THE U.S.-CHINA RELATIONSHIP: ECONOMICS AND SECURITY IN PERSPECTIVE

HEARING

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U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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THE U.S.-CHINA RELATIONSHIP:

ECONOMICS AND SECURITY IN PERSPECTIVE

THURSDAY, FEBRUARY 1, 2007

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in Room 562, Dirksen Senate Office Building, Washington, D.C. at 8:35 a.m., Chairman Carolyn Bartholomew and Vice Chairman Daniel A. Blumenthal (Hearing Cochairs), presiding.

CHAIRMAN BARTHOLOMEW: Welcome. The Vice Chairman and I will have opening statements after we've heard from our congressional witnesses. Since Congressman Forbes is here and we know he's very busy, we want to welcome him and turn the microphone over to him.

PANEL I: CONGRESSIONAL PERSPECTIVES

STATEMENT OF J. RANDY FORBES
A U.S. REPRESENATIVE FROM THE STATE OF VIRGINIA

MR. FORBES: Thank you, Madam Chairman and Mr. Vice Chairman. It's always an honor to be with you and I want to begin by just thanking you for the privilege of appearing before you and also to thank you for what you do as an organization to help our country. Your voice is important, and I just appreciate the hard work and dedication that you have always committed to our country.

It's been almost two years since I spoke before your Commission formally, and unfortunately, as I look back on the remarks that I made approximately 18 months ago, those remarks were not as optimistic as I would have liked for them to be. Yet upon going back and rereading them, they were probably more optimistic than the actual facts warranted.

I hate to report to you that little has transpired that would allow me to make them more optimistic to you today. If you remember, and if you do you would be exceptional for doing so, but I offered in those

remarks an analogy of how the prominence of China manifested itself to the world much like the Hollywood shark splashed upon the scene in the movie "Jaws."

As I traveled around the world, it seemed as I talked to various world leaders that it was as if the world was going along like the little sheriff on the movie throwing bait back in the water, and all of a sudden this huge giant appears on the scene and everybody looks around and says where did it come from and how did it get here.

We were awed, to say the least, and yet unlike the sheriff in Jaws, it seemed sometimes that we continued to throw bait off the rear of our ship of state even though we have now seen the magnitude of this giant entity, and we're somehow content to hope he will befriend us and not use his growing power to hurt us.

I pray that we are not wrong. You would think by now that we would be shocked into some different courses of action, but I see little evidence that we have been. The only thing that continued to surprise us, that continues to surprise me, is that our government continues to be surprised over and over again by what we find and what we see in the development of China.

The question that I would raise to you this morning, a question I ask myself, is exactly what catalyst, what revelation, is going to emerge that will make us as a nation step back and say maybe we need to do something more comprehensive in our planning as it relates to China.

This morning in the very brief time that I have, I'd like to walk you through five circumstances in which I think China's actions seem to have failed to have significantly changed the mind-set of us as a government and then again ask the question what is it going to take to wake us up?

The first one is will it wake us up when our Department of Defense does an about-face on China's military intentions? It hasn't in the past. In the 2003, the Department of Defense reported in its PRC Military Power Report, as you well know, and, quote:

"While continuing to research and discuss possibilities, China appears to have set aside indefinitely plans to acquire an aircraft carrier."

I was over there. I was looking at the steel plants that they have, how they'd relocated them near their shipbuilding facilities. We told our aides--we came back and told everybody--that metal can be used for carriers. It can be used for ships, and in the 2005 PRC report, as you are well aware, the DoD would state that China does not appear to have broadened its concept of operations for anti-access and sea denial to encompass sea control and waters beyond Taiwan and its immediate periphery.

Less than one year later, the Department of Defense would drastically change course reporting in the 2006 PRC Military Power Report that there were indications last year that China plans to organize a combat air wing for a future aircraft carrier.

China's actions and words have been consistent with this latest analysis. Last year, the Chinese were spotted at an air show in Moscow, as you know, scouting planes that could only be used on a newly designed aircraft carrier, and only a month ago President Hu would send a call to a meeting of the delegates to the Communist Party urging the building of a powerful navy prepared, quote, "at any time," for military struggle.

The second thing I would ask is whether or not we'll wake up when we find that a Chinese sub is stalking a U.S. carrier? Clearly, the answer to that seems to be no. In November, America was shocked to discover that a Chinese submarine had stalked a U.S. aircraft carrier battle group in the Pacific and surfaced, as you know, within firing range of the USS Kitty Hawk before being detected, and yet we continue down a path upon which the United States' current shipbuilding plan will result in a force structure below the minimum 48 submarine requirements for 14 years beginning in 2018, which would reach a low of 40 in 2028 to 2029. And we're doing that at the same time with our decrease in subs that the Chinese plan to build 17 new diesel-powered and three new nuclear-powered subs by the end of the decade, which would allow them to expand their sphere of influence into the Pacific and beyond.

Granted their subs primarily are diesels, but diesels are very quiet and very hard to detect and are going to give us monitoring problems as we move into the decade.

China will soon have more attack submarines in the United States with the addition of four Russian Kilo-class subs, which demonstrates to me that they have a blue water or are trying to get a blue water capability.

Within only about a decade, the United States will find itself out of position of maintaining even a moderate risk capability in submarine strength while China will face us in its strongest numerical and strategic position yet.

The third thing is will America choose to take a different course when we see China modeling its military aggression towards the United States in sophisticated computer simulation? I chair also the Modeling and Simulation Caucus. I am amazed at what we can do today with modeling and simulation.

I was equally amazed when I discovered and had presented to me a very sophisticated modeling program in Chinese on the Web site with literally thousands of registered gamers where the gaming was against

U.S. assets, U.S. carriers, U.S. planes.

Watching that scenario shows us two things. One, that they don't mind targeting on their simulation U.S. assets, but secondly, the degree of sophistication in their simulation industry, and what they could do poses a real concern because, as you know, the key to jointness in any military operation is our ability to do modeling and simulation today.

We also would think that we might change our course when America realizes that China's sophisticated intelligence collection rivals that of any other foreign nation in its threat to the United States. We have seen what has happened here in the United States with espionage. Not too long ago in a hearing in the Judiciary Committee, I specifically asked the Attorney General about the espionage from China and he stated that China was now the number one espionage threat against the United States.

Finally, we have to ask ourselves after recent discoveries, things that we've been writing about and talking about for some time, whether or not our leaders will take a different course if China fires lasers or has the capability of firing lasers at our satellites or creates an ASAT that could take out some of our computers? Clearly it hasn't.

As you know, only weeks ago, we watched as China destroyed an orbiting weather satellite signaling to the world that it had the capability to intentionally destroy our communications networks and certainly had the capability to unintentionally damage them because, as you know, as we begin destroying those satellites, some of that debris will be up there for a hundred years, and, granted, the likelihood of running into it is not as huge as the likelihood that we might in the earth's atmosphere, but if we do, it could be fatal not to just our satellites, to any other programs we have in space.

The other thing I'd just point out to you, in capabilities, they don't have to match us carrier for carrier, ship for ship, plane for plane. You take out our eyes, you take out our ears, you take out our ability to communicate, and you've drastically hurt our overall capabilities.

So, in conclusion, I just want you to know, I understand the immense economic pressures that encourage us to pretend that these situations don't exist. I understand the enormous pressure not to embarrass another government, especially the Chinese government, at the negotiating table. I understand the vast interests that prevent us from publicly addressing China's true intention for fear of economic retaliation.

I hear that over and over again. If we say something, they're going to hurt us economically; our companies won't be able to deal there, even though many of our companies aren't able to deal there today.

I understand the political and military incentive to hope China will never be a threat, just as we worry today about situations like Iraq, Iran and North Korea. But you and I also understand that it's desperately important for us to create a comprehensive governmental plan to address our future relationship with China.

I believe that one of the critical solutions to this problem is the creation of a national strategic interagency staff to harness the collective energy and opportunities of our nation to prepare for the long-term impact of China's rising power and influence around the world. It simply isn't happening that our agencies are not only sharing information but coming together on long-term planning to just see what are the facts, what are the predictability scenarios that could occur, and then creating plans to do that.

This cadre of senior agency staff would be trained in a common lexicon perhaps at one of our war colleges and would be tasked with developing, modeling and coordinating and evaluating complex operations across agency lines. Until America harnesses its collective strategic assets, we will not truly be able to see the whole picture of our relationship with China, and indeed, two years from now we'll find ourselves with more powerful examples of how we've allowed America to be surprised by China and, hopefully not, but possibly, her intentions.

Thank you for your time and thank you for creating and maintaining the dialogue which may be the catalyst we need to birth a comprehensive strategy to deal with this new giant swimming in world waters. And Madam Chairman, I'll be happy to answer any questions that you might have for me.

[The statement follows:][1]

Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Thank you, Congressman Forbes. Thank you for your leadership. Thank you for appearing before us today. You serve on three very important committees--Armed Services, Judiciary and Science and Technology--all of which have a pivotal role in addressing this relationship. I also want to acknowledge your leadership with now Chairman Skelton in co-founding and cochairing the Congressional China Caucus.

You have been a very important voice for us and we really appreciate it, and with your succinct testimony, I think you've laid out the challenges that we're going to be focused on over the course of the next year. I'm particularly interested in your idea of this creation of a

[1] **Click here to read the prepared statement of U.S. Representative J. Randy Forbes**

national strategic interagency staff.

I think Vice Chairman Blumenthal has a question.

VICE CHAIRMAN BLUMENTHAL: Thank you very much, Congressman Forbes for you excellent testimony. I think that it's a stark contrast to some of the statements we get from the administration. I suppose we have a framework now that the administration talks about, have a dialogue about making China into a responsible stakeholder, but of course you've mentioned all these incidents where we've been surprised militarily.

I think a lot of us agree that these are serious incidents--the emergence of submarines around the Kitty Hawk, the satellite. I wonder if you think the general framework that we have on the concept of responsible stakeholder is, in fact, making us less able to turn and deal with surprise after surprise that even today is I think cause for great concern?

MR. FORBES: Mr. Vice Chairman, thank you for that question. I think it's an excellent question. I don't think our framework is making us less capable. I think what's making us less capable is that the Chinese are growing in capabilities everyday and we're not matching our response to those capabilities, and so the result is that we're becoming less capable.

I think it's just imperative--and I've tried--I've gone to agency after agency, had briefing after briefing, as I know many of you have, and the first question I always ask them, are you talking to this agency or are you doing this? And without exception, when Congressman Skelton and I would go, we would always be told, no, we need to, but we're not.

We asked do we have a comprehensive plan? No. Every once in awhile we're told we have one, and maybe there's one that exists in some closet somewhere that I've just never seen, but I've never met the person that has seen it. Unless we have that comprehensive plan, I think we're going to continue to be surprised, and we can't afford to be surprised. We don't live in a world anymore where we have the resources that we can afford those tolerance levels.

What baffles me is that I don't think that we have gotten very far out of positions of weakness. I don't think you can continue to just simply say we don't want to embarrass somebody; we don't want to raise the issue. I think it's time we put it on the table because the question I ask everybody that I meet with is where are we winning? Tell me where we're winning. You pick the point wherever it is.

Is it trade? We have a $202 billion trade deficit and, by the way, that's what's financing a lot of their military build-up. But if nothing else alone, and I raised this to President Hu, we had $62 billion of intellectual property theft that took place. If we just had that, just

playing by the rules on property theft, it would have been $62 billion more in our economy and less that they would have for some of this weapons build-up.

I am just absolutely convinced, unless we can find a way to do--kind of like we did with Goldwater-Nichols with bringing all of our services together--if we can't do that on our agencies, I am very concerned that we'll continue to reduce our capability of dealing with these surprises down the road.

VICE CHAIRMAN BLUMENTHAL: Thank you very much.

CHAIRMAN BARTHOLOMEW: Commissioner Wortzel.

COMMISSIONER WORTZEL: Thank you very much, Congressman Forbes. I would like to pursue the comments you made on counterintelligence and see if you could elaborate on the nexus between industrial espionage by China and state-directed espionage, whether we can figure which is which, and whether the FBI primarily has the legislative authorities to deal with the way the Chinese are able to combine industrial espionage with improving their military and state-directed stuff?

MR. FORBES: Mr. Commissioner, first of all, another great question. I can't answer it, not because I don't know the answer, but because some of the answers to that are classified information and I don't want to cross that line.

I can tell you that one of the big differences is when dealing with China in so many areas, is they do it differently than the rest of the world. If you continue to try to monitor it in the same way that we monitor the rest of the world, you'll miss it. You miss how it's done and where it's done.

Are we successful in doing that? In some areas. But until you get this comprehensive look so Congress knows what State is doing, knows what FBI is doing, knows what the CIA is doing, I think it's going to be impossible for us to truly get a handle on what's happening. What we do know, what we can talk about that's not classified, is we know that now they're the number one espionage threat to the United States. That's huge.

The second thing we know is that they are dealing with computer access and they're looking at areas that would significantly hurt us in terms of our strategic advantages down the road. Are there things that we could do to deal with that problem? Yes.

But I think they have to be done in a comprehensive network so we can share intelligence or you'll miss the operational mode that I think they're using.

CHAIRMAN BARTHOLOMEW: Thanks. Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you very much, Madam

Vice Chairman, and thank you very much, Congressman, for coming and participating in this long-term exploration of how we can handle this growing power.

The question of response and analysis on our part is, as you point out, is one of the things that we're worried about in terms of our effective integration of our agencies. I'm thinking about CINCPAC, and we visited CINCPAC several times, and the question is have you been out there and do you have a sense that CINCPAC and our forces in the Pacific as well as the evolution of our doctrine in the Pacific is sufficiently addressing the military build-up and the military evolutionary doctrine of the Chinese in the Pacific?

MR. FORBES: I think one of the things that we really err on is when we look solely at military strategy and military planning. I chaired the Gap Panel for the House Armed Services Committee last year, and basically what that was designed to look at is our strategic gaps if we had a situation that would occur with Iraq, North or South Korea, China going into Taiwan, and even India and Pakistan, again, not that we thought those scenarios would present themselves, but what are the gaps?

Every combatant commander, and they flew in from all over the world and they gave us the best testimony they could, everyone of them said we're in a different world than we've ever been in before. It's no longer just platforms, it's no longer just ships and guns and boats that we have to use. We're in a world scenario and we'll continue to be there, where it's important for us as a nation to be able to marshal all of our resources to any conflict anyplace in the world.

I don't think we have the capabilities of doing that very well now. We can marshal our guns and boats and things, but I think it is very difficult to say how do we marshal our trade policies, how do we marshal some of the other things that we're doing, and the reason is because we don't have that interagency connectivity that I think is vitally important for us to do.

So if we assume, one, that those combatant commanders are correct, which I would suggest they are, and if, number two, I am right and you are right, because I think many of you recognize the same problem, that we don't have that interagency coordination that we have, then I think it's very difficult for us to present the scenarios and the planning that we need to comprehensively deal with these world situations.

We tend to think in six month segments. If we get a crisis, we think how do we deal for the next six months. I don't think you can do that with world powers that are coming on the scene. I think we need two and three year and four year strategies and plans, and that's why I think it's vitally important that we have this kind of strategic planning

that would survive administrations, so it's not just political, but it's a cadre of agency people we're building up, not that they're going to make the decisions, but we just need all the facts and all the connecting the dots so that we can make good policy decisions from that.

So the answer to your question is I don't think we have the kind of comprehensive planning that our commanders need and their ability to get total resources until we do this kind of interagency program to do it. Militarily, I think we've done a very good job and they're doing a good job, but it's just a military game.

COMMISSIONER D'AMATO: Thank you.

CHAIRMAN BARTHOLOMEW: Thank you, Congressman Forbes, for your leadership on this. We look forward to working with you, and you've set us up very nicely for our first administration witness, who will be Deputy Undersecretary of Defense, so we'll have lots of questions for him.

MR. FORBES: Thank you all for what you're doing.

CHAIRMAN BARTHOLOMEW: Thank you. And now it is a real pleasure to welcome Senator Cardin to the China Commission. Senator Cardin, a brand new senator here, who also serves on committees of importance on this issue, the Committee on the Judiciary, Committee on Small Business and Entrepreneurship, Committee on the Budget, and Committee on the Environment and Public Works, and Committee on Foreign Relations. I think our issues touch on each of those.

I'd like to defer for a moment to Commissioner D'Amato, a long-time resident of Maryland, who has, I believe, a few words of welcome, too.

COMMISSIONER D'AMATO: Senator Cardin, on behalf of the China Commission and as one of your loyal constituents, welcome. It's my privilege and honor to welcome you to the China Commission. Senator Cardin is not only my senator; prior to he was my congressman in Annapolis. So we have a loyal relationship. He is well-known in Annapolis, a member of the House of the Delegates for 20 years--I think its youngest speaker--the distinguished Speaker of the House of Delegates for many years.

He is a highly effective veteran legislator and already has in-depth knowledge of many of the issues on the agenda of this Commission from his service partly on the Ways and Means Committee, issues such as intellectual property rights, currency manipulation, WTO dispute panel issues, which you've done some legislation on, trade deficit imbalances, fair dealing in enforcing our trade laws, other persistent issues that we have on the table with the Chinese.

