

EXECUTIVE SUMMARY

The 2008 Annual Report to Congress of the U.S.-China Economic and Security Review Commission sets forth the Commission's analysis of the U.S.-China relationship in the topical areas designated by the Commission's Congressional mandate: the areas for the Commission to consider and about which it is to make recommendations to the Congress. These include China's proliferation practices, the qualitative and quantitative nature of economic transfers of U.S. production activities to China, the effect of China's development on world energy supplies, the access to and use of U.S. capital markets by China, China's regional economic and security impacts, U.S.-China bilateral programs and agreements, China's compliance with its accession agreement to the World Trade Organization (WTO), and the implications of China's restrictions on freedom of expression. Our analysis, along with recommendations to the Congress for addressing identified concerns, is chronicled in the Report and summarized herein.

COMMISSION ASSESSMENT OF U.S.-CHINA ECONOMIC AND SECURITY RELATIONS

Congress gave the Commission the mission of evaluating "the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China" and reporting its evaluation to Congress annually together with its findings concerning the topical areas listed above. The Commission adopts a broad interpretation of "national security" in making its review and its evaluation of how the U.S.-China relationship affects the economic health and industrial base of the United States, the military and proliferation risks China poses to the United States, and the threat to U.S. economic and security interests and influence in Asia.

As in its previous five Annual Reports, the Commission sees progress on some issues but the continuation of a number of troubling trends. The Commission also notes that it continues to stand behind both its conclusions as enunciated in the previous Reports to Congress—unless it specifies in this Report that a circumstance and therefore the Commission's conclusion regarding a particular issue has changed—and its recommendations to Congress contained in those Reports, and it does not routinely repeat either its conclusions or recommendations from prior Reports.

COMMISSION CONCLUSIONS

The Report presents its conclusions, analyses, and recommendations to Congress in 17 segments organized in six chapters. However, the Commission has attempted to take an integrated approach to its assessments, believing that economic, security, and other issues are interrelated. The intersections of U.S. geopolitical,

economic, security, diplomatic, and cultural interests form a complex web of concerns that are connected to the overall relationship between the United States of America and the People's Republic of China.

The Commission's conclusions are included in this Executive Summary. At the end of this summary, the Commission's 10 key recommendations are listed. The Commission makes a total of 45 recommendations to the Congress in this Report. Those pertaining to each of the six Report chapters appear at the conclusion of the chapter, and a comprehensive list is provided beginning on page 337.

The U.S.-China Trade and Economic Relationship

China held to its hybrid model of a state-directed economic system throughout 2008 as it consolidated its position as one of the world's fastest-growing countries. Alone among the world's major economies, China refuses to allow the renminbi (RMB), its currency, to respond to free market movements. China's leaders instead keep the currency trading at an artificially low level in order to suppress export prices—a deliberate violation of the rules of the International Monetary Fund, of which it is a member. As a result of this and other factors, China's current account surplus with the United States and the rest of the world soared and added to China's record foreign exchange reserves of nearly \$2 trillion when this Report was completed, up from \$1.43 trillion at the publication of the Commission's Report a year ago. China began employing this foreign exchange in new ways. Rather than using it to improve the standard of living for the Chinese people through education, health care, or pension systems, China began investing the money through new overseas investment vehicles, including an official sovereign wealth fund, the China Investment Corporation. Despite statements by Chinese leaders that they seek only financial gain from diversifying their investments into equity stakes in western companies, there are increasing suspicions that China intends to use its cash to gain political advantage globally and to lock up supplies of scarce resources around the world.

Other Chinese government economic policies harmed the United States, China's trading partners, and its own citizens. China made scant progress in reining in the rampant counterfeiting and piracy that deprive legitimate foreign businesses operating in China of their intellectual property, while they provide an effective subsidy to Chinese companies that make use of stolen software and other advanced technology. Chinese regulators failed to prevent the domestic sale and export of consumer goods tainted with industrial chemicals and fraudulent ingredients. In one case examined by the Commission, China's lax controls on the production and handling of its seafood exports led to a partial U.S. ban for health reasons on imported Chinese seafood. Yet, thanks to artificially low prices partly resulting from an array of subsidies to its seafood industry, China has become the largest exporter of seafood to the United States.

