” successor to the KMT was forced to spend a good bit of its campaign defending its candidates against DPP charges that they were too close to China and not pro-Taiwan enough. In short, the differences among political parties in Taiwan over whether Taiwan should seek any arrangement with the PRC has narrowed greatly, and shifted toward the “no deal” end of the spectrum.

This shift has left Beijing without an effective Taiwan policy. The dwindling number of “soft approach” advocates cling to the view that indigenization need not inevitably lead to permanent, sovereign separation (or a Taiwan Strait conflict to prevent that from happening), and that even an indigenized Taiwan could still be persuaded to join in some arrangement with the motherland especially if the PRC continues on the course of economic and political reform.

Nevertheless, Beijing hardliners seem once again on the ascendancy. The PRC, for example, was quick to use the divisive Taiwan election and angry demonstrations that followed in its immediate aftermath as a possible pretext for direct intervention, stating that China could not stand idly by if Taiwan descended into chaos. More recently, the PRC has chosen to give significant publicity to its annual military exercises in the Taiwan Strait, in contrast to the low key approach it had taken in recent years. This year’s exercise involved 18,000 troops, the largest force assembled for this exercise since the near-crisis in the Taiwan Strait in 1996. Moreover, this year’s exercise featured a display of virtually all the high tech equipment in the PLA’s arsenal. More thought is reportedly now being given in Beijing toward a possible early “surgical strike” against Taiwan, rather than wait until after the 2008 Beijing Olympics for a larger scale and possibly prolonged conflict.

Whether anticipating the worst or simply seeking to send signals of its own, Taiwan has also stepped up military exercises and publicity of its war preparedness. For the first time since the late 1970s, Taiwan this summer resumed practice take-offs and landings of its fighter aircraft on Taiwan’s expressways near air force bases, an emergency procedure that would be put into play if its bases were knocked out by PRC air strikes. Taipei is also reportedly seeking Singapore’s and the Philippines’ cooperation to evacuate Taiwan’s leaders in case of war.

Heightened tensions in the Strait have been abetted somewhat by the unfortunate timing of Pentagon activities. Unprecedentedly large-scale U.S. Navy exercises this summer culminated in positioning seven of the twelve U.S. carrier groups within striking distance of the PRC in July. In June, U.S. war game planners proposed that in the event Taiwan were attacked by the PRC it could retaliate by hitting high value PRC targets such as the Three Gorges Dam.

Although it is extremely unlikely that the U.S. political leadership intended either of these activities as a signal to Beijing (and, in fact, the White House was probably not aware of the war games proposal until after the media got a hold of it), the reactions in both Beijing and Taipei served to underscore once again the unavoidable shadow that the U.S. casts over the Strait, whether we like it or not. That being the case, our policies toward the Mainland and Taiwan must be clear and consistent. They are currently neither, thus raising the risk of conflict in the Strait.

President Bush made clear upon taking office that he wanted to end nearly 30 years of creative ambiguity over our relations with Taiwan and the Mainland. As an outgrowth of that desire, two salient points have emerged over the past three years that sum up the Bush administration policy toward the issue of cross Strait relations. Point one was delivered in April 2001 when Bush said that the U.S. would "do whatever it takes" to defend Taiwan if it were attacked. Point two surfaced during a press conference with PRC premier Wen Jiabao when he warned against unilateral action by either side that could destabilize the Taiwan Strait. On the latter point, he was specifically referring to President Chen's just-announced plan to conduct a referendum in conjunction with the March 2004 presidential elections in Taiwan. There are also two other points to our policy which did not originate with the Bush administration, but which the Bush administration has embraced – that the U.S. does not support Taiwan independence and that it desires a peaceful outcome to the Taiwan Strait issue, one that is acceptable to both sides.

On the surface we appear to be delivering a fairly clear message: "PRC: don't attack Taiwan; Taiwan: don't provoke an attack by the PRC; both sides: work together to solve this issue." Why, then, are tensions rising in the Taiwan Strait? Because our actions have not matched our words and indeed are shrouding our supposedly clear policy in greater, not less, ambiguity, creating a vacuum which both Beijing and Taipei feel pressed to fill.

The principal "actions" culprit is our continuing – indeed, accelerating – support for Taiwan's military. Soon, Taiwan will begin taking delivery of the $18.2 billion arms package that President Bush approved in 2001. The package includes Patriot anti-missile batteries, submarines and anti-submarine aircraft. The U.S. military is also permitting, even encouraging, more direct contact, communication and coordination between the U.S. Pacific Command and Taiwan's military commanders.

The rationale for our continuing efforts to beef up Taiwan's military capability (which by now irrefutably abrogate our pledge to China in the 1982 Joint Communiqué to "gradually decrease the quantity and quality" of arms we would sell to Taiwan) has been that a Taiwan confident of its capability to resist a Mainland attack would be more willing to talk with the Mainland and seek an arrangement acceptable to both sides. What has happened instead is that our growing support for, and involvement with, Taiwan's military is being increasingly viewed on Taiwan (and especially by the ruling party leadership) as a signal of U.S. support of Taiwan's political goals, including eventual independence. As a senior Mainland diplomat said to me recently: "When you tell Chen Shui-bian not to destabilize the Taiwan Strait, that has no teeth; when you sell $18 billion worth of arms to Taiwan, that has teeth."

While a cut-off of arms sales to Taiwan would be politically unsupportable in the U.S., we need to formulate a more precise and convincing rationale for any future sales or military-to-military contacts with Taiwan, one that would advance our goal of peaceful resolution of the Taiwan Strait issue. Our position now is anything but precise, is not advancing our policy goal, and is being subjected to a variety of interpretations in the manner in which it is articulated among various agencies of the U.S. government. The policy vacuum we are creating invites miscalculations on both sides of the Strait that could quickly transform into armed conflict.