We look forward to working with you, Senator, and your staff on many of these issues to find acceptable answers to them. And as a new member of the Environment Committee, how we can develop initiatives together with the Chinese to address the growing and dangerous challenge of climate change, greenhouse gas emissions and solutions of alternative energy systems.

So we welcome you and we look forward to working with you, Senator.

STATEMENT OF BENJAMIN L. CARDIN
A U.S. SENATOR FROM THE STATE OF MARYLAND

SENATOR CARDIN: Commissioner D'Amato, thank you very much, and Chairman Bartholomew, I thank you for your invitation to be here, and Vice Chairman Blumenthal and all the commissioners, I thank you very much, and for your kind introduction. I could spend a lot of time talking about each of the issues that Commissioner D'Amato mentioned.

This past week on the Environment and Public Works Committee, we have taken up the issues of global warming, and China plays a critical role in this regard and with the emission of greenhouse gases from just the power plants that they plan to put in force, so I could spend my time talking about that, or circumstances involving Iran and the market that China needs in Iran, and China's importing of oil from Iran that complicates our need for unity on the sanctions against Iran in order to move forward with an effective policy against the nuclear build-up in that country.

But if I might, Madam Commissioner, the work you're doing, I'd like to concentrate on one area which is trade. And I do that because in the last Congress, the 109th Congress, I was the ranking Democrat on the Trade Subcommittee of the Ways and Means Committee. I have been studying the issues of trade in China for considerable period of time. Later today, in the Budget Committee, we are going to be holding a hearing on the effect on our economy long-term on the amount of debt being held by foreign countries.

China is our number one country for trade imbalance. It's not sustainable, our trade relations with China. It is dangerous in my view, and we need to do something, and it's unfair. China is not complying with the trade agreements and trade rules that have been established, and this has been well documented.

Just to mention the currency manipulation issues. As you know, China ties its currency to the U.S. dollar and, in doing that, economists tell us that they have overvalued our currency by about 40 percent, giving Chinese importers an unfair trade advantage over U.S. exporters and that cannot be tolerated, and yet we allow China to say, oh, we'll

get to it, we'll do something about it, and it has not addressed the issue of the trade--of the currency manipulation.

In regards to intellectual property rights, China regularly parrots U.S. property rights. It's not just in the entertainment area; it's in the industrial area with products that are copied without any effort by the Chinese government to stop that. China subsidizes its industrial manufacturers. China does not adhere to the safeguard agreements that they've entered into, and the list goes on and on and on. China puts up roadblocks to U.S. manufacturers by their registration rules and their operational rules.

The bottom line is that we now have an unsustainable trade imbalance with China. It is dangerous for our national security. It's dangerous for our economy. We need to do something about it. Quite frankly, I think the laws are adequate if they were enforced. I introduced in the 109th Congress legislation to strengthen those laws.

I think that their currency practices are illegal in the WTO today. I introduced legislation in the last Congress to make that abundantly clear. I think that the safeguards are clear today that China is violating them. I've introduced legislation to strengthen the safeguards and to reestablish the Super 301. I think that legislation should not necessarily be needed if the administration would enforce the current trade rules.

So I welcome your view and the responsibility that you have because I think you can help us by identifying the areas where we should be concerned as a nation for the security and economy of our country, which is the charge of this Commission, and I look forward to working with you and I'd be more than happy to apply additional information if it's useful to your work.

I can tell you that our staff on the Ways and Means Committee, the committee I formerly served on, can document each of the points that I have brought forward. I'd be glad to make that available to the Commission.

[The statement follows:]

Prepared Statement of Benjamin L. Cardin
A U.S. Senator from the State of Maryland

Chairwoman Bartholomew and Vice-Chair Blumenthal, thank you both for the opportunity to testify on the U.S.-China relations and its implications for economic and security cooperation.

Prior to my election in 2006 to the United States Senate, I spent 18 years on the House of Representatives Committee on Ways and Means Committee. The last two years I served as the Ranking Member of the Trade Subcommittee.

The matter of U.S.-China trade was a matter that often made its way on the Subcommittee's agenda. There can be no mistake; China is the fastest growing economic force in the world today. China's need for

sources of energy and markets to absorb its products means there are few nations in the world that have yet to be impacted by China's largesse.

China is one of the most important trading partners of the United States, yet, there are severe problems with this relationship due to China's longstanding unfair trade practices. Their unfair trading practices have led to historic trade imbalances allowing China to acquire too large amount of U.S. debt. That is not in our security or economic interest.

China's unfair trade practices include currency manipulation, flagrant piracy of intellectual property, unreasonable restrictions on market access and industrial subsidies.

The U.S. trade deficit with China has doubled in the last 5 years. This is a dangerous trend as it forces our nation to borrow massive amounts of money from foreign countries to fund the deficit. The imbalance is caused in part by China's continuing currency manipulation. Despite repeated promises to adopt a more flexible exchange rate, China continues to peg its currency to a rigid policy that has caused the yuan to be under valued by as much as 40%. Thus, Chinese exports are cheaper than U.S. exports.

China also continues to flaunt international trade rules by failing to crack down on wide-spread pirating of intellectual property. Again, despite repeated commitments to protect and enforce intellectual property rights—in accord with the WTO—every year more and more American companies lose an estimated $2 billion to Chinese copy cats.

Additionally, China continues to use unfair trade practices to provide advantages to Chinese companies and restrict U.S. companies from competing on equal footing. China often imposes overly burdensome licensing and operating requirements and often discriminatory regulations to restrict U.S. exports of services.

In response to China's unfair trade practices, I introduced the Fair Trade with China Act of 2005 (FTCA). The FTCA addressed the four key facets of the U.S. trade relationship with China.

First, the FTCA amended the U.S. countervailing duty (CVD) law to direct the Dept. of Commerce to investigate subsidies provided by the Chinese government to sectors of industry or agriculture.

Second, the FTCA proposed to change U.S. law to make currency manipulation an unjustifiable act, policy or practice. Thereby, the USTR could file a case in the WTO to address currency manipulation.

Third, the legislation proposed strengthening the special China safeguard law, which is intended to provide a remedy for U.S. industries against import surges caused by China's non-market economy. Additionally, we proposed to amend the customs provisions to ensure the collection of duties owed on imports from China.

Fourth, the FTCA would revive the "Super 301" trade law to direct USTR to identify the priority barriers to U.S. exports of goods and services and China's unfair trade practices. This would also include China's failure to protect intellectual property rights and unfair trade practices.

For America's economic and security interest it is essential that we aggressively enforce fair trade laws with China and if necessary strengthen our enforcement provisions through congressional action.

China/Iran Relations

Another cautionary aspect of China's economic ascendancy is its relations with Iran. This relationship is both mutual dependence and political calculation.

China finds in Iran a permanent source for its exports and growing energy demand. China is the second

leading exporter of goods to Iran with 8.3% of total market share. Between 2000 and 2005, Iran's imports from China rose by 360%. In dollar value, this represents a leap from US$3.3 billion in trade to US$9.2 billion. Additionally, 13.6% of China's oil imports come from Iran.

There should be no surprise as to why China opposes sanctions against Iran for Iran's non-compliance with the international community regarding its nuclear energy program.

As long as China enjoys a United Nations Security Council veto authority, Iran finds that it has a very useful and powerful ally.

I believe the United States should include Iran's nuclear program in all high level talks with China to ensure Iran is clear it can not circumvent international compliance by hiding behind China's economic and political clout

Again, I thank the Commission for an opportunity to testify and I look forward to the final report on these hearings.

Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Senator Cardin, thank you very much. In addition to your leadership on trade, I'm also very aware of your leadership in the Congress on human rights issues through your work on the OSCE. It was one of my privileges over the years to work with you on the Bosnia war crimes issues. So we really have great expectations for you in the Senate to carry on your good work.

If you have a moment, Commissioner Wessel has a question.

SENATOR CARDIN: Sure.

COMMISSIONER WESSEL: Thank you, Senator. It is great to see you here after so many years in the House working with you on various trade issues.

SENATOR CARDIN: Thank you.

COMMISSIONER WESSEL: You mentioned the hearing this afternoon that the Budget Committee is going to have on the question of long-term vulnerabilities from our trade deficit, which as you said is unsustainable.

How do you see those vulnerabilities and how should we be responding to those over time?

SENATOR CARDIN: The United States is dependent upon the will of foreign countries buying our dollars. Our imbalance requires capital coming in. Those that are buying it are not the traditional buyers of U.S. debt. Traditionally, investors bought U.S. debt. It's a good investment. They wanted diversity in their portfolio. But today the largest amount of our debt is being bought by financial entities controlled by foreign governments, and many of these foreign governments are not necessarily in agreement with our economic policies.

They're doing it not because the dollar is a good investment;

they're doing it in order to stabilize the U.S. dollar so that that country can have greater penetration into our own market. That could change at any time. That could change. The foreign markets could say, look, we have enough dollars; we don't need it anymore. We have a strong enough penetration; we feel like we're safe enough that we can allow the dollar to float. And that could have a pretty dramatic impact on our economy. Rather than having a gradual change, it could cause an abrupt change.

There's also an issue of whether we have enough capital in America to meet our own needs. We don't save enough as a nation and if foreign capital were to be turned off and we don't do anything about our savings rates, it could have a dramatic impact on our economy.

So for all these reasons--the fact that we are so far out of balance on the trade issues--the fact that we don't have a strong enough domestic saving ratios in this country--make us particularly vulnerable to the whims of other countries that buy U.S. dollars.

COMMISSIONER WESSEL: Thank you.

CHAIRMAN BARTHOLOMEW: Senator Cardin, we understand that you have a commitment that you need to move on to next so we thank you very much.

SENATOR CARDIN: Thank you.

CHAIRMAN BARTHOLOMEW: We look forward to working with you over the course of the next year.

SENATOR CARDIN: Thank you all very much for your work.

OPENING STATEMENT OF CHAIRMAN CAROLYN BARTHOLOMEW

CHAIRMAN BARTHOLOMEW: Our next two scheduled witnesses, Senator Levin and Senator Graham, both had rather important commitments come up this morning. Senator Levin has submitted a statement for the record. The Vice Chairman and I will give our opening statements, and then when Senator Brown arrives, we'll move right to him.

Good morning and welcome to the first hearing of the U.S.-China Economic and Security Review Commission's 2007 reporting cycle. We are pleased that you could join us today. I would like to start by welcoming our two new commissioners, Commissioner Jeff Fiedler and Commissioner Pete Videnieks. We look forward to working with both of them.

Five years after China's accession to the World Trade Organization, it is timely for us to step back and look at the big picture in U.S.-China relations and what it means for the lives of the people in the United States. When this commission was established,

we were tasked with the responsibility of monitoring the national security implications of the U.S.-China economic relationship. How are those implications shaping up in national security which embodies both our economic security and our military security? Is China abiding by the commitments it has made and how is its compliance or noncompliance having an impact here at home?

The rapidity of China's economic development and its ability to sustain that rapid growth has had serious implications for U.S. policy. When Congress passed PNTR legislation in the year 2000, according to U.S. Census Bureau statistics, the U.S. trade deficit with China was $83.8 billion.

We closed last year with a trade deficit of $213.5 billion representing a 155 percent change in just six years, and it wasn't a change for the better.

This difference is not just a matter of statistics or economics. It is experienced everyday in communities across this country in the transfer of jobs, the shift of manufacturing, the piracy of intellectual property and the erosion of our competitiveness.

And what are we to make of the Chinese government's interests and activities on the military front? The recent test of an anti-satellite missile has caused even some of the Chinese government's most ardent fans to question how much we really know about both the Chinese government's intentions and its capabilities and what that means for the security of the United States.

Certainly President Hu Jintao's recent call for purification of the Internet does not bode well for freedom of expression. What does that mean for us?

We anticipate spending our time this year assessing the state of U.S.-China relations and the course China is taking on the important areas Congress has instructed the Commission to examine including proliferation, energy, regional economic and security issues, and freedom of expression.

We will continue to build on the idea of China as a responsible stakeholder, and we will work to identify not only troubling trends but also avenues for meaningful constructive cooperation on issues like energy affecting the economic interests and the security concerns of the United States.

At today's hearing, we are starting the Commission's work for this new year with a broad assessment of U.S.-China relations. We will explore the progress of China's economic reforms since its WTO accession and evaluate the impact of those reforms on the U.S.-China economic, security, and political relationship.

We are very pleased to hear this morning from a group of senators and congressmen who will greatly assist us in understanding

the perspective of members of Congress on these issues, and on the priorities of the 110th Congress for addressing U.S.-China relations.

As I mentioned, both Senator Levin and Senator Graham are busy preparing for other important hearings and cannot be with us this morning.

Later today and tomorrow, key officials from executive branch agencies and expert witnesses from the private sector and academia will offer their views and advice on economic and security issues. I am looking forward to the testimony of our witnesses and to the insight they will provide.

Commission Vice Chairman Daniel Blumenthal is serving as a cochair for today's hearing. I'll turn the proceedings over to him for his opening remarks. Welcome again to all of you and thank you for your interest in the Commission's work.

[The statement follows:]

Prepared Statement of Chairman Carolyn Bartholomew

Good morning and welcome to the first hearing of the U.S.-China Economic and Security Review Commission's 2007 reporting cycle. We are pleased that you could join us today. I would like to start by welcoming our two new Commissioners, Jeff Fiedler, and Pete Videnieks. We look forward to working with both of them.

Five years after China's accession to the World Trade Organization, it is timely for us to step back and look at the big picture in U.S-China relations and what it means for the lives of people in the United States. When established, we were tasked with the responsibility of monitoring the national security implications of the U.S.- China economic relationship. How are those implications shaping up in national security, which embodies both our economic security and our military security? Is China abiding by the commitments it has made and how is its compliance or non-compliance having an impact here at home?

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We are very pleased to hear this morning from Senators Ben Cardin, Lindsey Graham, and Sherrod Brown and Congressman Randy Forbes, who will greatly assist us in understanding the perspective of members of Congress on these issues and on the priorities of the 110th Congress for addressing U.S.-China relations. Senator Carl Levin is preparing for an important Armed Services Committee hearing and has submitted a statement for the record.

Later today and tomorrow, key officials from Executive Branch agencies and expert witnesses from the private sector and academia will offer their views and advice on economic and security issues. I am looking forward to the testimony of our witnesses and to the insight they will provide.

Commission Vice Chairman Daniel Blumenthal is serving as a co-chair for today's hearing. I'll now turn the proceedings over to him for his opening remarks. Welcome again to all of you and thank you for your interest in the Commission's work.

OPENING STATEMENT OF VICE CHAIRMAN DANIEL A. BLUMENTHAL

VICE CHAIRMAN BLUMENTHAL: Thank you, Madam Chairman, and thank you all for joining us here. Welcome to the first hearing of the U.S.-China Commission in 2007. As the chairman mentioned, the United States held very high expectations for China's reemergence into the global economy and political landscape after it had been outside of the world economy for so long.

These expectations were and still are in many quarters widely held throughout the United States on both sides of the political aisle.

The United States hopes and still hopes, I would say, that China chooses to become a cooperative responsible member of the community of nations.

The United States anticipated that China's entrance into the WTO not only would catalyze reform of China's economic institutions, but would also promote an evolution of China's government into a more democratic transparent government that would play an active and positive role in international politics.

Our task today and throughout the year is to evaluate what has transpired in China compared to what we thought would transpire when the United States first granted China Permanent Normal Trade Relations to support its entry into the WTO. We will look at the effect

of China's performance, its compliance with agreements it's already made, the impact of China's development on the U.S. economy and our national security, and the successes and failures of our diplomacy in the past five years.

As Congressman Forbes rightly testified, one would have expected a decade ago much greater reactions in the United States. One would have expected if China had submerged submarines near our carriers, had tested an anti-satellite weapon, and so on down the list, we would have had a much greater reaction than we have had.

It's our duty to explore why this is and what China's intentions are. We ask the witnesses who will kindly testify today and tomorrow to give their honest evaluation of the U.S.-China relationship. It will greatly assist our Commission and help us in our duty in advising Congress on this very complex and very important relationship.

Thank you to the witnesses who are joining us today. We look forward to your testimony.

CHAIRMAN BARTHOLOMEW: Thank you. We're not expecting our next witness until 9:30, so we will take a short 15-minute break and come back when Senator Brown arrives. Thank you.

[Whereupon, a short break was taken.]

CHAIRMAN BARTHOLOMEW: It is a distinct privilege to introduce another one of the freshman senators, Senator Sherrod Brown, who served in the House of Representatives. We expect great things from him in the U.S. Senate representing Ohio.

Senator Brown has been a leader on issues relating to U.S.-China trade and other issues in the U.S.-China relationship. He has been a leader on U.S.-Taiwan issues and is generally a spokesperson for the American workers in a way that we think is really wonderful.

He's serving here in the Senate on the Committees on Veteran Affairs, Agriculture, Nutrition and Forestry, Urban Affairs, and the Committee on Health, Education, Labor and Pensions. Welcome, Senator Brown. We look forward to hearing your testimony.