Conclusions

The U.S.-China Trade and Economic Relationship's Current Status and Significant Changes During 2008

- China's trade surplus with the United States remains large, despite the global economic slowdown. The U.S. trade deficit in goods with China through August 2008 was \$167.7 billion, which represents an increase of 2.4 percent over the same period in 2007. Since China joined the WTO in 2001, the United States has accumulated a \$1.16 trillion goods deficit with China and, as a result of the persistent trade imbalance, by August 2008 China had accumulated nearly \$2 trillion in foreign currency reserves. China's trade relationship with the United States continues to be severely unbalanced.
- The U.S. current account deficit causes considerable anxiety among both economists and foreign investors who worry that future taxpayers will find it increasingly difficult to meet both principal and interest payments on such a large debt. The total debt burden already is having a significant impact on economic growth, which will only increase in severity.
- China's currency has strengthened against the U.S. dollar by more than 18.5 percent since the government announced in July 2005 it was transitioning from a hard peg to the dollar to a "managed float." Starting in July 2008, however, the rate of the RMB's appreciation has slowed, and there are some indications this may be due to the Chinese government's fear that a strong RMB will damage China's exports. China's RMB remains significantly undervalued.
- China continues to violate its WTO commitments to avoid trade-distorting measures. Among the trade-related situations in China that are counter to those commitments are restricted market access for foreign financial news services, books, films and other media; weak intellectual property protection; sustained use of domestic and export subsidies; lack of transparency in regulatory processes; continued emphasis on implementing policies that protect and promote domestic industries to the disadvantage of foreign competition; import barriers and export preferences; and limitations on foreign investment or ownership in certain sectors of the economy.
- Over the past year, China has adopted a battery of new laws and policies that may restrict foreign access to China's markets and protect and assist domestic producers. These measures include new antimonopoly and patent laws and increased tax rebates to textile manufacturers. The full impact of these laws is not yet known, particularly whether they will help or hinder fair trade and investment.
- In 2008, China emerged as a stronger power within the WTO as it took a more assertive role in the Doha Round of multilateral trade talks, working with India and other less-developed nations to insist on protection for subsistence farmers.

China's Capital Investment Vehicles and Implications for the U.S. Economy and National Security

- The significant expansion of the Chinese government's involvement in the international economy in general and in the U.S. economy in particular has concerned many economists and government officials due to uncertainty about the Chinese government's and the Chinese Communist Party's motivations, strategies, and possible impacts on market stability and national security. At the same time, cash-strapped U.S. firms have welcomed the investments, viewing them as stable and secure sources of financing in the wake of the credit crunch.
- China's government uses a number of state-controlled investment vehicles among which it chooses depending on its particular investment purposes and strategies; most widely known among such vehicles are China Investment Corporation (CIC), the State Administration for Foreign Exchange (SAFE), and China International Trust and Investment Corporation (CITIC).
- Some aspects of China Investment Corporation's mandate follow China's industrial policy planning and promotion of domestic industries by, for example, investing in natural resources and emerging markets that are relevant for the advancement of China's value-added industries. CIC and SAFE form just one part of a complex web of state-owned banks, state-owned companies and industries, and pension funds, all of which receive financing and instructions from the central government, promote a state-led development agenda, and have varying levels of transparency. Many of their investment activities contravene official assurances that they are not being managed to wield political influence.
- Regulations governing investments by sovereign wealth funds, especially disclosure requirements pertaining to their transactions and ownership stakes, are still in development, both in the multilateral arena and in the United States. There is concern that the Chinese government can hide its ownership of U.S. companies by using stakes in private equity vehicles like hedge or investment funds.
- China's foreign exchange reserves continue to grow, while its management of the exchange rate has given it monopoly control on outward flows of investment. This strongly suggests that China will have a very substantial and long-term presence in the U.S. economy through equity stakes; loans; mergers and acquisitions; ownership of land, factories, and companies; and other forms of investment.

Research and Development, Technological Advances in Some Key Industries, and Changing Trade Flows with China

- China has been pursuing a government policy designed to make China a technology superpower and to enhance its exports. Some of its tactics violate free market principles—specifically its use of subsidies and an artificially low RMB value to attract foreign investment.

- Foreign technology companies, such as U.S. and European computer, aerospace, and automotive firms, have invested heavily in research and development and production facilities in China, sharing or losing technology and other know-how. Chinese manufacturers have benefitted from this investment.
- The U.S. government has not established any effective policies or mechanisms at the federal level to retain research and development facilities within its borders.
- China's trade surplus in advanced technology products is growing rapidly, while the United States is running an ever-larger deficit in technology trade. China also is pursuing a strategy of creating an integrated technology sector to reduce its dependence on manufacturing inputs.
- China seeks to become a global power in aerospace and join the United States and Europe in producing large passenger aircraft. China also seeks to join the United States, Germany, and Japan as major global automobile producers. So far as China competes fairly with other nations, this need not be a concern. But China's penchant for using currency manipulation, industrial subsidies, and intellectual property theft to gain an advantage violates international norms.

A Case Study of the Local Impact of Trade with China: Seafood Imports from China into Louisiana and the U.S. Gulf Coast, and Related Safety Issues

- Many fish imports from Chinese aquaculture pose a health risk because of the unsanitary conditions of some Chinese fish farms, including water polluted by untreated sewage; fish contaminated by bacteria, viruses, and parasites; and fish treated with antibiotics and other veterinary medicines that are banned in the United States as dangerous to human health.
- Since 2001, China has become the world's dominant seafood exporter, due in large part to the government's promotion of industrial fish farming and the application of extensive government subsidies to the industry, including cheap fuel, outright construction grants, and free use of reservoirs and rivers.
- China is building an industrialized aquaculture sector through the use of extensive subsidies. In addition to producing food for domestic consumption, China has succeeded in creating a large aquaculture export industry as part of the government's overall industrial policy. As a result, China now is the largest volume exporter of fish to the United States, shipping more than one billion pounds annually, or one in five pounds of seafood eaten by Americans.
- Import-sensitive seafood product lines in the Gulf of Mexico region of the United States, such as shrimp, crawfish, and catfish, have suffered significant declines as a result of Chinese imports. Predicted long-term trends for the Gulf seafood industry are for flat or lower sales.

- Antidumping penalties imposed by the United States on Chinese shrimp and crawfish exports sold at below market value accomplished little of their intended effect. This appears to be due in part to transshipment by China through ports of other Asian nations in order to avoid the penalty tariffs and in part to the failure to collect the penalty tariffs.
- The U.S. Food and Drug Administration (FDA), with responsibility for monitoring imports of fish, does not yet have the authority or the personnel to inspect fish farms or processors in China nor to require and enforce regulation of Chinese aquaculture by the Chinese government equivalent to U.S. Department of Agriculture requirements for foreign meat and poultry producers. The European Union, Japan, Canada, and even Hong Kong have more rigorous inspection regimes.
- The FDA lacks the authority to seize and destroy seafood shipments it has rejected for import into the United States. In some cases, the FDA must relinquish the fish to the shipper, which has led to a practice known as “port shopping” in which importers try to bring seafood rejected at one U.S. port through another one. The situation is exacerbated by the fact that it takes the FDA, on average, a year to notify U.S. ports of the potential for a banned shipment to attempt to enter at another port. The FDA also lacks the authority to order a mandatory recall of seafood or even to block imports of Chinese seafood at the request of Chinese officials.
- In an effort to forestall epidemic diseases due to overcrowding and to compensate for the use of water polluted by agricultural fertilizers, industrial wastes, and partially treated sewage, Chinese fish farmers, acting on unscientific advice, often add chemicals and pharmaceuticals to the water of their farms.
- The challenge of assuring that Chinese-produced seafood meets minimal quality standards is exacerbated by the fact that there is little traceability or accountability of the products of China’s 4.5 million fish farms and one million processors, most of them small operations whose products are aggregated by wholesalers and processors.
- The current form of a memorandum of agreement addressing seafood safety and related procedures that is being negotiated by the U.S. and People’s Republic of China governments would allow the U.S. Food and Drug Administration to monitor the performance of various Chinese government agencies in ensuring the safety of China’s seafood exports but would not provide the FDA with the authority to conduct its own inspections in China.
- The current Country of Origin Label regulations pertaining to imported fish are ineffective because of the many exemptions the law provides.

China’s Activities Directly Affecting U.S. Security Interests

China’s record of proliferating weapons of mass destruction or effect has improved in recent years, and the nation has played a significant role in some important nonproliferation activities such as

the Six-Party Talks intended to denuclearize North Korea. However, the United States continues to have concerns about the commitment of China's leadership to nonproliferation and to enforcing the strengthened nonproliferation laws and procedures the nation has established and about China's refusal to participate in some international nonproliferation agreements and regimes. The United States also is concerned that the nuclear power technology China is selling to other nations may result in nuclear proliferation.