STATEMENT OF SHERROD BROWN
A U.S. SENATOR FROM THE STATE OF OHIO

SENATOR BROWN: Thank you, Madam Chair. It's good to be back in front of you and see familiar faces and thank you for your service on this Commission and all that you do to help our country and to help drive our country's economy.

I have a written statement that I would like to submit to the record and just speak for not very long and based on some things that happened yesterday. Yesterday, in the Banking Committee, Secretary

Paulson testified, and it was an interesting couple of hours in large part because of the frustration I think that senators and I assume House members, took, from my time there, the growing frustration that we all have towards our China policy, and particularly those of us who represent states and communities, as most people in this country, most members of the House and Senate do, where we have been pretty buttressed by China trade policy and what it's meant to the middle class and what it's meant to our workers and our families and our communities.

Secretary Paulson, the frustration greeting him, if that's the proper word, the frustration greeting him was based more on not just what's happened but on the inaction from the administration where Secretary Paulson himself seemed a bit frustrated by not being able to do very much.

But it seems that when I've watched what's happened in the last five years in our dealings with China, in our dealings with the World Trade Organization, and the USTR, it seems to me that we could be doing much better. Secretary Paulson says he needs time; we need patience--my words, not his necessarily--and that we're doing all we can on currency issues. We have formed this committee, this joint committee between the United States and China, where we're talking to each other on the highest levels, but it seems to me we're not using the opportunities and the legal channels we have.

Some five years ago, four to five years ago, the National AFL-CIO petitioned Section 301, asked the USTR to petition the World Trade Organization, and that that was just summarily rejected.

Then back in 2004 on two occasions, the China Currency Coalition asked the USTR to represent our country at the WTO on currency issues, also on everything from--both of these petitions reflected some issues on labor standards, the environment and public health--asking, frankly asking China, simply asking the WTO to tell China to enforce its own laws.

That was rejected summarily out of hand, in almost a dismissive way because of the speed at which they rejected it. Then 35 House and Senate members, I believe later that year, I think September of '04, if I remember correctly, again asked the USTR to represent American interests, representing literally millions of workers, businesses, agricultural concerns, farmers, consumers and others, to move forward, and again the administration rejected it out of hand without, clearly without reading the analysis and the petitions, simply because the rejection was so quick.

It seems to me that the administration says we need patience. The government, the people in this country are saying we need to do something. Yet, they're not even availing themselves of the channels,

the legal channels that we have. The whole dispute resolution mechanism was set up at the WTO to respond to labor concerns, to environmental concerns, to currency concerns, to concerns of fair play and intellectual property, and all of that, and we're simply not using them.

The thrust of my message to you and argument to you is to urge the administration, formally and informally, to use the dispute resolution mechanism, to use the channels that we have, at least to try with the WTO to give us a more level playing field, if you will.

Secretary Paulson, his response to members of both sides of the aisle, was unclear to me if he is, in fact, going to be more serious with the next. I'm not blaming him personally because he was not there during those other dismissals of our concerns and the petitions. But in the future I'm hopeful that he pays attention to them, examines them, and moves forward if in fact they warrant them.

That's the conclusion of my statement and I will enter the written statement in the record.

[The statement follows:]

Prepared Statement of Sherrod Brown
A U.S. Senator from the State of Ohio

Mr. Chairman. Members of the Commission. It is an honor to appear before you today. Since the creation of this Commission in the wake of Congress' passage of Permanent Normal Trade Relations with China, you have performed a vital service to Congress and the public in analyzing and reporting on a variety of important issues regarding China's relations with the U.S. and the world.

Let me first comment briefly on China's recent destruction of one of their satellites using a ground-based missile. This raises serious questions about the militarization of space and is something that we must all evaluate carefully. I know that your hearings this week will look at this important matter. I hope that you will pay particular attention to this issue during this year's reporting cycle.

Your field hearing in my home state of Ohio more than two years ago helped small- and medium-sized businesses and their employees add their voices to the debate over what impact China's entry into the World Trade Organization has on our country. I, and my constituents, thank you for taking your valuable time to visit our state.

This past November voters all across this country spoke out on issues of national concern. Certainly our presence in Iraq dominated the minds of voters.

But voters also voiced their concerns about the direction of our trade policy. They know firsthand what only now the economists are beginning to understand – that the NAFTA trade model has not lifted all boats.

In fact, it's lifted a very few. They know that, for the majority of Americans, our nation's trade policies have resulted in loss. The Loss of jobs, the loss of income, the loss of health and retirement benefits and the loss of dignity.

China cannot be blamed for our nation's misguided trade policies, but they have certainly been a

beneficiary of those policies.

China is engaged in an effort to promote the interests of its people. We certainly can't fault them for that. But, when their efforts to promote their own interests come at the expense of ours, when they engage in predatory and exclusionary trade practices, we do have a right and, indeed, a duty, to speak out and take action.

When proponents of China's entry into the WTO argued that Congress should grant them permanent normal trade relations, they told us this would assure China's move to be more of a market economy. They said that it would help promote growth and opportunity for the people of both our nations.

Unfortunately, on both counts, that has not been the case. Certainly, China has engaged in much more economic activity. Last week's news that China's economy grew at more than a 10% rate is a measure of their success.

But the economic data shows that the fruits of trade are not being shared equitably. The gap between the haves and the have-nots in both the U.S. and China continues to grow.

And communist China's chokehold on their economy and all their activities continues. Indeed, in December the Chinese leadership, building on the 11th Five Year Plan adopted in 2006, announced seven sectors that would continue to be controlled by the state. And, they announced a number of other so-called "heavyweight" industries, which would continue to be dominated and guided by the state.

I don't know about you, but to me that doesn't sound like a bold transition to a market economy.

Last Congress, I and others spoke out against CNOOC's proposed acquisition of UNOCAL and argued, in part, that it was not a "market transaction" because of the state involvement and state-subsidized capital that was involved in the transaction. It's impossible for our companies to compete against state-controlled and state-supported actors – and they shouldn't have to.

China has amassed a surplus of US dollars, treasury notes and related assets topping $800 billion.

If history is any guide, China will eventually spend these dollars and the interest they accrue, interest which comes out of the pockets of US citizens.

Our hope, of course, is that they will spend those dollars on US products, truly opening their markets to our nation's products and permitting their consumers to purchase our exports.

Hopes, even the sincerest of them, do not form a sound basis for trade and economic policy. China's markets are not free now, and unless something changes -- and by "something" I mean our nation's laissez faire attitude -- China's markets are unlikely to be free tomorrow.

China may also choose to recycle U.S. dollars by purchasing other assets, such as brick and mortar in the U.S. In so doing, the real question is whether China will invest dollars here or engage in a "cash and carry" approach of buying our companies, dismantling them and shipping our productive capacity back home to China, further exacerbating our trade and job loss problems.

Mr. Chairman, there are a number of important issues this year that must be addressed with regard to U.S.-China relations. I've already mentioned the ASAT issue. We need to better understand China's military buildup and what their intentions are. We need to carefully evaluate and influence, where possible, their energy acquisition and utilization policies.

In the trade and economic arena, there a myriad of issues. We all know about currency manipulation and

intellectual property rights violations that are rampant and virtually unaddressed by the Chinese – or, indeed, the Bush Administration.

But, an important looming issue is how the U.S. can respond to the hundreds of billions of dollars in subsidies that the Chinese give to their industry – directly and indirectly through such mechanisms as subsidized and no-cost loans.

Late last year a U.S. paper company filed a countervailing duty case against Chinese subsidies given to their industry.

For many years the Department of Commerce has interpreted the law and court decisions to indicate that they do not have the authority to impose countervailing duties against a non-market economy. They are now reviewing that decision.

I think we should place a priority on passing legislation making it clear that we will not let Chinese subsidies go unanswered.

There are other trade issues you have raised in your reports that demand attention. In the short time I have left, let me turn to one last issue – our defense industrial base.

As a new Senator and member of the Banking Committee, which has jurisdiction over the Defense Production Act, I intend to spend a good bit of time and energy understanding exactly what impact our trade policies have had on our defense industrial base and our ability to meet our national and homeland security needs.

I know that this Commission held a hearing on this important matter last summer in Michigan and intends to further work on this issue.

Your findings will be important as our committee works to better understand the implications of our weakened manufacturing sector and the appropriate steps needed to prevent its further erosion.

Thank you.

Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Senator Brown, thank you very much. One of the things that we sometimes hear from people in the administration, about employing WTO mechanisms, for example, is the free-rider problem, which is that they have difficulty getting other countries to join in on challenges. Yet at the same time, if the U.S. succeeds, other countries benefit, but if we don't succeed, then other countries don't bear the cost, and there is indeed a diplomatic cost and other costs for the U.S.

You know that the Chinese government will withhold trade deals, for example, if they see that people are doing things that they don't like.

You have a lot of experience in international relations. Do you have any suggestions on how the administration could work better with

other countries to address some of these issues?

SENATOR BROWN: First of all, I think we practice multilateralism when we believe we want to practice multilateralism, whether it's any kind of foreign policy, whether it's trade or other kinds of foreign policy, and I think that's an excuse more than it is a real reason.

We import a third of Chinese exports. We clearly have way more at stake than most countries, and we are, as some of us in this committee and I have discussed over the years, when you're the largest customer, if you're in business and one of your customers buys one-third of your products, you're going to pay attention to them. You're not going to walk away from them. The Chinese aren't going to walk away from us if we insist on intellectual property, on fairness and intellectual property, if we insist on enforcing labor standards, just their own labor law, their own environmental law, their own health and safety law.

The United States is too big a player. We're the most lucrative market in the history of the world. They're not going to walk away from us if we demand fair play.

CHAIRMAN BARTHOLOMEW: One more question. Over the course of the past couple of years, this Commission has held field hearings in Akron, Ohio and Dearborn, Michigan and Columbia, South Carolina, and we have heard firsthand some of what's happening in America's communities because of the job losses.

I'm always challenged when we go out and do these hearings as to what we can say to working Americans to give them hope that the government will actually respond to their concerns?

SENATOR BROWN: That's a question?

CHAIRMAN BARTHOLOMEW: It is. It is a question.

SENATOR BROWN: Let me begin by thanking you for going to Akron because I appreciated your doing that. I couldn't join you then, but I appreciated that and was very aware of your successful hearing there.

Yesterday was an important day. In addition to Secretary Paulson making I believe one of his first appearances, at least the first appearance in the new Congress, it was also an important day because President Bush announced Wednesday, or Tuesday in Peoria, and then Wednesday on Wall Street at the, I believe Federal Building it's called, the Federal Courthouse in New York, that he was asking for the renewal of fast track authority, trade promotion authority fast track, and I asked Secretary Paulson, how do we explain this to people where when I first ran for Congress in 1992, we had a $32 billion trade deficit?

Our trade deficit bilaterally with China was in the low double

digits, if I recall, ten, 12, 14 billion, something like that. 2006--I don't think we have all the numbers yet--but from the 38 billion in '92 to some 800 and some billion this year, our deficit worldwide, and our bilateral deficit with China went from low double digits 14 years ago to 250, whatever it's going to be, this year.

And then the president is asking us to do more of the same, and many in Congress are saying that they want to do more of the same, and I think that's hard to justify. We've got this problem so let's make it better by doing more of what we've done to help create this problem. I think they have a lot of explaining to do. I think the elections this fall all over the country in large part, in part, hinged on people's frustration, middle class anxiety, the belief that part of our problems with health care intentions, in stagnant wages and potential layoffs are because of trade policy.

Not all of those problems can be laid at the feet of trade, of course, but some significant part of them can, and I think voters spoke last year because they haven't gotten an answer to the question that you posed.

CHAIRMAN BARTHOLOMEW: Thank you, Senator Brown. Commissioner Blumenthal.

VICE CHAIRMAN BLUMENTHAL: Yes, thank you very much, Senator Brown. You've been a staunch supporter of Taiwan for a number of years. The issue of trade in Taiwan has come up again in the last few years because many in Taiwan, I think rightfully, feel that they're being left out of economic arrangements, purposefully, throughout Asia Pacific, and there was this issue and a desire of Taiwan to enter into a free trade agreement with the United States as a geopolitical issue as well as an economic issue to end their isolation and push back against deliberate attempts by the Chinese to isolate Taiwan.

I wonder if you had any comments on that? That's an issue that I think the administration has not gone forward with, and I wonder if you had any reaction to that?

SENATOR BROWN: I think we push forward with any recognition we can to bring Taiwan into the community of nations. I know that the last two presidents in each party, the president in each party, has generally supported the one-China policy. I don't.

I think by any measurement in the world community Taiwan is its own nation with a thriving economy. It made major strides in labor rights, less so in the environment, but not too bad compared to some other countries in that region in the environment. They have had a transition of power from one political party to another with no shots being fired, which is a mark of a more mature democracy. It really is a miracle in that country in many ways what they've done.

I remember the most poignant example of, in my mind, the ludicrous nature of this relationship that Taiwan has with many of the community of nations, is that after an earthquake in September, I believe, 2000, Taiwan suffered a pretty bad earthquake, pretty severe earthquake, and international relief organizations wanted to come in and help, and they had to go through Beijing, and Beijing delayed 24 hours just to send a message that presumably that they were in charge.

I fought to get Taiwan, in an ongoing way, in the World Health Organization. There is simply no reason they shouldn't be and be brought closer to the community of nations.

VICE CHAIRMAN BLUMENTHAL: Thank you.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Wessel.

COMMISSIONER WESSEL: It's an honor to have you here today. Thank you.

SENATOR BROWN: Thank you, Mike.

COMMISSIONER WESSEL: It's great to see you again. Several of the 421 actions that were taken by U.S. businesses over the last several years, which was the provision in the China Accession Agreement that allowed simply to respond to surges, came from Ohio based industries.

Each one of those was rejected by the White House in terms of providing relief that had been authorized by the ITC.

Do you think Congress this year is going to look at limiting discretion of the White House and the administration in terms of responding to some of these trade actions?

SENATOR BROWN: I don't know. I think that there's a different view of this trade policy in both houses this year. There were a good many people elected in both houses that want to take a more aggressive, I think fair-minded, stance on trade issues, that will stand up for American interests, and frankly stand up for interests of workers in support of good environmental policy all over the world, and in addition I think that people that didn't maybe share our views on a more aggressive policy read the election results too.

So I'm hopeful. I don't know specifically if that will be on the table. I think it will be interesting to see what plays out with TPA, with trade promotion authority, in the next month or two. I think we'll get some indication of how active the Senate and the House engage based on that.

CHAIRMAN BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: Thank you. I've heard and read that a lot of the currency problem in U.S. analysts' view is that the Chinese banking system is dysfunctional, at a minimum, and that they are afraid that if the currency floats freely, that the banking system

will collapse.

Do you view this as a political decision since the banking problems are largely caused by bad loans that are made for political reasons or not?

SENATOR BROWN: I guess I don't know the answer to that. I think you know more about that than I do.

COMMISSIONER FIEDLER: It's the state subsidy question.

SENATOR BROWN: Yes.

COMMISSIONER FIEDLER: Because in effect it seems to me that we are, through our jobs, i.e., the impact of the currency problem on jobs in the United States, subsidizing the dysfunctional Chinese banks because of the political decisions made by the leadership not to make those banks fully financial institutions but rather half-baked political institutions.

SENATOR BROWN: Surely China hasn't moved nearly as rapidly towards a market economy as I think both the Clinton and the Bush administrations have suggested that they would. That would be part of that. I don't feel particularly qualified to really know the answer to that beyond that, but I think that--I'm hopeful that this committee that Secretary Paulson has negotiated with the Chinese will be able to move towards market economy on some of those issues like banking especially, ownership of certain industries, that kind of thing.

CHAIRMAN BARTHOLOMEW: Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Madam Vice Chairman.

CHAIRMAN BARTHOLOMEW: You keep calling me Vice Chairman.

COMMISSIONER D'AMATO: Madam Chairman. I'm sorry.

SENATOR BROWN: It says chairman under Carolyn Bartholomew. You've got to turn that around for him.

COMMISSIONER D'AMATO: Sorry about that.

SENATOR BROWN: He'll pay for that. Go ahead.

COMMISSIONER D'AMATO: Senator, welcome. It's good to see you here and staying engaged in these issues that we think are very important.

SENATOR BROWN: Thank you.

COMMISSIONER D'AMATO: This Commission has recommended in the past that the United States take a more assertive leadership role not only in enforcing the laws, as we have a right to in agreements that we've reached with the Chinese, but to take initiatives, to promote initiatives with the Chinese. We promoted an idea for a joint U.S.-China energy working group, for example, two years ago.

I think the same can be said today of the question of climate change and working together with the Chinese. My question is do you

feel, as I do, and I think as some others, that the United States is missing opportunities to engage the Chinese a lot more directly in terms of cooperative programs and to see whether they will take us up on them? And this joint committee that Secretary Paulson has put together may be the beginning of that.

But my question is do we as a power, are we missing the opportunity to exert leadership to really work together with the Chinese and really rolling our sleeves up on some issues where we can make some progress together on energy, alternative energy, climate change, and things that are on the table that absolutely need our attention and their attention together to solve?

SENATOR BROWN: I think absolutely. I think everyday we wait is more hardship for workers and small businesses and communities in this country and more lost opportunity in China. When you go back to something we talked about earlier, that roughly one-third of Chinese exports come to the United States, we have a lot of leverage with them to do the right thing, and the right thing means moving in the right way in environmental policy, with child labor, with forced labor, with all kinds of--with banking issues.

And there is simply no reason we can't with a carrot and a stick move in a better direction in guaranteeing intellectual property rights and things like that when they have so violated in so many cases our intellectual property protections in the past, and I just think it needs a more engaged aggressive policy.

Secretary Paulson, as you point out, the relationship that he's negotiated, that he's working on, is important, but there doesn't seem to be enough behind it, enough stick behind it and probably enough carrots around it that we can really move forward on that as we should.

But I just think we're right now, we're, I don't know this for sure, but if we're one-third of Chinese exports now, I got to think those numbers over time will decline as they become a wealthier nation and other nations become wealthier and they begin to sell more. So the sooner we act, the more leverage we have and the more opportunity we have to see China come into the community of nations in a way that serves their interests and our interests, too.

COMMISSIONER D'AMATO: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Houston.

COMMISSIONER HOUSTON: Thank you, Madam Chairman, and thank you, Senator, for spending so much time with us this morning. We really appreciate it. It's nice when we can do the back and forth.

SENATOR BROWN: Yes.

COMMISSIONER HOUSTON: You've been in politics a long time, and you know that sometimes there is value in pushing for a vote for something even if you know you're going to lose. People know

where you stand and you move the ball down the field a little bit on the issue and people understanding it.

You had mentioned earlier that we have options, the U.S. has options, already in dispute resolution; it never seems to be moving. So my question is twofold. Do you see value in pursuit of a WTO case even if there is some knowledge that it's not going to fly, and what in your opinion would be the worst case scenario to go to the WTO or to one of the other world bodies and lose on a trade issue?

SENATOR BROWN: Having a lot of experience in the House in the last 12 years, I'm pretty used to losing so I know a lot about that.

The Senate moves so slowly. So I'm not used to winning in the Senate either yet. So I don't know if I'm qualified to answer that.

I think the risk is relatively minimal. The chairwoman brought up the administration will say we go and lose and what does that do with our standing with other countries? I think a fight well made on principle, well articulated, that garners a lot of public attention and also a lot of attention among diplomats and among economists around the world is always a good thing, particularly because it will help to educate all the players. It will help to educate the trade lawyers and the environmental advocates, the small business representatives and labor and the public and the newspapers about what these agreements are all about.

The American public knows there is something askew in our China trade policy. I don't think they quite know what. They think we're at a disadvantage and they're right in many ways. In some ways perhaps they're wrong. But they don't exactly know why, and if they saw a government that actually looked like it was representing a large swath of the American public--workers, small businesses, agriculture, consumers, environmentalists, bankers, people that really were players in this and affected by this--I think it would have a much more positive impact.

I guess the worst thing is we bring it to the WTO, we lose, it makes it perhaps harder to bring the next one, but I don't think that's a big loss.

CHAIRMAN BARTHOLOMEW: Senator Brown, you've been very generous with your time. Do you have time for a few more questions? Commissioner Reinsch.

COMMISSIONER REINSCH: Thank you. I must say I was very impressed with one of your answers to Commissioner Fiedler's questions. You said, “I don't know.” I've worked up here 20 years. I don't think I've ever heard a senator say that before.

SENATOR BROWN: With that introduction, I'm probably going to give you the same answer, too.

COMMISSIONER REINSCH: No, no, no. I only ask softballs.

We'll have you back in a year and see if you still answer questions that way or whether you've learned how the Senate operates. SENATOR BROWN: I've been saying I don't know for 14 years; it seems to have worked, so--

COMMISSIONER REINSCH: Let me do the opposite side of Commissioner Houston's question. Let's assume we file a complaint at the WTO on currency, and let's assume we win, just for the moment, what would you expect--what would you like the WTO to recommend as relief if we prevail?

SENATOR BROWN: I guess ultimately a currency that really floats in a way that their economic system would be market-oriented. To me the best part of winning the currency coalition, 301 petition, would be what it would lead to in terms of labor standards and the environment because I think once we win, once we win one of those serious important issues that there's going to be a more receptive WTO and be a more receptive USTR and WTO.

I'm not enough of a currency expert, as reflected in my answer to him about banking, that I would know exactly what that would mean except--I mean I don't think it changes everything overnight but moving in that direction. We're not going to see sharp, sharp change in China policy even if Congress pushes hard with success because of the huge numbers of dollars at stake and the more and more mature industries that have grown in China and what it means to our imports and exports and our retail operations and all that.

But I think that a currency that's more receptive to international finance is going to move us in that direction.

COMMISSIONER REINSCH: Well, we don't need to get into a float. There's not enough time. But let's suppose they bump it up. Let's suppose they bump it up 27.5 percent. I think that was the amount in the bill, in the Schumer-Graham bill.

SENATOR BROWN: Right.

COMMISSIONER REINSCH: How much of an impact do you think that would have on the bilateral trade deficit?

SENATOR BROWN: I don't think that it would have an immense--it's 27 percent. It would be significant. I don't know. I don't think it's going to all of a sudden say that our bilateral trade deficit is cut in half or cut by two-thirds or eliminated, but I think it's the first step. We're going to have a trade deficit with China for decades or at least a decade, but I think it moves us in the right direction where other issues are on the table.

I don't think it's all about currency. I think currency is the easiest one on some level to understand and the one around which you can get the most agreement. Almost everybody thinks we should do something about currency except the people making the decisions in

the government.

But on labor and environment, there is marked difference. Many people don't want major stronger labor and environmental laws in our country. They sure don't want them in our bilateral trade negotiations and trade relations. So that's one reason currency seems to have been one people have coalesced around I think.

COMMISSIONER REINSCH: I think I should stop. Thank you.

SENATOR BROWN: Thanks.

CHAIRMAN BARTHOLOMEW: Commissioner Wortzel.

COMMISSIONER WORTZEL: Senator, thanks for being here.

SENATOR BROWN: Thanks.

COMMISSIONER WORTZEL: Sounds great; doesn't it?

SENATOR BROWN: Thank you. It's not a hostile group.

COMMISSIONER WORTZEL: I want to draw you back to the House a minute, because you provided such great leadership on a very important issue in the Taiwan Caucus, and just ask what's happening? How is that going? Is somebody picking that up, I don't want to call it a burden, but that responsibility up?

SENATOR BROWN: Yes. There was a group of four of us--Steve Chabot, a Republican from Cincinnati, Ohio; Dana Rohrabacher, Republican from California; Robert Wexler, a Democrat from Florida; and I--the four of us started the Taiwan Caucus. It grew to about a hundred members, slightly fewer than that I think, but roughly a hundred. As in all organizations, a small number of people are the most active, but they will continue.

There will be more support now from the Senate. I think the movement will have new life and I think it's a question of continuing to work with the administration. We made progress on the World Health Organization. All we're asking for is observer status initially. We haven't gotten there yet, but I think we're doing better.

The administration is more responsive today than they were five years ago, and the Bush administration has been more responsive than the Clinton administration. I think it's a question of--I remember when I think about patience and Taiwan, I think of when Chou En-lai was asked in 1975 what he thought about the success of the French Revolution; he said it's too early to tell.

I don't want to wait that long on Taiwan WHO observer status, but I think we are moving in that direction.

COMMISSIONER WORTZEL: Thank you. We had a group of intellectuals and Party officials come through from Beijing before the election and they said, well, what's going to happen and how things are going to go in the House? And I said, well, ya'll are focusing on the House because you're afraid of changes, but, if Senator Brown ends up in the Senate, you may find some leadership in there in the same

direction it went in the House, so I'm glad you're able to bring that to them.

SENATOR BROWN: Thank you for saying that. Thanks, everybody.

CHAIRMAN BARTHOLOMEW: Thank you very much for your time and we look forward to working with you. Thanks.

We are waiting for Deputy Undersecretary Lawless who is supposed to be here shortly. So we will take a five minute break.

[Whereupon, a short break was taken.]

PANEL II: ADMINISTRATION PERSPECTIVES

CHAIRMAN BARTHOLOMEW: Thank you very much. I think we'll go ahead and get started. Undersecretary Lawless is apparently quite close, but in the interest of keeping track of everybody's time, we'll go ahead and start.

In our next panel, we are pleased to welcome two representatives from the administration, the Honorable Richard Lawless, Deputy Undersecretary of Defense for Asian and Pacific Security Affairs, and Mr. David Pumphrey, Deputy Assistant Secretary for International Energy Cooperation.

Deputy Undersecretary Lawless joined the Department of Defense in 2002 and under the Office of the Undersecretary of Defense, he is responsible for the formulation of U.S. security and defense policy in the Asia Pacific region. Prior to his appointment, Mr. Lawless served as co-founder, and chairman/CEO of U.S. Asia Commercial Development Cooperation.

The Commission has asked Deputy Undersecretary Lawless to speak today on issues of U.S. security challenges in Asia, U.S.-China military-to-military relations, U.S. assessment of Chinese military modernization, and the U.S.-China strategic balance.

Also joining us today, and we extend a warm welcome, is Deputy Assistant Secretary Pumphrey. Mr. Pumphrey is responsible for the development and implementation of strategies that will strengthen U.S. energy security, improve environmental quality and create investment and trade opportunities for U.S. energy companies, all critically important issues.

The Commission has asked Mr. Pumphrey to speak on U.S.-China energy cooperation including the recent agreement for Westinghouse to supply China with nuclear reactors and the department's role in the strategic economic dialogue.

We welcome you, Mr. Pumphrey. You'll have seven minutes in which you can speak. Your written statement will be submitted for the record, and we look forward to hearing your testimony.

STATEMENT OF DAVID L. PUMPHREY
DEPUTY ASSISTANT SECRETARY, OFFICE OF POLICY AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF ENERGY

MR. PUMPHREY: Thank you, Madam Chairman, Mr. Vice Chairman, members of the Commission. It's a pleasure to be here today to discuss our perspectives on the energy relationship with China and the challenges ahead for 2007.

We have actively engaged China on a wide variety of issues since the last hearing of this Commission in August of 2006. We are encouraged that our cooperative efforts to promote clean energy, foster improved energy efficiency and enhance energy security have achieved some successes in the past few months.

Nevertheless, there is much work to do as China's growing appetite for energy will continue to impact world energy balances and the environment.

Driven by strong economic growth, China has become the world's second-largest energy consumer after the United States. By 2030, our Energy Information Administration projects, assuming current policy, that China's energy demand will exceed that of the United States and will account for 19 percent of the world's total demand.

As you'll see by the figures that are attached to the testimony, coal will continue to be the dominant fuel in the Chinese economy. This heavy reliance on coal will make China the number one emitter of carbon dioxide in the next ten years. Oil consumption is also expected to continue to increase, driven by strong growth in the transportation sector and will drive up China's demand for imported oil.

By 2030, we expect the consumption of oil in China to be about 15 million barrels per day, with imports about 11 million barrels per day.

By 2030, China's nuclear generating capacity is expected to grow about more than six-fold, but still represent only a small share of total energy use.

China has recognized its energy challenges and has proposed significant actions to address this rapid growth in demand in its 11th Five-Year Plan covering the period from 2006 to 2010.

The most striking aspect of this plan is a mandatory target calling for a 20 percent reduction of energy consumption per unit of GDP by 2010. To meet this target, China has introduced measures to improve building efficiency including a target to reduce energy consumption by urban buildings by 50 percent by 2010.

China will also introduce more stringent fuel efficiency

standards in 2008 to rein in escalating demand for transportation fuels which is driven by projected increase in automobile ownership from 27 million cars in 2004 to 200 to 387 million cars by 2030.

In addition to efforts towards the development of domestic energy sources, the plan calls for continuation of what's been called the "going out strategy," which is encouraging investment by China's state-owned energy companies in oil and gas production overseas.

In light of these developments, the Department of Energy has continued to engage China in the fields of policy-making, energy security, fossil energy, energy efficiency, renewable energy, nuclear energy and nuclear nonproliferation.

We have done this through five primary mechanisms including the U.S.-China Energy Policy Dialogue, the U.S.-China Science and Technology Agreement, the U.S.-China Peaceful Use of Nuclear Technology Agreement, also known as the PUNT, the U.S.-China Oil and Gas Industry Forum, and in the context of the recently established the U.S.-China Strategic Economic Dialogue.

In our last meeting of the Energy Policy Dialogue held in China, one of our key messages was the importance of relying on market forces to determine energy prices and production.

We've also emphasized that China should also rely on the operation of the international marketplace to meet their energy import needs rather than following a policy that puts heavy emphasis on securing energy supplies through equity purchases.

The dominant issues during that discussion were focused on energy efficiency and renewable energy, including biofuels.

Under the U.S.-China Science and Technology Agreement, we have several protocols that are employed to promote technical cooperation in fossil energy, renewable energy and energy efficiency, and I'll describe those in just a minute.

As the chairwoman mentioned, the Strategic Economic Dialogue did touch on energy this year. Secretary Bodman participated in this meeting and energy and environment were key themes, including looking at how to integrate energy in the overall discussion of economic issues.

Outcomes from the SED included the renewal of our Protocol for Cooperation on Energy Efficiency and Renewable Energy, and China's agreement to join the FutureGen Government Steering Committee.

Another key forum used to interact with China on energy issues is the Asia-Pacific Partnership on Clean Development and Climate. The APP is a public-private effort which also includes Australia, Japan, Korea and India to accelerate the development and deployment of clean energy technologies to meet energy, security and climate

goals.

I'd like to discuss briefly some of our specific activities with China. In the fossil energy area, our cooperation includes the FutureGen project which I just mentioned, which we are now beginning the process of negotiating China's participation in the Government Steering Committee. The China Huaneng Group, which is a major electric power company, is already part of the private sector part of the FutureGen Industry Alliance.

Another area of cooperation is the U.S.-China Oil and Gas Industry Forum which is designed to promote private investment in oil and natural gas development in China and involves our private sector as well.

And finally, in the area of fossil energy, we have long-term cooperation on ways and areas of using coal more cleanly.

With regard to energy efficiency and renewable energy, a significant outcome under the SED I mentioned was the renewal of our Energy Efficiency and Renewable Energy Agreement. Under this agreement we hope to deepen our collaboration on industrial energy efficiency, green buildings, and biofuels.

Also in the area of industrial energy efficiency, DOE will work with Chinese energy professionals to better identify industrial energy efficiency opportunities.

In the area of nuclear energy, China's ambition to expand its nuclear capacity represents significant commercial opportunities. Westinghouse is closing in on a commercial contract to build four so-called AP1000 nuclear reactors, which is an advanced reactor design. They would be the first AP1000 reactors to be built, worth $5.3 billion.

This deal, once finalized, would affirm that the U.S. remains a leader in the design and construction of civilian nuclear power plants. The deal would create some 5,500 new jobs in the U.S.

During Secretary Bodman's trip to Beijing, he and Ma Kai, Chairman of the National Development and Reform Commission, signed a Memorandum of Understanding that reaffirms the position of the U.S. government to support peaceful development of nuclear power in China, specifically these advanced pressurized water reactors and related technology transfer.

The U.S. has agreed to support the transfer of this civilian nuclear technology consistent with both nations' commitments to nuclear nonproliferation.

We have also been working with China under the PUNT on nuclear technologies and nonproliferation, looking at physical protection of materials, reactor safety and safeguards technology

development.

Finally, as China has moved to integrate itself into the world market, there are a number of areas of cooperation. I see I'm running out of time so I'll move quickly. The one I would highlight the most is our efforts to bring China closer in its coordination with the International Energy Agency.

China recently participated in a seminar with the IEA to talk about their outlook for investment and energy needs, but more importantly, they participated for the first time in the IEA Governing Board meeting, although not yet a member of that process.

In addition, China just hosted a meeting of five major consuming countries--India, Japan, Korea and the United States--to discuss strategies to enhance energy security and promote diversification of energy markets. Secretary Bodman led the U.S. delegation to this meeting in December.

We think most importantly the statement issued at the end of this meeting highlighted, and was agreed to by all countries, the importance of following market principles in addressing our common energy concerns and recognized the value of coordinating drawdowns of strategic oil stocks.

So, Madam Chairman, I will conclude my oral remarks there and I would look forward to any questions that you may have.

[The statement follows:][2]

CHAIRMAN BARTHOLOMEW: Thank you, Mr. Pumphrey. We'll move next to Secretary Lawless. It's a pleasure to welcome Secretary Lawless. I already introduced you with glowing words, but I simply would like to note for the record that you used to be Vice Chairman Blumenthal's boss, which we will keep in mind as Vice Chairman Blumenthal asks any question.

VICE CHAIRMAN BLUMENTHAL: I think he still is my boss.

CHAIRMAN BARTHOLOMEW: I want to remind everybody that our witnesses get seven minutes in which to speak. Commissioners will get five minutes for questions and answers after that. Welcome, Secretary Lawless.