China increasingly is devising unique interpretations of agreements or treaties to which it is a party that have the effect of expanding the territory over which it claims sovereignty and rationalizing such expansions, particularly outward from its coast and upward into outer space. This development, coupled with its military modernization, its development of impressive but disturbing capabilities for military use of space and cyber warfare, and its demonstrated employment of these capabilities, suggest China is intent on expanding its sphere of control even at the expense of its Asian neighbors and the United States and in contravention of international consensus and formal treaties and agreements. These tendencies quite possibly will be exacerbated by China's growing need for natural resources to support its population and economy that it cannot obtain domestically. The United States should watch these trends closely and act to protect its interests where they are threatened.

Conclusions

China's Proliferation Policies and Practices

- China has made progress in developing nonproliferation policies and mechanisms to implement those policies. Although it is apparent that China is making some meaningful efforts to establish a culture and norms supporting some aspects of nonproliferation within its bureaucracy and industry, gaps remain in the policies, the strength of government support for them, and their enforcement.
- Although China has acceded to numerous international agreements on nonproliferation and has cooperated with the United States on some nonproliferation issues (e.g., the Six-Party Talks), China has been reluctant to participate fully in U.S.-led nonproliferation efforts such as the Proliferation Security Initiative and in multilateral efforts to persuade Iran to cease its uranium enrichment and other nuclear development activities.
- China's support for multilateral negotiations with North Korea can help to reduce tensions on the Korean Peninsula, open North Korea to dialogue, and improve bilateral relations among the countries participating in the process—which may be crucial ingredients for peace and cooperation in northeast Asia and beyond.
- Experts have expressed concerns that China's sales or transfers of nuclear energy technology to other nations may create conditions for proliferation of nuclear weapons expertise, technology, and related materials. These activities also could feed the insecur-

rities of other nations and cause them to pursue their own nuclear weapons development efforts. This could lead to an increase in the number of nations possessing nuclear weapons capability.

China's Views of Sovereignty and Methods of Controlling Access to its Territory

- China's leaders adamantly resist any activity they perceive to interfere with China's claims to territorial sovereignty. At times this priority conflicts with international norms and practices.
- Some experts within China are attempting to assert a view that China is entitled to sovereignty over outer space above its territory, contrary to international practice. If this becomes Chinese policy, it could set the stage for conflict with the United States and other nations that expect the right of passage for their spacecraft.
- China has asserted sovereignty over the seas and airspace in an Exclusive Economic Zone that extends 200 miles from its coastal baseline. This already has produced disputes with the United States and other nations and brings the prospect of conflict in the future.
- Any assertions by Chinese officials of sovereignty in the maritime, air, and outer space domains are not just a bilateral issue between the United States and China. The global economy is dependent upon the fundamental principles of freedom of navigation of the seas and air space, and treatment of outer space as a global "commons" without borders. All nations that benefit from the use of these domains would be adversely affected by the encroachment of Chinese sovereignty claims.
- China's efforts to alter the balance of sovereignty rights are part of its overall access control strategy and could have an impact on the perceived legitimacy of U.S. military operations in the region, especially in times of crisis.
- China is building a legal case for its own unique interpretation of international treaties and agreements. China is using "lawfare" and other tools of national power to persuade other nations to accept China's definition of sovereignty in the maritime, air, and space domains.

The Nature and Extent of China's Space and Cyber Activities and their Implications for U.S. Security

- China continues to make significant progress in developing space capabilities, many of which easily translate to enhanced military capacity. In China, the military runs the space program, and there is no separate, distinguishable civilian program. Although some Chinese space programs have no explicit military intent, many space systems—such as communications, navigation, meteorological, and imagery systems—are dual use in nature.
- The People's Liberation Army currently has sufficient capability to meet many of its space goals. Planned expansions in electronic and signals intelligence, facilitated in part by new, space-based

assets, will provide greatly increased intelligence and targeting capability. These advances will result in an increased threat to U.S. military assets and personnel.

- China's space architecture contributes to its military's command, control, communications, computers, intelligence, surveillance, and reconnaissance (C4ISR) capability. This increased capability allows China to project its limited military power in the western and southern Pacific Ocean and to place U.S. forces at risk sooner in any conflict.
- Cyber space is a critical vulnerability of the U.S. government and economy, since both depend heavily on the use of computers and their connection to the Internet. The dependence on the Internet makes computers and information stored on those computers vulnerable.
- China is likely to take advantage of the U.S. dependence on cyber space for four significant reasons. First, the costs of cyber operations are low in comparison with traditional espionage or military activities. Second, determining the origin of cyber operations and attributing them to the Chinese government or any other operator is difficult. Therefore, the United States would be hindered in responding conventionally to such an attack. Third, cyber attacks can confuse the enemy. Fourth, there is an underdeveloped legal framework to guide responses.
- China is aggressively pursuing cyber warfare capabilities that may provide it with an asymmetric advantage against the United States. In a conflict situation, this advantage would reduce current U.S. conventional military dominance.

China's Energy and Environment Policies and Activities

China's economy, energy use, and environment are inextricably linked. China's rapid economic growth has resulted in an increase in energy consumption, and a reliable energy supply is needed to continue fueling this growth. A significant portion of China's energy consumption is supplied by coal, and with changing consumption patterns, oil and gas also are becoming important fuel sources. This reliance upon fossil fuels, coupled with weak environmental governance, has resulted in pollution that affects public health, air and water quality, and the economy. This pollution is not limited to China, as it has been found to reach the United States. The fossil fuel reliance also has resulted in China becoming the world's largest emitter of carbon dioxide. China is developing a regulatory framework to address these problems, but stricter enforcement, oversight, and industrial compliance are needed. The United States is cooperating with China on these issues through various agreements and programs to assist China in devising and implementing the right incentives needed to establish effective energy and environmental policies.

Conclusions

China's Current Energy Picture

- China's total energy consumption is growing and is projected to surpass that of the United States in 2010. By 2030, China will consume 25 percent more energy than the United States. The effects of such consumption growth already are influencing world energy markets, the global availability of energy resources, and the price of these resources.
- Coal remains China's primary fuel source, and China's coal consumption is expected to increase. This will increase China's already troubling emission of pollutants, notably including carbon dioxide, and will exacerbate the challenge of reducing China's pollution.
- China's energy consumption results in environmental consequences that have real economic and human costs. The cost of pollution has been reported to equal 781 billion RMB (\$112 billion) per year, and pollution-related illnesses cause an estimated 750,000 deaths per year in China. Continued declines in environmental quality potentially could hinder the nation's economic growth and possibly lead to a challenge of the Communist Party's authority.
- The pollution produced by China's energy consumption increasingly is reaching and harming other portions of the world, including the United States. If current projections for China's emissions are realized and production of these emissions is not substantially mitigated, major international tensions may appear.
- China's carbon dioxide emissions are the largest of any nation and are projected to grow significantly. Global efforts to address climate change must consider the impact of China's current and future emissions.

Tackling the Consequences of China's Energy Consumption

- China's energy and environmental policy institutions are weak, and without significant support and strengthening by the PRC leadership, these institutions will be incapable of reversing the trends of China's energy consumption and environmental pollution.
- The most obvious explanation for the weakness of China's energy and environmental institutions is the government's lack of commitment to devote the necessary resources to achieving substantial progress in these arenas. The government demonstrated in its preparations for the Beijing Olympic Games that it has the ability to use governmental mechanisms to develop and enforce environmental policies to achieve its objectives—specifically improving the quality of Beijing's air.
- Given the transboundary environmental impact of China's unbridled energy consumption, the United States has a keen interest in supporting China's energy and environmental bureaucracy to improve its transparency, expertise, and capacity to promulgate

and enforce regulations designed to reduce emissions and increase energy efficiency.

- Chinese leaders are aware of the need to moderate the growth of energy consumption and to improve energy efficiency but to date they have not made a commitment to reduce carbon dioxide emissions at the cost of economic development.
- China participates in multilateral negotiations to address climate change but has major difficulty supporting an agreement that requires it to reduce its net emissions. Chinese negotiating efforts attempt to shift the burden to reduce emissions to developed, industrialized nations and to escape being placed in this group.
- As the negotiations for a post-Kyoto climate change mitigation framework move forward, the United States and China have a joint interest in cooperating to influence the outcome of the negotiations and to resolve their bilateral differences in order to achieve a mutually acceptable solution and a shared understanding of each country's commitments under the agreement.
- Without a reduction in tariffs, and effective protection for intellectual property rights and technology, it will be very difficult for American companies to participate in transferring energy and environmental technologies to China.

China's Foreign Activities and Relationships

China, as all other nations, uses economic, military, and political tools to advance its interests on the world stage. In some cases, China's foreign relations activities support the advancement of global peace and security, and in other cases—such as selling arms to Sudan—they harm efforts to resolve international crises.