[2] **Click here to read the prepared statement of David L. Pumphrey, Deputy Assistant Secretary, Office of Policy and International Affairs, U.S. Department of Energy (Read Pumphrey Attachment)**

STATEMENT OF RICHARD P. LAWLESS
DEPUTY UNDER SECRETARY OF DEFENSE FOR ASIAN & PACIFIC SECURITY AFFAIRS, DEPARTMENT OF DEFENSE

MR. LAWLESS: We obviously are delighted to be here. Earlier in the week, I received your guarantee that this would not be a get-even session on behalf of Dan Blumenthal, but I'll move through this, and I'll begin with an apology for my late arrival, and we are across the river and sometimes it takes us longer to get here.

Madam Chairman, distinguished members of the Commission, I thank you for the opportunity to address this important topic today. My oral testimony is necessarily an abridged version of a more comprehensive statement that we'll be passing to you shortly. I do appreciate your indulgence. I know that I am working against the clock here, but I will attempt to push through. There is a lot to talk about today and I want to make sure that each of the areas that you're all interested in is appropriately addressed.

China's rapid emergence is an important element of today's strategic environment, of course, one that has significant implications for the United States, the Asia Pacific region, and the world.

The uncertainty surrounding China's rise underscores the importance of the Commission's charter to identify approaches that best serve U.S. interests in managing the way forward. I do commend the Commission for its efforts.

With regard to U.S. policy, our national defense strategy emphasizes the importance of influencing events before challenges become more dangerous and less manageable.

The 2006 Quadrennial Defense Review describes China as being at a strategic crossroads. On that basis, our policy is to shape China's choices in ways that foster constructive cooperation in addressing common security challenges. It is through these efforts the Department of Defense supports the broader U.S. government objective of building a cooperative, constructive relationship with China.

In this forum, in our Annual China Military Power report, and in other fora with the Chinese, we have previously discussed China's military transformation. Whether China's emergence will be peaceful or not remains uncertain. The pace and scope of China's military transformation has accelerated each year. China continues to invest heavily in the modernization of its military, particularly in weapons and capabilities for power projection and access denial.

The lack of transparency behind this effort continues to be a source of concern. China's military modernization appears focused on preparing for potential conflict in the Taiwan Strait.

The cross-Strait balance of power continues to shift in Beijing's favor. Beyond the near-term Taiwan-oriented efforts, however, China's military modernization efforts also support capabilities for broader regional applications.

As will be discussed in our upcoming report to Congress, China continues to deploy short-range ballistic missiles to garrisons opposite Taiwan. The PLA maintains more than 700 combat aircraft within operational range of Taiwan. While many of China's aircraft are obsolete or upgraded versions of older aircraft, modern aircraft such as the SU-27, SU-30 and China's own indigenous F-10 fighter make up a growing percentage of that force.

An increasingly sophisticated array of armaments and China's development of an aerial refueling capability combined with new platforms has improved China's offensive air capabilities.

The PLA Navy continues to enhance its regional force projection capabilities through the acquisition of new surface combatants, submarines and advanced long-range anti-ship cruise missiles and ship-based air defenses.

China's strategic force modernization to include the development of the DF-31 and the DF-31A road-mobile solid propellant intercontinental range ballistic missiles, a new submarine-launched ballistic missile, and quantitative and qualitative upgrades to some of its older systems is altering the historical nuclear calculus.

China's counterspace developments punctuated by the January 2007 successful test of a direct-ascent anti-satellite weapon poses dangers to human space flight and puts at risk the assets of all space-faring nations.

Its continued pursuit of access denial capabilities and strategies are expanding from the traditional land, air and sea dimensions of the modern battlefield to now include space and cyberspace.

In the face of these potentially disruptive developments, the United States continues to monitor closely China's military modernization while pushing for greater transparency. At the same time, as our QDR outlines, the department will continue to work with partner states to build capacity and reduce vulnerabilities.

Critical components of this effort involve diversifying our basing structure, promoting constructive bilateral relationships in the region, and developing appropriate counters to anti-access threats.

China's emergence as a world power, its companion military transformation must also be assessed we believe in the context of regional and global security challenges. China's emergence brings with it opportunities to demonstrate whether or not it intends to take on the role of the responsible stakeholder, but we continue to receive

some mixed signals from Beijing.

In the last year, China appears to have begun to view the North Korean nuclear issue with more concern than in the past. North Korea's ballistic missile launches over the Sea of Japan last July and the nuclear test in October no doubt served as catalysts giving China cause to reconsider its previous attitudes toward North Korea's nuclear programs.

We strongly encourage Beijing to more fully leverage its special relationship with Pyongyang to convince the North to give up its nuclear ambitions. The proliferation of weapons of mass destruction remains one of the U.S. government's foremost concerns.

Over the past several years, Beijing has improved its nonproliferation posture by promulgating export control laws and regulations, strengthening its oversight mechanisms and committing to respect multilateral arms export control lists.

However, there remains more for China to do to curtail proliferation. Despite Beijing's improved measures to counter proliferation, we still observe the transfer of a wide variety of technologies to customers around the world, including those states of concern such as Iran, Sudan, Burma, Zimbabwe, Cuba and Venezuela.

We remain concerned with China's efforts that seek also to limit the United States presence and influence. Efforts to develop exclusionary regional frameworks are contrary to the trend of greater regional cooperation in Asia. The use of its influence in the Shanghai Cooperation Organization to call for a U.S. withdrawal from a regional basis runs counter to our efforts on the war on terrorism.

The agreement China concluded with Tajikistan this past month calls attention to this very issue. There is also an important underlying message in China's military transformation, and I believe this message comes through clearly in the overall tone of China's Defense White Paper. That is in 2007 China has assumed a more confident and increasingly assertive posture than when the U.S.-China Commission was established in the year 2000.

The January 2007 ASAT test, the October broach of a Song-class of diesel-electric submarine in proximity to the USS Kitty Hawk in international waters can be viewed in this context.

China is beginning to see the fruits of its long-term investment in comprehensive military modernization. However, with this comes the risk of miscalculation. On the one hand, we may underestimate the development of China's military capabilities, and additionally as capabilities increase both quantitatively and dimensionally, there are greater opportunities for miscalculation absent improved transparency in the relationship.

China's leaders themselves may overestimate the proficiency of their forces owing to their lack of real operational experience, leading potentially to more risk acceptance behavior. This is an important factor to consider as the United States military assesses its own transformation efforts and considers how best to manage and shape this critical relationship with China.

I would like to briefly overview our progress in military-to-military relations. Since the low point reached during the 2001 EP-3 incident, there has been positive momentum behind the development of the U.S.-China military-to-military relations.

Our military-to-military engagement encourages cooperation with China in areas where there are shared interests. But we are also cognizant of differences and where there are differences, we seek to speak candidly on areas where these interests diverge.

We have made incremental, yet meaningful, progress in the quality and quantity of our educational and functional exchanges with China and we seek to build on this progress with the objective of demystifying one another.

For example, in 2006, we saw the completion of a two-phase bilateral search and rescue exercise. This was an important development. The PLA has indicated greater willingness and interest in conducting archival research to support efforts to account for American service personnel missing from past conflicts.

We have also undertaken several initiatives to address the challenges posed by PLA's modernization. Based on concerns regarding China's accelerated modernization of its strategic missile forces, President Bush and President Hu Jintao agreed to initiate a dialogue on strategic nuclear policy doctrine and strategy.

Since 2004, we've encouraged Beijing to establish a defense telephone link between our defense leadership to support senior-level communications in the event of a crisis. Based on our discussions with the Chinese Ministry of Defense officials late last year, we now expect to move forward on both of these efforts in the months ahead.

We believe there's continued room, however, for improvement, but progress in military-in-military relations will depend on choices made by China's military leadership. These choices emphasize transparency over opacity, substance over symbolism, implementation over negotiation. United States has long been a force for stability in the region, and we will continue to play that positive role.

Our relationship with China is a key part of our strategy to promote a stable, peaceful and prosperous Asia Pacific region. The department recognizes the important role defense exchange can play in supporting the president's overall vision for U.S.-China relations, and

we will continue to manage our activities to best shape China's choices in a responsible and constructive direction.

That concludes my oral presentation. Thank you.

[The statement follows:]

Prepared Statement of Richard P. Lawless
Deputy Under Secretary of Defense for Asian & Pacific Security Affairs, Department of Defense

Madam Chairman, distinguished members of the Commission, I thank you for the opportunity to address this important topic. China's rapid emergence as a regional political and economic power with global aspirations is an important element of today's strategic environment – one that has significant implications for the United States, the Asia-Pacific region, and the world. The uncertainty surrounding China's rise underscores the importance of the Commission's charter to identify approaches that best serve US interests in managing the way forward, and I commend the Commission for its efforts.

U.S. Policy

Our National Defense Strategy emphasizes the importance of influencing events before challenges become more dangerous and less manageable. This approach, along with the recognition that China, as described in the 2006 Quadrennial Defense Review, finds itself at a strategic crossroads, provides the basis for our policy towards China. That is, to shape China's choices in ways that foster constructive cooperation in addressing common security challenges, including terrorism, proliferation, narcotics trafficking and piracy. It is through these efforts that the Department of Defense supports the broader U.S. policy that welcomes the rise of a peaceful and prosperous China, a China that emerges as a responsible international stakeholder.

China's Military Transformation

Whether China's emergence will be peaceful or not remains uncertain. Fueled by extraordinary economic growth for the past two decades, the pace and scope of China's military transformation has accelerated with each passing year. China continues to invest heavily in the modernization of its military, particularly in strategic weapons and capabilities to support power projection and access denial operations.

The Defense White Paper released by the Chinese government at the end of 2006 is considered by most observers to be an improvement over earlier versions of this paper, published on a biennial basis since 1998. It continues a trend of modest improvements in transparency and in the quality of reporting. We noted a moderation in rhetoric, but unfortunately, the paper continues to lack basic factual details on PLA force composition and defense expenditures.

Following a thorough review of the White Paper, the question remains of China's military transformation – to what ends? What are China's objectives and intentions? There is little information in the White Paper or other official Chinese pronouncements to explain the motivations behind much of China's military modernization efforts.

The principal focus of China's military modernization in the near term appears to be preparing for potential conflict in the Taiwan Strait. In this context, the cross-Strait balance of power continues to shift in Beijing's favor. Beyond the near-term Taiwan-oriented efforts, however, China's military

modernization efforts also support capabilities for broader regional applications.

As will be discussed in our upcoming report to Congress, China continues to deploy short-range ballistic missiles to garrisons opposite Taiwan. The PLA maintains more than 700 combat aircraft within operational range of Taiwan. While many of China's aircraft are obsolete or upgraded versions of older aircraft, modern aircraft (e.g. Su-27 and Su-30/FLANKER variants and the indigenous F-10 fighter) make up a growing percentage of the force. An increasingly sophisticated array of armaments and China's development of aerial refueling capability, combined with its new platforms, has improved China's offensive air capabilities. The PLA Navy continues to enhance its regional force projection capabilities through acquisition of new surface combatants, submarines, and advanced weapons systems (e.g. long-range anti-ship cruise missiles and naval mines) and ship-based air defenses. China received the second of two Russian-made SOVREMENNY II guided missile destroyers in late 2006 and took delivery of two KILO-class diesel-electric submarines – China now operates 12 KILO-class submarines.

China's strategic forces modernization, to include development of the DF-31 and DF-31A road-mobile, solid propellant intercontinental range ballistic missiles, a new submarine launched ballistic missile, and qualitative upgrades to some of its older systems is altering the historic nuclear calculus. China's counterspace developments – punctuated by the January 2007 successful test of a direct ascent anti-satellite weapon – pose dangers to human space flight, and put at risk the assets of all space faring nations. Its continued pursuit of access denial capabilities and strategies are expanding from the traditional land, air, and sea dimensions of the modern battlefield to include space and cyber-space.

In the face of these potentially disruptive developments, the United States continues to monitor closely China's military modernization, while continuing to push for greater transparency and openness. At the same time, as our QDR outlines, the Department will continue to work with partner states to build capacity and reduce vulnerabilities. Critical components of this effort involve diversifying our basing structure; promoting constructive bilateral relationships in the region; and developing appropriate counters to anti-access threats.

Regional and Global Security Challenges

China's emergence brings with it opportunities to demonstrate whether or not it intends to take on the role of a responsible stakeholder in the international system, especially regarding key security challenges. In this regard, we continue to receive mixed signals from Beijing.

In the last year, China appears to have begun to view the North Korean nuclear issue with more concern than in the past. North Korea's ballistic missile launches over the Sea of Japan last July and nuclear test in October no doubt served as catalysts giving China cause to reconsider its previous ambivalence toward North Korea's nuclear programs. We commend China's continued facilitation of the Six-Party Talks, however, we strongly encourage Beijing to more fully leverage its special relationship with Pyongyang to convince the North to give up its nuclear ambitions.

The proliferation of weapons of mass destruction remains one of the U.S. Government's foremost security concerns. Over the past several years, Beijing has improved its non-proliferation posture by promulgating export control laws and regulations, strengthening its oversight mechanisms, and committing to respect multilateral arms export control lists. Government white papers on defense and non-proliferation have also served to increase transparency of China's efforts. However, there remains more for China to do to curtail proliferation. Despite Beijing's improved measures to counter proliferation, we still observe transfer of a wide variety of technologies to customers around the world – including to states of concern such as Iran, Sudan, Burma, Zimbabwe, Cuba, and Venezuela.

We remain concerned with Chinese foreign relations efforts that seek to limit United States' presence and influence. Efforts to develop exclusionary regional frameworks are contrary to the trend of greater regional cooperation in Asia. The use of its influence in the Shanghai Cooperation Organization to call for a U.S. withdrawal from regional bases runs counter to our efforts in the War on Terrorism.

There is an important underlying message that we can derive from the manner with which we see China's military transformation proceeding, and I believe this message also comes through in the overall tone of China's Defense White Paper. That is, in 2007, China has assumed a more confident and increasingly assertive posture than when the U.S. China Commission was established in 2000. The January 2007 ASAT test and October broach of a SONG-class diesel-electric submarine in close proximity of the USS KITTY HAWK in international waters, can be viewed in this context. China is beginning to see the fruits of its long-term investment in comprehensive military modernization. However, a risk of miscalculation exists. On the one hand, we may underestimate the development of China's military capabilities. On the other hand, China's leaders themselves may overestimate the proficiency of their forces owing to their lack of real operational experience, leading potentially to more risk acceptant behavior. This is an important factor to consider as the United States military assesses its own transformation efforts and considers how best to manage and shape this critical relationship with China.

Military-to-Military Relations

Since the low-point reached during the 2001 EP-3 incident over the South China Sea, there has generally been positive momentum behind the development of a U.S.-China military-to-military relationship. Our military-to-military engagement encourages cooperation with China in areas where there are shared interests, but we also are cognizant of differences, and seek to speak candidly on areas where our interests diverge.

Our engagement efforts are organized along four channels: high level, educational, functional, and bilateral dialogues. High level exchanges and bilateral dialogues provide direction for our defense relations, but also serve as a mechanism to secure endorsement from the PLA leadership to implement their commitments. We have made incremental, yet meaningful progress in the quality and quantity of our educational and functional exchanges, and seek to build on this progress with the objective of "demystifying" one another.

To support an overall program of exchanges that is substantive and equitable, we adhere to the principles of transparency and reciprocity in development of all military-to-military activities. In this way, it is our goal to improve mutual understanding, and prevent conflict by communicating U.S. resolve to maintain deterrence and stability in the Asia-Pacific region.

We are seeing greater opportunities for educational exchanges at lower levels, particularly at our military academies. Importantly, in 2006, we saw the completion of a two-phase bilateral search and rescue exercise that contributed to greater understanding of each other's responses to humanitarian disasters at sea. The PLA has indicated greater willingness and interest in conducting archival research to support efforts to account for American service personnel missing from past conflicts.

Our defense relationship, however, faces significant challenges. In the conduct of our military-to-military activities, we remain mindful of the PLA's modernization efforts I described earlier and its coercive posture directed at Taiwan. In recognition of these challenges, we closely manage our defense exchanges to ensure these contacts are consistent with the guidelines established by the National Defense Authorization Act for Fiscal Year 2000; avoiding any activities that would put U.S. national security at risk.

We've also undertaken several initiatives to address these challenges. Based on concerns regarding China's accelerated modernization of its strategic missile forces, President Bush and President Hu Jintao agreed to initiate a dialogue on strategic nuclear policy, doctrine and strategy. U.S. Strategic Command is prepared to host the Commander of the PLA's Second Artillery Corps as a first step. Since 2004, we've encouraged Beijing to establish a defense telephone link between our defense leadership to support senior level communications in the event of a crisis. Based on our discussions with Chinese Ministry of Defense officials late last year, we expect to move forward on both of these efforts in the months ahead.

At the same time, we continue to seek ways to develop our relationship in a constructive manner. We believe there's continued room for improvement, but progress in military-to-military relations will depend on the choices of China's military leadership. Choices that emphasize transparency over opacity, substance over symbolism, and implementation over negotiation will go a long way to further our defense relations.