This chapter examines the regional economic and security effects of China's relationships with Taiwan, South Korea, and Japan and the ways in which its regional and global activities impact the United States and its security interests. In April 2008, a Commission delegation traveled to the People's Republic of China and Hong Kong, and in August 2008 a delegation traveled to South Korea, Japan, and Taiwan. The meetings during these trips with government officials, military leaders, academicians, business leaders, U.S. diplomats, and others form the basis for analyzing how China's role in the region is affecting and will affect U.S. economic and security partnerships and how common interests can be pursued.

Conclusions

China's Expanding Global Influence and its Foreign Policy Goals and Tools

- China's growing diplomatic activism is an attempt to demonstrate that China has attained great power status. China is relying upon its "charm offensive" to win friends around the world, and it is using its influence to push back potential adversaries.
- China has been able to use its economic weight to create financial dependencies that can constrain or censure the actions of

other countries that rely on China's trade. This has allowed China to expand its influence among developed nations, namely the United States and the European Union, and to be more assertive of its own economic interests, as was most recently observed in its behavior at the World Trade Organization's July 2008 Doha negotiating round.

- China's use of aid and investment may have detrimental consequences for the U.S.' and international financial institutions' desire to promote transparency, accountable governance, environmental protection, and human development in the developing world.
- China has continued to transfer weapons and military technology to nations that may use or retransfer them in ways that violate international norms and values and harm U.S. interests.
- China's engagement in United Nations (UN) peacekeeping operations is a positive contribution to global security. However, Beijing's continuing arms sales and military support to rogue regimes, namely Sudan, Burma, and Iran, threaten the stability of fragile regions and hinder U.S. and international efforts to address international crises, such as the genocide in Darfur.
- The U.S.' ability to promote its foreign policies around the world and to protect its interests may be challenged by rising Chinese influence.
- Holding China accountable for fulfilling its international commitments and encouraging it to adopt a constructive global role will strengthen the international system.

Taiwan

- The United States has an important interest in ensuring the survival of a democratic government in Taiwan. The United States has explicit commitments set forth in the Taiwan Relations Act to assist Taiwan with its own defense.
- While relations between Taiwan and the People's Republic of China (PRC) have improved over the past year, tensions remain, and unresolved issues regarding Taiwan's sovereignty and status continue to divide the two sides. The status of Taiwan creates a potentially dangerous situation that risks armed conflict if the relationship and its inherent tensions are not managed carefully by both sides.
- An armed conflict between the PRC and Taiwan would impair security, stability, and prosperity in East Asia and could involve the United States. It is in the interest of the United States to foster a peaceful resolution of Taiwan's international status and maintenance of a peaceful status quo until that resolution can be achieved.
- The successful peaceful change of government between rival parties in Taiwan during 2008 demonstrates the continuing maturation and stabilization of Taiwan's youthful democratic process.

- Taiwan's political discourse remains vibrant and strong, with pronounced policy differences between Taiwan's major political parties regarding economic ties with mainland China and the best means to provide for Taiwan's prosperity and security. Taiwan's new government has introduced significant shifts in economic and diplomatic policy that emphasize seeking improved relations and liberalized economic ties with mainland China while also seeking improved relations with the United States.
- Officials of Taiwan's government have indicated that they will follow a pragmatic policy of seeking membership in international organizations that do not require internationally recognized status as a state as a prerequisite for membership, and official observer status or other avenues for meaningful participation in international organizations that require statehood for membership.
- Officials in the Ma Administration have described a new defense policy that deemphasizes deterrent or power projection options directed against the mainland and instead relies on a more conventional defense strategy based on defensive weapon systems.
- Arms purchases from the United States are a keystone of Taiwan's plans for its future defensive forces, and those plans cannot be realized if the United States does not supply the weapon systems sought by Taiwan. No other country has been willing to sell arms to Taiwan in the recent past.

Japan's Relationship with China

- The United States and Japan share similar concerns about China's commitments under the World Trade Organization, its increasing pollution, its failure to protect intellectual property, the safety of Chinese food and other imports, and the security of the supply chain of each country's defense industrial base.
- Japan and China have several territorial disputes, one of which is about the proper demarcation for their Exclusive Economic Zones in the East China Sea. Although these disputes have not been resolved, the two countries have found a temporary compromise in one case by agreeing to the joint development of the East China Sea's oil reserves.
- Japan plans to pursue a five-year buildup of the Japanese Self-Defense Forces that is designed to enable it to respond effectively to conflict scenarios near Japan, some of which could involve China.

The Republic of Korea's Relationship with China

- The United States continues to be a close ally of the Republic of Korea, even as South Korea seeks to strengthen and is strengthening economic and diplomatic relations with China. South Korea views the United States as a stabilizing presence in the region and sees the United States as continuing to play an important role, even if Korean reunification were to occur. In this

vein, there appears to be a strong desire by South Koreans for the U.S. government to retain its military forces there.

- Republic of Korea-China trade continues to grow. South Korea believes that expanded trade with China is essential to its economic future. At the same time, many South Koreans fear the loss of their technologies to China and consequent loss of commercial leadership.
- North Korea is the Republic of Korea's largest security concern. The concern includes North Korea's nuclear capability, its missiles, and anarchy resulting from possible regime collapse.

Hong Kong

- The United States maintains a keen interest in the development of democracy in Hong Kong and adherence to the "one country, two systems" principle permitting that development. The Commission remains concerned about China's willingness to honor its commitment to establishing universal suffrage in Hong Kong. Electoral reforms in Hong Kong that fall short of universal suffrage will damage confidence in the implementation of the "one country, two systems" principle.
- China's denial of entry to ships visiting Hong Kong is of great concern to the United States, especially when such denials are based on reactions to the internal policies of the United States. Denial of permission to a ship to enter Hong Kong harbor is even more disturbing when the ship is seeking safe harbor during a severe storm.
- Hong Kong immigration officials' refusal of entry for Chinese and American citizens during Olympic events suggests that a supposedly independent entry process has been influenced and politicized by the PRC government. Furthermore, Beijing's restrictions on visas for entry into China by American businesspeople living in Hong Kong placed stress on the business environment before and during the Olympics and hindered the growth of new business opportunities.

China's Media and Information Controls—The Impact in China and the United States

In the lead-up to the 2008 Olympic Games in Beijing, the Chinese government made extensive promises of both greater media openness and increased information access through the Internet. It kept some but not all of these pledges. There were limited improvements for foreign journalists, such as relaxations on travel restrictions. But the government's anxieties regarding "social stability" during this high-profile period led to increased surveillance of foreign journalists and other visitors, notably including intensified Internet monitoring conducted by China's security forces.

For China's own citizens, this year saw no significant improvement in media freedom or access to information. Instead, during the Olympics period, the government increased controls over the media and access to information. The Chinese government continues to control media outlets through direct censorship and deter-

mination or approval of personnel appointments in the media, educational, and cultural sectors, and it suppresses information that may be contrary to the preferred narratives of the ruling Communist Party. The government also uses its control of information to stoke Chinese nationalism and resentment of the United States in a manner harmful to productive relations between the two countries.

Conclusions

- The Chinese government has created an information control regime intended to regulate nearly every venue that might transmit information to China's citizens: the print and broadcast media, the Internet, popular entertainment, cultural activities, and education.
- The Central Propaganda Department and its subordinate regional bodies exercise extensive authority over the hiring and firing of personnel in the media, educational, and entertainment sectors.
- Personnel working in the media, educational, and cultural fields have been conditioned into self-censorship by the rewards and punishments of China's information control system and also face possible fines, demotion, termination of employment, and even prison for publishing information contrary to the party's preferred narratives.
- The Chinese government did not fully honor promises of greater media freedom that it made in conjunction with its bid to host the 2008 Olympic Games. Those promises now appear to have been tactical moves intended to smooth the way for the games rather than serious statements of policy intent. There were limited improvements in the latitude granted to foreign journalists, particularly in terms of travel rights within the country. However, many western journalists, particularly those from the United States and the United Kingdom, remained subject to government scrutiny and to opaque regulations restricting their activities.
- The Chinese government has established an extensive physical infrastructure to screen and monitor information on the Internet. An Internet police force of large but indeterminate size monitors and censors information on the Internet.
- The propaganda system's central purpose is to perpetuate the political authority of the Chinese Communist Party by concealing negative information about the party and its history and by propagating narratives intended to bolster the party's authoritarian rule. The propaganda system also actively seeks to inflame Chinese nationalism in order to co-opt nationalist sentiment as a means of legitimizing the party's authority.
- The U.S. government takes the position that current Chinese government regulations requiring all financial services companies to operate through a subsidiary of the Xinhua news agency, and similar regulations that make a Xinhua subsidiary a regu-

lator of all financial services information, violate China's signatory commitments to the WTO.