Agenda for the Future

As noted in the 2006 QDR Report, the U.S. Department of Defense is transforming according to our best understanding of ongoing changes in the international security environment. On this continuum of change, better understanding affords better cooperation, while greater uncertainty requires greater hedging.

China's lack of transparency cultivates an environment of uncertainty rather than understanding. Greater openness on the part of China would go a long way to reversing this trend. For the Department, we must make every effort to develop an accurate understanding of China's intentions and capabilities.

In the years ahead, the Department would benefit from greater insight on China's:

- strategic intentions

- calculus of deterrence in the context of its strategic forces modernization

- priorities in the military research, development and acquisition process

- plans and intentions in military space and counterspace

- investment strategies in military and dual-use science and technology

- emerging views on the security situation on the Korean Peninsula and Iran

- the impact of China's growing dependence on foreign sources for energy and strategic minerals on defense policy and force planning

Conclusion

The United States has long been a force for stability in the region, and will continue to play a positive role. The United States relationship with China is a key part of our strategy to promote a stable, peaceful and prosperous Asia-Pacific region. The Department recognizes the important role defense exchange can play in supporting the President's overall vision for U.S.-China relations and will continue to manage our activities to best shape China's choices in a responsible and constructive direction.

Panel II: Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Thank you very much, Mr. Secretary, for a very thoughtful and balanced statement. I also want to thank both of our witnesses for their service to our nation. We know that there are always opportunities in the private sector, but we all benefit from your service. So thank you. I'm going to start with Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Madam Chairman, and thank both our witnesses for bringing us up to date with the detailed summary of the activities the administration is underway with the Chinese government.

I might point out, Secretary Lawless, that two years ago in our annual report, we recommended the administration move forward with the development a more robust inventory of confidence-building measures with the Chinese based on what happened during the downed crash of our aircraft and the lack of communication subsequent to that. So I'm glad to hear that we're moving forward and attempting to do more on the communication side. It seems to us very critical to do that. I commend you for that.

I do have a specific question for Secretary Pumphrey. In the rendition of all of the proposed agreements and joint projects that you talked about with regard to the Chinese on energy and environment, and looking at your testimony and the chart at the end with regard to Chinese coal use, obviously coal is going to be the central factor in their energy development from time to come. The question, of course, is how well can we work with the Chinese in proposing technology solutions to the downsides of coal use, not only the health side but obviously the climate change side?

The administration has been talking about technology solutions. One technology issue that I'm interested in pursuing is the question of carbon sequestration. Obviously, with these new coal plants, something has got to be done about greenhouse gas emissions or we're not going to be able to get a handle on climate change.

This new nascent technology, tell us a little bit if you can about the question of carbon sequestration technology development and whether we are moving with the Chinese on that particular technology?

MR. PUMPHREY: Thank you. In the full version of the testimony, there's a little more description of some of the carbon sequestration work that we have moved forward on. It is an area of prime importance for us as well to engage China, recognizing that coal will be the fuel that they will use. India is in the same situation. We think it's very important to work with them on finding solutions to

CO2 releases.

The FutureGen project which they have now joined both on the industry side and the government side is designed to demonstrate the feasibility of building a power plant that can capture and sequester CO2. So we're very pleased that they're showing that interest. There is also some movement within China to build their own demonstration plant as well. So we see very strong interest.

The key is going to be the investment framework that's put in place to actually have the investment in these technologies, and we think that there are still some things that will need to be done in terms of making certain that the market is allowed to set prices in a way that will allow these investments when these technologies become economic to move forward.

So we're very hopeful. On the research side, there's a great deal of interest. I think we will have to watch carefully to see if on the investment side we can move to large-scale deployment of the technologies.

COMMISSIONER D'AMATO: Thank you. Just a quick follow-up. It's one thing to be economical about carbon sequestration, which may be years away, and I understand the Chinese are building power plants like there is no tomorrow. So the question is when do we have technology available, economical or not, but feasible from a technology point of view, to begin capturing this stuff and are we prepared to start moving in the direction of programs?

Forget about the investor technology climate for the moment and the question of transferring technology to the Chinese that's usable in terms of these power plants, whether it be an aid program or a cooperative program or whatever kind of program you organize. What kind of time frame are we talking about in terms of being able to demonstrate this technology that will be put into place?

MR. PUMPHREY: The overall goal of the United States Department of Energy's Carbon Sequestration Program is to develop, by 2012, pilot-scale fossil fuel power generation systems that achieve 90 percent CO2 capture with 99 percent storage permanence at less than a 10 percent increase in the cost of energy services. Reaching this goal requires an integrated research development, and demonstration program linking fundamental advances in Carbon Capture and Storage (CCS) to practical advances in technologies amenable to extended commercial use. The technologies developed in this Program will also serve as fundamental components of the FutureGen project, which will be the first power plant in the world to integrate permanent CCS with coal-to-energy conversion and hydrogen production and with respect to which China has expressed interest in

becoming a member of the U.S.-led FutureGen Government Steering Committee. Commercial deployment of these systems could occur by 2020 in the United States. In addition, China is a partner in the U.S.-led Carbon Sequestration Leadership Forum.

COMMISSIONER D'AMATO: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Videnieks and then Commissioner Wortzel.

COMMISSIONER VIDENIEKS: Secretary Pumphrey, a question for you. I did not hear you mention at all pebble bed technology. That reactor technology is small, proliferation proof, suitable for China's interior type of reactors.

And the other thing is I understand that the coal sector in China is a closed sector. In other words, that foreign investment is discouraged, and also at this point, I think China is discouraging coal liquefaction. Can you comment on that, please?

MR. PUMPHREY: The Chinese have been one of the leading countries in demonstrating pebble bed reactor technologies in a project that they have at a major university in Beijing. We have included in one of the international technology collaborations underway called the Generation IV Nuclear Technologies pebble bed reactors as one of the technologies that may be an area for cooperation. So, this is actively under discussion.

I believe you're correct in that the coal sector is closed to foreign investment. Private Chinese investors are beginning to invest in the coal sector. This is one of the areas for discussion we think perhaps can be usefully brought up in the broader economic discussions make them more open.

And then on coal liquefaction, the Chinese are beginning a project on coal liquefaction commercial scale demonstration plant to look at its technology. So they are starting to move forward on some coal liquefaction technologies.

COMMISSIONER VIDENIEKS: I understand that the government is discouraging the liquefaction projects by specifying a certain minimum size to these.

MR. PUMPHREY: We are not aware of the Chinese Government discouraging coal liquefaction projects by specifying a certain minimum size. It is our impression that the Direct Coal Liquefaction Facility by the China Shenhua Coal Liquefaction Co. Ltd. is being constructed in modules of a specific size to permit considerable flexibility in gaining operating experience as they proceed. The first of three trains (currently under construction) that will constitute Phase I of the project is expected to produce over one million tons per year of liquid products (i.e., approximately 20,000 barrels per day). A

successful start-up of this first train will support a decision to proceed with the construction of the other two trains or completion of the planned Phase I of the project. Phase II of the project will include the construction of the additional 7 trains needed to achieve the project's planned production goal of 10 million metric tons of oil products by 2010.

COMMISSIONER VIDENIEKS: Thank you. Secretary Lawless, a question for you. General Pace appears to define threat as a combination of two major factors: the capability and intent. Your testimony used the word "challenge" a lot. I did not hear "threat" once. How do you view the Chinese military modernization and force projection and so forth?

MR. LAWLESS: I believe the simple answer is that unless we have a very firm understanding or reasonably firm understanding of intent and the logic behind the intent of actions, then the capabilities lead to a threat. It was not necessarily intentional that I did not use that word, but our stress still remains in the face of this growing broad range of capabilities.

We need to much better understand the intent and the logic behind the intent as well as the doctrine behind the intent. That is a major challenge when you don't have the degree of transparency and the degree of interaction you would like to have.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Wortzel and then Commissioner Wessel.

COMMISSIONER WORTZEL: I have a question for each of you and I'll just ask them sequentially. Mr. Pumphrey, do you have any concerns at all about the nuclear technology transfers to China and whether some of that technology would get to other nations? And I guess, Mr. Lawless, you actually might have a comment on that too.

But for you specifically, in the 2006 Quadrennial Defense Review, I think it dealt with four quadrants or vectors of threats. And China falls into the ability, capability, to threaten the United States in traditional ways, with catastrophic weapons, weapons of mass destruction, and as a major disruptive threat.

Can you think of any other country that presents that sort of challenge in that many vectors as we face with China?

MR. PUMPHREY: The proliferation of nuclear technologies are very much at the top of our concerns, and we work very hard in making sure that the framework is in place, the assurances are in place, and that any nuclear technology exchanges on have the full review of the regime for potential transfer of those technologies. So we feel that we've been working very hard. We're vigilant about making certain that any transactions that go forward are completely within the

framework of both the agreements, commitments under in the Nonproliferation Treaty and the other nonproliferation activity.

MR. LAWLESS: Let me take an opportunity to respond to the broader question you're posing to us. I mentioned dimension and the fact that China is availing itself of the S&T background that it has, the broad industrial base that it has, the economic growth that it has, to improve these capabilities in every dimension.

I mentioned specifically the space dimension and the cyberspace dimension. What we see today is essentially the fruition of some programs that have been underway for five, eight, ten, 15 years. We have to take into consideration that what's happening here is that China has very well leveraged its industrial, its S&T base, its economic base, to engage in all these areas at the same time.

It is an impressive full-court press, if you will, in all these areas. I cannot think of a situation in which we are more challenged in more dimensions than we have been in the past over the near, middle and long term given the dynamics of this economy to deal with and manage the process. It is indeed a new situation and it will continue to evolve in challenges.

COMMISSIONER WESSEL: As the chair indicated, thank you both for being here and for your service. We appreciate that tremendously. Mr. Pumphrey, in your testimony you said that rather than following a policy that emphasizes securing energy supplies through equity purchases is one of the goals of our policy.

In December, the Chinese indicated that one of the industries or sectors that they would continue state control and did not indicate any end point to that would be the energy, both oil, natural gas, coal, et cetera, those sectors.

How should we view the policies and approaches of their companies when they've indicated that state control will continue? Can we view them as market players?

MR. PUMPHREY: One of the areas that we have talked frequently with the Chinese about is the difference in approach that we have in terms of how you assure that you have access to imported oil around the world, and the United States and China have been following different policies.

Chinese companies appear to be acting in commercial ways. We did a study recently to try to look at the relationships between government and enterprises and whether there is government direction and the government funds. We could not find the direct evidence of that. I think there is still the thought that there is a connection between those two.

So it's an issue that we watch carefully. They are acting like

commercial players in the marketplace. They are striking deals and joint ventures with companies. They are bidding on assets in the way other commercial companies or other state-owned companies that are out in the marketplace would be doing. But it is an area that we are continuing to watch with concern.

COMMISSIONER WESSEL: But if the Chinese leadership, as they did in December, said that this is an area that they will continue state control, how can we separate the two? You indicate that you don't see the evidence of that, but they've stated that this is their policy. I believe in the CNOOC transaction there was significant amount of state-sponsored capital at preferential rates that were part of the transaction.

I'm having trouble understanding how we can distinguish between the market and non-market forces in state control?

MR. PUMPHREY: I think you're right. There will be state influence on a state-owned company, and it's an area where we have a disagreement on the policy of ownership of companies. Unfortunately, it's a disagreement we have with a number of countries around the world.

We do believe that the marketplace will be more stable with less state intervention and that's a point we're trying to make. We're trying to encourage the separation of state control and company control, and we have emphasized that our policy approach is to go that way. But it is a complication to the operation of the marketplace.

COMMISSIONER WESSEL: If you could also just respond quickly, and Secretary Lawless as well, as we've looked at the energy acquisition strategies over time as well as military force projection and political efforts, there seems to be a pretty direct link between energy acquisition that their "go-out strategy."

How should we be looking at that when you look at Iran, when you look at Sudan, places that we have concerns about? It seems that energy tends to drive the Chinese in a direction that is antithetical to many of our own interests.

MR. LAWLESS: I think that again you put your hand on something that is really critical and really important. It's something that we're wrestling with understanding. Understanding intent, understanding the degree to which China is willing to pursue energy security at the cost of other commitments that we're looking for China to make as a stakeholder remain an issue.

We're highly focused on China's energy strategy, as are other players in the region, and the fact that there is a disruptive capability there as well. So I think that this is an area that we believe bears close attention, and we think it's only going to increase in importance in the

years immediately ahead.

MR. PUMPHREY: I would certainly agree with those comments that we're watching it closely. They seem to be going to countries where there are resources. They're in countries obviously like Canada and other places that have resources for which we don't have political issues, but the connection between their "going out strategy" and other international strategies is one that we are watching closely.

COMMISSIONER WESSEL: Thank you.

CHAIRMAN BARTHOLOMEW: I'm going to take the prerogative of the chair and ask my questions now and also note, gentlemen, that we could spend a day, I think, with each of you. Because you're administration representatives, we've got both of you in the same panel, so we're jumping around a little bit.

Secretary Lawless, we seem to have been surprised a fair number of times with Chinese military capabilities and I guess I just would like some sense from you as how confident are we that we have sufficient knowledge of what the Chinese military is up to in terms of its capabilities, let alone its intent?

And I have a second question for you, which is what is the Chinese government accomplishing with its activities and its role vis-à-vis other countries' militaries, both in terms of what are they learning and accomplishing with peacekeeping activities and what's going on with military diplomacy with other countries?

MR. LAWLESS: Thank you. I think that in the first instance, you asked about surprise and the degree to which we can project and predict. I can't emphasize enough the fact that military modernization has many characteristics to it. It has issues not only of weapons and deployment of weapons systems but things such as the logistical component or the doctrine component.

In each of these areas, we have to try to understand where they are coming from and where they are going. While I would suggest that individual systems from time to time may be deployed, more quickly than we had anticipated, and by the way, this is a very important issue. The sense of how quickly a system can be designed, developed, tested and deployed remains a challenge for us to understand because decisions are made in sequence on that time line, which we're still in the process of understanding and building into our estimates.

I would say that our predictive capabilities are fairly good with the caveat or with the understanding that challenge.— We simply do not have enough visibility into why they make the decisions they make.

Second question that you've asked I think is an interesting one as well. They try to address it in this year's defense report, Defense White Paper that came out in late December. In that, they discuss their

strategy for engaging other militaries.

They do have a very robust nuanced engagement strategy. They engage with a lot of countries. They bring a lot of countries to China. It is obviously their intent to expand that relationship, particularly in those areas where they're attempting to build a strategic relationship, be that Sudan, be that potentially Venezuela or some other area in which they perceive as part of a broader policy an opportunity to establish a relationship and also a relationship of a supplier and client basis.

So I think all of these things we continue to monitor very carefully, and I don't think we're as surprised as we were at one point. They are very consistent and very outward going, if you will.

CHAIRMAN BARTHOLOMEW: Thank you. I think at some point I'd like to engage in further discussion with you, not in an open forum, about what we might need to be doing in order to make sure we have the resources we need on terms of understanding their capabilities, and as to the military role, the Chinese government's military role overseas. There is, of course, growing concern being expressed about just what activities they might be up to in Africa. So thank you very much.

MR. LAWLESS: Excuse me. We would be prepared to do that, but I think that taking a cue from that very issue, we attempt to expand that issue in this year's China's Military Power report along with some of the other issues that have already been raised. So I think we would welcome the opportunity to talk with you in a more closed forum, but also I commend to you that report once we get it out.

CHAIRMAN BARTHOLOMEW: Perhaps we'll invite you up to testify again.

MR. LAWLESS: Okay.

CHAIRMAN BARTHOLOMEW: Now to your former employee, Vice Chairman Blumenthal.

VICE CHAIRMAN BLUMENTHAL: As I said before, I think current employee as well in a way. Once you work for Secretary Lawless, you feel like you always will be working for Secretary Lawless.

CHAIRMAN BARTHOLOMEW: It's like a member of a Congress.

VICE CHAIRMAN BLUMENTHAL: That's right. Thank you both for your testimony, and I have a question for Secretary Lawless. Pushing a little bit more on what Chairman Bartholomew asked about, which is this notion of surprise. I think what's unsettling to people is the notion that we get a Defense White Paper that mentions some capability, some intent, but really toes the peace and development line.

Then as Congressman Forbes also mentioned today, we have things like the ASAT test and the submarine near the Kitty Hawk, and as you mentioned eloquently, we don't have a good window into intent and all we can do is infer. And, there is this big delta, this big gap, between stated intentions and between ongoing activity today. You mentioned before confidence about those activities.

What are we to make of those sorts of activities? What are we to make of the ASAT test and the way it was timed after the Defense White Paper? What are we to make of the probing going on near the Kitty Hawk and other U.S. assets? What are we to make of that?

MR. LAWLESS: I think I'd like to say something about the ASAT test and it gets to your point. We did regard this matter very seriously, and in fact we will consider to regard any matters that relate to counter-space and space activity in that manner.

But the test of the direct-ascent anti-satellite system, which we consider to be an offensive weapon, with the spirit of cooperation, particularly in the face of the spirit of cooperation that we've attempted to engage the Chinese in the space area--I believe there was a visit by our NASA Administrator this past fall to China in an effort to broaden that dialogue--actually comes as a quite unpleasant development.

The event not only increased the risk to human space flight, but it of course involved potential damage to the space assets of other nations as well as commercial operators.

Suggestions that perhaps the senior leadership in China may have been unaware of this test are somewhat misplaced and really misdirects the dialogue that should take place on this. We have detailed in our annual reports to Congress, as we have detailed repeatedly and will again this year, China does have a robust multidimensional program to develop counter-space activities.

This ASAT test was essentially just one component of that, and we ask that you understand again, this is a very broad-based activity and one that bears a lot of scrutiny. I think that these initiatives that we have with China to explore specific areas of concern, and I come back to the offer that we made during Secretary Rumsfeld's trip there in October 2005, when we went and visited the Second Artillery Headquarters and began that dialogue with them, and have attempted to pursue that dialogue with mixed results, shows our intent to open the subject for discussion in a very sensitive area and an area that's only going to become more sensitive in the years ahead.

In a sense, we're chasing and trying to get into and inside of some very important developments and get dialogues going on each one of these. In some cases, China has been responsive. In other cases

they have not.

For example, we have been promised a return visit by General Cisheng, who is the head of the Second Artillery, the Strategic Rocket Forces. Invitation has been on the table for about as year and a half--it has just been delayed again--an invitation to come and be hosted by STRATCOM, and we are anxiously awaiting that return visit, but it takes two to tango in this case, and we really need to get this dialogue going and get it going seriously.

The fact that the ASAT test took place in the absence of a strong dialogue is all the more concerning because we just simply are not being allowed to develop the quality of discussion that we need to have with them in these critical areas, especially areas where miscalculation is possible that is characterized not only by the ASAT test, but also by the Kitty Hawk Song incident. And probably in the near future, as Chinese capabilities continue to increase and they project themselves further out into the environment, the opportunity for additional miscalculations and misunderstandings will present themselves.

VICE CHAIRMAN BLUMENTHAL: Thank you very much.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Houston.

COMMISSIONER HOUSTON: Thanks again for being here today, and thank you to the chairman and vice chairman for seating you at the same table because it kind of leads into my question which is about your phone habits really.

Until recently, North Korea and Iran both claimed that their nuclear programs had to do with light bulbs and not any kind of military strategy on their part, and you've both talked today about bilateral talks and meetings with Chinese and cooperative agreements and all that kind of stuff, which is nice.

My question is, do you talk amongst yourselves, particularly the Department of Energy in either the DoD or other national security arms of the U.S. government? As Congressman Forbes pointed out this morning before you had your panel, that part of the problem that is putting United States at risk is that there's very little interagency cooperation and meeting.

So my question for both of you is, is there a nexus between the two factors, the energy side and the security side, either formal or informal, within the agencies that you know of?

MR. LAWLESS: Without going into that much detail on a DoD/DOE aspect, rather casting a response in the whole interagency and the people that we normally deal with, I would say that I've been in my present position about four years, going on four-and-a-half years, and I think the interagency coordination has been exceptional.

Between ourselves, OSD Policy, the Joint Staff, the National Security Council, State Department, Office of the Vice President, we interact several times a week, and we interact very intensely. There are differences of opinion and the differences of opinion manifest themselves frankly often not between individual agencies or individual departments, but rather on functional, regional levels and within departments.

A fair understanding of where we are in the interagency is that I think that everyone of us gets a fair hearing in front of the others, and we have the mechanisms in place to allow that exchange to take place, and last but not least when we do have an engagement, particularly on such sensitive issues as nuclear energy, these positions are well coordinated in advance.

MR. PUMPHREY: I would reiterate those comments, especially in the area of nuclear nonproliferation and nuclear energy. There's a very extensive interagency collaboration that goes forward. DOE and NNSA are quite directly involved with State, Defense, the NSC on those issues. So I think it's an area where there is considerable and often frank discussion. I don't think the communication has proven to be a problem.

COMMISSIONER HOUSTON: Can I ask just a quick follow-up?

CHAIRMAN BARTHOLOMEW: Yes.

COMMISSIONER HOUSTON: Do you find concern in particular between the energy component and the national security component? Is there any fear or sense or worry that going forward with sharing of the technologies, especially on the nuclear side, negatively impacts national security?

MR. PUMPHREY: From my experience, and this is not an area in which I participate as directly, the national security interests are the paramount interests. There obviously is interest in moving forward with sharing of nuclear technology, but the concerns about proliferation of those technologies in harmful ways is an overriding concern for everyone involved in the discussions.

MR. LAWLESS: Very briefly, I think the issue with us is more on the porous nature of China's economy, the way they run their industrial programs, and the concern over dual use and dual use technology, not specifically so much nuclear but rather the enablers that allow would-be proliferators to say to acquire missile-related, ballistic missile-related technology, or the other technologies that complement a nuclear-weapons or a weapon of mass destruction programmed by another country.

There is a lot of work to be done here. I think that the Chinese are on the learning curve, so it's both a case of their demonstrating the

will to do it and the ability to do it, particularly given, as I mentioned, the loose nature sometimes of the industrial base there.

CHAIRMAN BARTHOLOMEW: Gentlemen, we told you that we'd get you out of here by 11. We have two more commissioners with questions. I was just wondering if maybe you could spare us an extra five minutes? Excellent. Commissioner Fiedler and then Commissioner Reinsch.

COMMISSIONER FIEDLER: Secretary Lawless, I'd like to take you back to the ASAT test and your testimony and the nexus between transparency and intent and add one factor to it, and that is Chinese decision-making. So the ASAT test happens, and we receive communication from the Chinese some two weeks later, if I am correct, and please correct me about exactly when they communicated back to us.

You used the term in your testimony about whether or not the leadership knew as a misplaced concern. If I recall correctly, the New York Times quoted National Security Advisor Hadley as saying we weren't certain whether Hu Jintao knew. It always struck me as more dangerous a conclusion. If he didn't know, that was more concerning to me than the test.

How much of their inability or their not communicating was careful and conscious, and how much do we believe it was because their own internal decision-making process is less than stable?

MR. LAWLESS: I think with either one of those options, we have a problem.

COMMISSIONER FIEDLER: So do I. That's why I'm asking the question.

MR. LAWLESS: So I think you agree there's a problem. But let me put my statement better in context. Perhaps I misspoke. What I was stating was that the suggestion that the Chinese leadership may or may not have known about the test I find rather farfetched.

Hu Jintao is the Chairman of the Central Military Commission. This engagement that we have with them, albeit at an embryonic stage, is in a critically important area and the leadership of China understands the importance we assign to the weaponization of space and space activities. So what I was trying to convey is it is hard to imagine that this was a surprise to the leadership of China. If it was a surprise, then we have a different problem, but I don't believe it was.

The gap between the actual test and the point in time they were willing to talk to us about it, and by the way they talked I believe the same day to the world with a press release, was not two weeks. I think it was something short of that. It may have been eight days.

But the point is that there was this gap, and you had a gap

created in the wake of a test by a system that potentially could have been seen as a military activity that it obviously can be. So we have a very serious issue here that we need to get them into a discussion plane on that they're comfortable with and we're comfortable with. Otherwise, these misunderstandings are going to continue to increase and we're going to have a much higher level of concern.

COMMISSIONER FIEDLER: Just one quick follow-up. You used the term in your testimony, both "confident" and "aggressive."

MR. LAWLESS: Yes.

COMMISSIONER FIEDLER: If we were to apply those terms to the ASAT test I think it's clear that it was aggressive. What is your reading on its state of confidence?

MR. LAWLESS: It was the demonstration of an important capability. A direct-ascent anti-satellite test demonstrates a capability. We will address this in the China Military Power report, but this is obviously a destabilizing capability, particularly when so many of our military spacecraft reside in a low earth orbit and are therefore vulnerable to direct ascent ASAT.

I would say this, there was a very timely report that your Commission released almost concurrent with the test, put it on your Web site, and it was one of the nicer pieces of work that I've seen done in attempting to capture the intent and the policy and the doctrine behind China's development of space-based capability, space capabilities. I commend the Commission for doing this. I think it's an area where you should continue to focus your attention and we appreciate the attention you're focusing on this area.

CHAIRMAN BARTHOLOMEW: Great, and we'll just acknowledge that the author of that report, Dr. Michael Pillsbury, is in the back row of our hearing today.

Commissioner Reinsch.

COMMISSIONER REINSCH: Mr. Pumphrey, much of your testimony was about supply and Chinese efforts to enhance supply. Can you relate that a little bit to demand in China and the intersection? Are they experiencing shortages, delivery problems, other glitches?

MR. PUMPHREY: The Chinese have recognized that they have to attack the demand side of their equation for the longer-term energy policies, and as I noted in the testimony, it was striking to us as we listened to their explanation of their new Five Year Plan that the targets on energy efficiency have been made as a mandatory target, one of a very few mandatory targets in the plan, rather than be guidance targets. So there seems to be a seriousness to get at that question.

On the question of shortages, the experience that existed a couple of years ago, those problems seem to have eased somewhat.

Shortages were driven in the electric power side by a mismatch between the capacity and the demand for electricity, some of which is driven by the way in which the pricing system works and the signals that it sends, which is a reason that we keep emphasizing the need to move to market-based pricing to send the right signals to both the demand side and the supply side.

The petroleum sector faced similar shortages recently and again was driven by the way the pricing mechanism was working. And we have been encouraging the Chinese that energy efficiency is a very important strategy. In the near-term it probably is the most important thing they can be doing, but it's going to be very difficult to achieve without putting in place a market that will send the right signals to all the participants.

COMMISSIONER REINSCH: Thank you. Mr. Lawless. On the ASAT test or more broadly their counter-space program, do you know if there's American technology involved in that?

MR. LAWLESS: We know what we know and I think we would be delighted to convey what we know either in a response to question, a QFR perhaps, that allowed us some additional level of classification, or in an exchange with you that could be held in a different format.

CHAIRMAN BARTHOLOMEW: We can arrange that. Thank you.

COMMISSIONER REINSCH: Thank you. Fitting note to end on, Madam Chairman.

CHAIRMAN BARTHOLOMEW: Thank you, and because he was our former chairman, I'm going to defer to Commissioner Wortzel who has a follow-up question.

COMMISSIONER WORTZEL: There were a lot of satellite questions. In the Chinese press, I think, Huanqiu Shibao, one of the Chinese PLA officers--yes, it was a PLA officer--made the statement that China notified the United States in advance of this ASAT test.

Now, obviously, I don't know who they notified. So here's a couple of questions. Did they notify the United States? Now when they launched those missiles near Taiwan in 1995 and 1996, they actually filed NOTAMs, notices to aviators, with the International Air Traffic Association, and that constituted notification of a missile launch.

They didn't say we're launching a missile. They said there's going to be some activity around the sea and airspace around Taiwan; don't go there. So was there a formal notification to any agency of the United States, including the American Embassy, that they were going to run this satellite shot, or was there a NOTAM filed that constituted informal but inferred notification of this ASAT launch?

MR. LAWLESS: The answer is no.

CHAIRMAN BARTHOLOMEW: Okay. And finally, one more question, and that is when we can expect the Annual Report to Congress? The tough question of the day.

MR. LAWLESS: That's always the $64 question. We have a lot of people asking that question, by the way, as you might imagine.

CHAIRMAN BARTHOLOMEW: People with more weight than we have.

MR. LAWLESS: I believe our obligation is the first of March. Typically, we're able to crank it out between May and July. Our goal this year is to have it out as close to our deadline as possible. We've just had a change in management, as you're well aware of.

However, the report--

CHAIRMAN BARTHOLOMEW: And a few small other issues going on.

MR. LAWLESS: However, the report is on schedule. I think it will be very timely because it addresses some of these issues that have been raised today and anticipates a lot of them, and we would hope to have it out certainly by mid-May.

CHAIRMAN BARTHOLOMEW: Wonderful. Thank you very much, gentlemen. Thank you. We look forward to more contact with you throughout the year.

We're going to take a five minute break before we start our next panel.

[Whereupon, a short break was taken.]

CHAIRMAN BARTHOLOMEW: Thank you very much, everybody, and I know that there is a fair amount of press interest in getting your hands on the transcript of the panel that just happened before us. What we're going to try to do is to see if we can get the transcript tonight and we'll e-mail out to the press people who have signed in as soon as we have it. It might not be until tomorrow morning, and similarly we'll send out hard copies of particularly Secretary Lawless's testimony.

We'll get it posted on our Web site, but we're trying to turn it around for you today if it's at all possible.

PANEL III: U.S.-CHINA RELATIONS IN REVIEW

CHAIRMAN BARTHOLOMEW: On to our next panel. Our third panel today is intended to provide broad perspectives on the U.S.-China relationship since China's accession to the WTO and to help the Commission identify trends in that relationship which will be further explored in following panels.

We are pleased to welcome two very distinguished experts to share their thoughts on this topic. Mr. Jim Mann, Author-in-Residence at the School of Advanced International Studies, has a distinguished career in journalism and political commentary. Jim wrote, of course, Beijing Jeep, which was one of the first books about the challenges posed by Chinese business practices.

He was, I know, also serving in Beijing during the time of Tiananmen Square, and new this year is Mr. Mann's most recent book entitled The China Fantasy: How Our Leaders Explain Away Chinese Repression, which examines the development of U.S. policy toward China.

And Dr. Philip Saunders, who is a Senior Research Fellow at the National Defense University, and has conducted extensive research on East Asian security issues. He has taught courses on Chinese politics, Chinese foreign policy and East Asian security.

Previously, he served as Director of the East Asia Nonproliferation Program at the Center for Nonproliferation Studies. He received his Ph.D. in International Relations from Princeton University.

This panel will set the tone for understanding U.S.-China diplomacy. I expect it will be a lively panel and provide us with a solid foundation for narrowing our analysis in our later panels. Thank you, again, to our panelists for joining us, and we'll begin our testimony with Mr. Mann.

STATEMENT OF JAMES MANN
FPI AUTHOR-IN-RESIDENCE, SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS HOPKINS UNIVERSITY WASHINGTON, D.C.

MR. MANN: Thank you. I want to talk to you today not about the details and day-to-day developments in U.S.-China relations, but about the broader perspective. What I'm about to say reflects what I've concluded after observing Washington policy towards China for the past 23 years, and it is a shortened version of the ideas I've presented in a new book, The China Fantasy.

In short, I think that many of the problems we face in dealing with China are conceptual in nature. Our policy and our public discourse about China are often affected by ideas, assumptions, rationalizations that we fail to examine or reexamine.

Above all, I believe our policy toward China simply operates with the wrong paradigm. Let me explain this idea of the wrong paradigm by way of an analogy.

Most of us, I think, are familiar with the argument--a legitimate one, I think--that the current administration was caught unprepared for the September 11 attacks because its officials had the wrong paradigm in foreign policy: they were preoccupied with conventional states and not focused on non-state actors like al-Qaeda.

The problem wasn't merely in policy, but in overall conception. They expected the world to operate much as it had been and they failed to anticipate a fundamental change.

In our dealing with China, the problem of the wrong paradigm comes from the opposite direction. It's not that we have failed to anticipate change. Rather, it's that we assume change is coming to China--that is change in China's political system.

Looking at the country's startling economic growth and the remarkable economic changes that have taken place in China, Americans, particularly political leaders, regularly talk as though China is inevitably destined for political change as well.

This paradigm of inevitable change has been repeatedly put forward by political leaders in both parties. President Bush offered his version of the paradigm at the beginning of his campaign for the White House when he said "trade freely with China and time is on our side," and in saying that, he was echoing the words of Bill Clinton. I won't give you the full quote, but who said that economic changes in China would help to "increase the spirit of liberty over time. I just think it's inevitable, just as inevitably the Berlin Wall fell."

I should emphasize here that when I'm talking about political change in China, I'm speaking about the fundamental realities of the current system in which there is no organized political opposition, the press remains under censorship, and in which there are no elections beyond the limited and problematic ones at the township level.

There are those who argue China's political system is already changing, but when they say that, they're focusing on far lesser changes, ones that do not affect the one-party state and its monopoly on political power.

The argument that the Chinese system is changing seeks to divert attention to smaller realities and away from larger ones. This paradigm of a China that is destined for political change has deep roots in American policy over the past 35 years.

It took hold because it has served certain specific interests in Washington and within American society. At first, in the late '70s and 1980s, this idea benefited America's national security institutions. At the time, the United States was seeking close cooperation with China against the Soviet Union so that the Soviet Union would have to worry about both America and China at once.

Amid the ideological struggles of the Cold War, cooperation with China's Communist regime at that time was politically touchy in Washington, and so the notion that the Chinese leadership--in this case, the leadership of Deng Xiaoping--was in the process of changing the political system helped to smooth the way with Congress and the American public.

In the '90s, following the Soviet collapse, the paradigm of a China headed for political change attracted a new and different constituency: the business community. As trade and investment in China became evermore important, American companies found themselves repeatedly beset with questions about why they were doing business with a repressive regime.

The paradigm of inevitable change offered multinational corporations the answers they needed. Not only was China destined to open up its political system, but trade would be the key that would unlock the door. Trade would lead to political liberalization, to democracy. The trouble is that the entire theory may be dead wrong.