China's Compliance with Agreements Pertaining to its Export to the United States of Prison Labor Products

The Commission examined the issue of prison labor imports from China and found that the Chinese government has not complied with its commitments under two formal agreements with the United States to cooperate with U.S. officials to stop the export to the United States of goods manufactured by prison or other forced labor in China. Under U.S. law, it is illegal to import into the United States products made with prison or other forced labor. Under two China-U.S. agreements signed in the early 1990s, the Chinese government agreed to facilitate investigations by U.S. officials of allegations of goods produced by prison labor, including allowing U.S. officials to visit suspect facilities. For several years, the Chinese government has not complied with these provisions, making it impossible for U.S. officials to conduct complete and useful investigations of such allegations. This has produced a perverse set of incentives for law-abiding U.S. importers, who may find themselves at a competitive disadvantage to competitors who obtain merchandise made by Chinese prison labor.

Conclusions

- The Chinese government has not complied with its commitments under the 1992 Memorandum of Understanding and the supplementary 1994 Statement of Cooperation with the United States related to prison labor exports to the United States. It particularly has failed to comply with the requirement that it grant permission for U.S. authorities to visit suspect prison labor sites within 60 days of receipt of a U.S. request to do so. Consequently, these agreements have been ineffective in enabling the U.S. government to ensure that Chinese prison labor products are not imported into the United States.
- The official PRC position that "reeducation through labor" represents an administrative sanction rather than a form of prison incarceration, and that it therefore is not covered by prison labor agreements, leaves a large portion of the Chinese penal system outside the scope of the prison labor agreements between the U.S. and Chinese governments. The U.S. government does not agree with the Chinese government's characterization of "reeducation through labor" as distinct from prison incarceration. The Chinese government's refusal to include "reeducation through labor" facilities in the scope of prison labor agreements eliminates any realistic possibility that the United States reliably can identify sources of goods manufactured with prison labor and prevent their importation into the United States.
- The import of prison labor goods into the United States is illegal. Although it is likely that prison labor products represent only a small fraction of Chinese-manufactured products imported into the United States, the preponderance of evidence suggests that Chinese prison-made goods continue to enter the U.S. market.

- The current failure effectively to enforce U.S. law prohibiting importation of prison labor products has established a perverse set of incentives for U.S. importers and their retail partners in which those willing to purchase prison labor products from Chinese suppliers may achieve and retain with impunity a competitive advantage over competitors who source from legitimate manufacturers.
- U.S. businesses that have cause to believe a competitor may be importing products manufactured with prison or other forced labor, thereby gaining an unfair competitive pricing advantage, currently have no private right of action to pursue civil claims against that competitor.

THE COMMISSION'S KEY RECOMMENDATIONS

The Commission believes that 10 of its 45 recommendations to Congress are of particular significance. These are presented below in the order in which they appear in the Report. The complete list of 45 recommendations appears at the Report's conclusion on page 337.

- **Employing World Trade Organization trade remedies more aggressively.** The Commission recommends that Congress urge the administration to employ more aggressively all trade remedies authorized by World Trade Organization rules to counteract the Chinese government's practices. The Commission further recommends that Congress urge the administration to ensure that U.S. trade remedy laws are preserved and effectively implemented to respond to China's unfair or predatory trade activities so as to advance the interests of U.S. businesses.
- **Responding effectively to China's currency manipulation.** The Commission recommends that Congress enact legislation that will ensure an effective response to China's currency manipulation.
- **Ensuring disclosure of foreign state-controlled investments in the United States.** The Commission recommends that Congress, within the context of its broader review of financial and corporate regulation, create enforceable disclosure requirements regarding the investments in the United States of all foreign sovereign wealth funds and other foreign state-controlled companies and investment vehicles. Such disclosure requirements, embodied in law or regulation, should include but not be limited to holdings in any public or private company, hedge fund, private equity fund, investment partnership, and/or investment vehicle.
- **Monitoring reviews of foreign state-controlled investments in the United States.** The Commission recommends that Congress monitor the implementation and application of the Foreign Investment and National Security Act of 2007 and other appropriate laws and regulations with respect to the possibility of China's sovereign wealth funds acting in concert with other Chinese government-controlled companies and/or investment vehicles in a manner that technically fails to activate the established review process.