Now, I sketch out in my testimony three scenarios for China's future. One is what I call the "soothing scenario," and it's what I just mentioned: that China is gradually going to evolve and open up towards a liberal political system.

There is a second possibility, and it's well-debated in this country, called the "upheaval scenario," which predicts that China is headed for some sort of major disaster--an economic collapse, a political disintegration--because it won't be able to maintain political stability. And one could point on behalf of this argument to the proliferation of strikes, protests, riots, environmental degradation, and so on.

And I argue that actually the regime is strong enough ultimately to withstand these internal pressures and that there will be no coming collapse of China.

Then there is a third scenario, and it gets discussed less in this country, and that is what happens if the country's economic system continues to evolve but the political system doesn't? And I know there are many people who think that's impossible, but I raise the question of why not?

Now, let me address one of the main arguments put forward by those who describe this "soothing scenario." They point to the fact that Taiwan and South Korea were both authoritarian governments and they both in the '80s moved towards liberalization, and what I say is the comparison doesn't work, first, because China is so geographically, culturally in so many ways different from Taiwan and South Korea. If China were merely Shanghai or Guangdong Province, that might fit,

but it's not.

And the second is that Taiwan and South Korea made their move towards liberalization with some, more than a little, goading from the United States, and the relationship that they had with the United States was entirely different from the one that China did. They were dependent on the United States for their own military security.

I will conclude there. My time is running out and I can deal with the rest in questions. Thanks.

[The statement follows:]

Prepared Statement of James Mann
FPI Author-in-Residence, School of Advanced International Studies, Johns Hopkins University, Washington, D.C.

Members of the Panel:

I want to talk to you today, not about the details and day-to-day developments in U.S.-China relations, but about the broader perspective. What I am about to say reflects what I have concluded after observing Washington policy towards China for the past 23 years, originally as a Beijing-based correspondent for the Los Angeles Times, but then throughout most of this period as a newspaper reporter and as an author based in Washington. This is a shortened version of the ideas I have presented in a new book, "The China Fantasy: How Our Leaders Explain Away Chinese Repression."

In short, I think many of the problems we face in dealing with China are conceptual in nature. Our policy and our public discourse about China are often affected by ideas, assumptions, rationalizations and phrases that we fail to examine.

Above all, I believe, our policy towards China simply operates with the wrong paradigm.

Let me explain this by way of an analogy. Most of us, I think, are familiar with the argument – a legitimate one, I believe-- that the current Bush administration was caught unprepared for the September 11 attacks because its officials had the wrong paradigm: In foreign policy, they were preoccupied with conventional states, and not focused on non-state actors like al-Qaeda. The problem wasn't merely in policy, but in overall conception: they expected the world to operate much as it had been, and they failed to anticipate a fundamental change.

In our dealing with China, the problem of the wrong paradigm comes from the opposite direction. It's not that we have failed to anticipate change. Rather, it's that we assume change is coming to China – that is, change in China's political system. Looking at the country's startling economic growth and the remarkable economic changes that have taken place in China, Americans, particularly in our political and business elites, regularly talk as though China is inevitably destined for political change as well. Yet, in my view, while China will certainly be a richer and more powerful country 25 years from now, it could still be an autocracy of one form or another. Its leadership (the Communist Party, or whatever it may call itself in the future) may not be willing to tolerate organized political opposition any more than it does today. This is a prospect that our current paradigm of an inevitably changing China cannot seem to envision.

The paradigm of China's inevitable political change has been repeatedly put forward by prominent political

leaders of both parties. President George W. Bush offered his version of the paradigm at the beginning of his campaign for the White House: "The case for trade is not just monetary, but moral," Bush declared in one of his earliest foreign-policy speeches in November 1999. "Economic freedom creates habits of liberty. And habits of liberty create expectations of democracy….Trade freely with China, and time is on our side."

In saying this, Bush was merely echoing the words of Bill Clinton. The Democratic president had told Chinese President Jiang Zemin at a 1997 press conference that "you're on the wrong side of history," thus suggesting that "history" would open up China's political system. Earlier that year, Clinton had declared that the economic changes in China would help to "increase the spirit of liberty over time…I just think it's inevitable, just as inevitably the Berlin Wall fell."

I should emphasize here that when I am talking about political change in China, I am speaking about the fundamental realities of the current system, in which there is no organized political opposition, in which the press remains under censorship, and in which there are no elections beyond the limited and problematic elections at the township level. There are those who argue China's political system is already changing, but when they say that they are focusing on far lesser changes, ones that do not affect the one-party state and its monopoly on political power. The argument that the Chinese system is changing seeks to divert attention to smaller realities and away from the large ones.

This paradigm of a China that is destined for political change has deep roots in American policy over the past 35 years. It took hold because it has served certain specific interests in Washington and within American society. At first, in the late 1970s and 1980s, this idea benefited America's national-security establishment. At the time, the United States was seeking close cooperation with China against the Soviet Union, so that the Soviet Union would have to worry about both America and China at once; the Pentagon was eager to ensure that the Soviet Union was required to deploy large numbers of troops along the Sino-Soviet border that might otherwise have been deployed in Europe. Amid the ideological struggles of the Cold War, cooperation with China's Communist regime was politically touchy in Washington. And so the notion that the Chinese leadership – in this case, the China of Deng Xiaoping -- was in the process of changing the country's political system helped smooth the way with Congress and the American public.

In the 1990s, following the Soviet collapse, the paradigm of a China headed for political change attracted a new and different constituency: the business community. As trade and investment in China became ever more important, American companies (and their counterparts in Europe and Japan) found themselves repeatedly beset with questions about why they were doing business with a repressive regime, one which had so recently ordered its troops to fire at unarmed citizens. The paradigm of inevitable change offered multinational corporations the answer they needed. Not only was China destined to open up its political system, but trade would be the key that would unlock the door. Trade would lead to political liberalization and to democracy. The trouble is that the entire theory may be dead wrong.

The notion that China's political system will inevitably move towards liberalization and democracy is what I call the Soothing Scenario for China's future. It is the one that dominates our official discourse. But it is really only one of three possibilities for where China is headed. Let me sketch out the others.

The second possibility for China's future is what can be called the Upheaval Scenario. The Upheaval Scenario predicts that China is headed for some sort of major disaster, such as an economic collapse or political disintegration, because it won't be able to maintain political stability while continuing on its current course. On behalf of the Upheaval Scenario, one might point to the numerous reports of political unrest in China these days – the proliferation of labor strikes, farmers' protests, riots over environmental degradation and ethnic strife. There are also broader developments, such as the ever-growing disparity between rich and poor or the continuing prevalence of corruption in China, and the fragility of China's

banking system.

The Upheaval Scenario for China gets a reasonable amount of attention in the United States. Lots of people spend quite a bit of time trying to figure out how much instability there is in China and what its impact will be, and there are lots of interesting arguments on all sides. My own belief is that the Chinese regime is ultimately strong enough to withstand these internal pressures – that there will be no "coming collapse of China," to quote the title of one book on the subject. China is a huge country, and it is particularly hard to draw conclusions about the overall political situation from what is happening in any one place or region. Labor strikes may spread through all of Northeast China; or political demonstrations may sweep through many of its leading cities; still, in the end such events don't determine the future direction of China.

The possibilities for China's future are not confined to these two scenarios, the Soothing Scenario or Upheaval. There is still another possibility: a Third Scenario. It is one that few people talk about or think about these days, at least not in the United States. It is this: What if China manages to continue on its current economic path and yet its political system does *not* change in any fundamental way? What if, twenty-five or thirty years from now, a wealthier, more powerful China continues to be run by a one-party regime that continues to repress organized political dissent much as it does today; and yet at the same time China is also open to the outside world and, indeed, is deeply intertwined with the rest of the world through trade, investment and other economic ties? Everyone assumes that the Chinese political system is going to open up – but what if it doesn't?

In one way or another, the essentials of the current political system would remain intact: there would be no significant political opposition. There would be an active security apparatus to forestall organized political dissent. In other words, China, while growing stronger and richer, wouldn't change its political system in any fundamental way. It would continue along the same political course it is on today. Why do we Americans believe that, with advancing prosperity, China will automatically come to have a political system like ours? Is it simply because the Chinese now eat at McDonald's and wear blue jeans? To make this assumption about China is to repeat the mistakes others have made in the past – that is, to think wrongly that the Chinese are inevitably becoming like us. "With God's help, we will lift Shanghai up and up until it is just like Kansas City," Senator Kenneth Wherry of Nebraska declared during the era of Chiang Kai-shek's Nationalist China. Those dreams ended in disappointment. So, too, in the early 1950s, Soviet leaders thought they were recreating a communist China that would be similar to the Soviet Union. They also were wrong.

Let me address one of the main arguments advanced by those who put forward the Soothing Scenario. Proponents often point to the recent history of other countries in East Asia. In particularly, they regularly cite the examples of Taiwan and South Korea. From the 1950s through the 1970s, both had authoritarian systems in which police and security officials regularly locked up political opponents of the regimes. Then during the 1980s, as rapid economic development brought increasing prosperity to Taiwan and South Korea, both countries opened up to democracy. And so, the logic goes, China will eventually follow along the political path of Taiwan and South Korea.

There are two problems with this logic. First, China is a much bigger country than either Taiwan or South Korea. It includes vast, impoverished inland areas as well as coastal cities of the east. If China were confined exclusively to these coastal areas, such as Guangdong, the province abutting Hong Kong, one could easily imagine it following the path of Taiwan and South Korea. Certainly Shanghai, with its educated, sophisticated citizenry and intense interest in politics, is as ready for democracy as any city has ever been.

But large expanses of China are isolated – geographically, politically and intellectually – from cities such as Shanghai. Outsiders who declare that China will follow the political evolution of Taiwan and South

Korea, based on their visits to eastern Chinese cities like Beijing and Shanghai, are roughly akin to foreigners who travel only to New York City and Boston and then come to the conclusion that the United States will behave like Western Europe.

There is also a second, more important way in which China is different from Taiwan and South Korea. When those two East Asian governments democratized in the 1980s, both of them were dependent on the United States for their military security. Indeed, direct American pressure played a crucial role in supporting the movement towards political liberalization in both countries. In the case of South Korea, at a key moment in June 1987 when the country was engulfed by riots, the Reagan administration bluntly told President Chun Doo Hwan he should give way and hold elections. In the case of Taiwan, leading Democratic members of the U.S. Congress took the lead, making plain to President Chiang Ching-kuo during the 1980s that his Kuomintang government was rapidly losing American support, and that the only way to regain it was through democratic reforms.

But China of course will never be as dependent on the United States for military protection as were South Korea and Taiwan, It is vastly less subject to American pressure, goading or influence. As a result, there is no reason to believe it will automatically follow their political evolution.

In conformity with America's continuing adherence to the Soothing Scenario for China (that is, the belief in China's inevitable political evolution), we have developed a series of rationalizations and euphemisms that help to maintain our beliefs. To take one example: "Two Steps Forward, One Step Back." When news breaks that China has rounded up someone or some group opposing the regime, proponents of the Soothing Scenario warn that one must not draw broader conclusions about China and the nature of its political system from this one particular untoward event. This latest arrest, it is said, was just one minor setback. Over the past two decades, the same cliché has been used, over and over again, to explain away repression or the absence of political change in China. Sometimes, when China carries out a broad crackdown, it looks as if the more accurate description would be "one step forward, five steps back." But the "two steps forward, one step back" cliché does not countenance such retrogression. Thus, even unpleasant news about Chinese repression tends to be safely embedded in an assumption of progress, a soft, warm gauzy wrapping of hopefulness.

Finally, it is worth considering the possibility that the paradigm of inevitable political change that our leaders use in talking in public about China does not represent what they privately believe.

It is possible to imagine a set of beliefs about China as follows: "We understand that China's political system is not destined for political liberalization. The Chinese system is going to remain relatively unchanged for a very long time, and the regime is going to continue to repress any sign of organized political opposition. Still, we want to and have to do business with China, both economically and diplomatically."

This would be a point of view that is certainly clear and coherent, and I suspect that among America's political and financial leaders, there are many who privately hold this view. It is worth asking why this point of view is so little discussed in public. The answer, I believe, is that American policy towards China requires public support – and the way to maintain public support for American policy, particularly its current relationship with China is to claim that this will serve the purpose of changing China's political system. Since 1989, virtually every change in U.S. policy towards China has been justified to the American public on the basis that it would help to open up China's political system. Whenever a president, either Republican or Democratic, spoke of his policy of "engagement" with China, it was said to be a way of changing China. When the George H.W. Bush and Clinton administrations extended most-favored-nation trade benefits to China, they asserted that the trade would help to open up China. When the U.S. Congress voted to support China's entry into the World Trade Organization, once again, congressional leaders

justified their votes as a way of helping to bring political liberalization to China.

Our economic policies in dealing with China have caused considerable hardship to significant numbers of Americans. Across the United States, factories have closed and millions of Americans have been put out of work. There have been some benefits to those policies as well, especially to companies investing or manufacturing in China; yet if these policies had been judged exclusively in economic terms, they might not have won the public support and congressional approval that was necessary. As a result, the American people have been told repeatedly that the reasons for our policy were not merely economic but political. Unrestricted free trade with China was going to lead to political liberalization. It was going to open the way for China to become a pluralistic country. These political arguments were the ones that made the difference. Without the claim that trade would open up the Chinese political system, trade legislation probably would not have been enacted. It is difficult if not impossible to find an American president or congressional leader who said, "China has a repressive political system and it's not going to change, but let's pass this legislation anyway."

In sum, I think the paradigm of inevitable change impairs America's thinking and its public discussion of China today. The paradigm prevents us from coming up with policies towards a China whose political may not change, in any fundamental way, for a long time. But I think the paradigm of inevitable change will endure -- that whenever American leaders talk in public about China, we will continue to hear some version or another of the Soothing Scenario.

CHAIRMAN BARTHOLOMEW: Thank you. Dr. Saunders.

STATEMENT OF PHILLIP C. SAUNDERS
SENIOR RESEARCH FELLOW, INSTITUTE FOR NATIONAL STRATEGIC STUDIES, NATIONAL DEFENSE UNIVERSITY
WASHINGTON, D.C.

DR. SAUNDERS: Thank you. It's a pleasure to be here. I've submitted testimony before in writing but never had the pleasure of coming in here person. My remarks represent my own personal views, not those of the Department of Defense, National Defense University, or the U.S. government.

What I want to try to do today is set a little bit of a broader context and deal with the issue of how we pursue relations with China when we have a lot of common interests and also a lot of competing interests. So I'm going to try to provide a little bit of a framework for that, and I want to make the argument that China really is a difficult strategic challenge because of this mix of interests.

We are increasingly interdependent. What they do affects us; what we do affects them. I think over the last five or six years, there's an increasing degree of cooperation at the diplomatic, at the security levels. Yet, underlying that are also great tensions and serious concerns on each side.

On our side, it's partly on economic issues where we worry about our bilateral trade deficit, protection of intellectual property rights,

the value of the Chinese currency, a host of issues like that, but also how China's economic growth over the last 20 years is starting to get transformed into power--military power, economic power--and is expanding their influence in the world.

I think the view on the Chinese side is also very ambivalent. They recognize that the U.S. is very important to their development and their national goals. They want stable cooperative relationships. They don't want a confrontation with us, and that's important for their domestic objectives as well as their international ones, but they also worry that the U.S. is out to subvert China's political system and to contain their economic and military potential.

So I really see this ambivalent relationship underlying the reality of increasing economic and security cooperation and also increasing interactions at a government-to-government level.

I guess I take a little bit different view of the U.S. approach to China. I think it's a fact that we are not sure how China is going to turn out and we want a policy that gives us the short-term benefits of cooperation and hedges against the possibility that we will have a strong China that is very threatening to the U.S. interests, and so I see a continuity in U.S. strategy based on that concept of a hedge.

On the one hand, we want to cooperate and integrate China into global institutions, and we want to do this both to influence their behavior and to try to shape their political evolution in positive directions. Some of the ideas that Jim [Mann] talked about do underline some of that concept, but I think it's more than that.

On the other hand, we want to maintain our military capabilities and especially our alliances in the region, so if we are faced with a China that is more aggressive or threatening in the future, we're prepared to deal with that.

The challenge, of course, is to keep both these elements in balance. You don't want to cooperate so much that you're unprepared strategically. You don't want to prepare so much militarily that you lose the benefits of cooperation or worse steer China in negative directions.

I think the Bush administration has done a pretty good job of this. They've tried to increase cooperation with China on a range of issues including energy security, nonproliferation and counterterrorism. The concept of a responsible stakeholder I think is a pretty good framework, one that Deputy Secretary Zoellick put forward, and I think after a lot of debate, internal debate inside China, they basically have accepted this.

I think President Hu in the April 2006 Summit said China and the United States are not only stakeholders but should also have a

constructive partnership. So I think that is accepting the concept, but modifying it a little bit, to say that both the U.S. and China have responsibilities at a global level and the acceptance of this concept is within the context of a positive ongoing U.S.-China relationship.

I won't go through the mechanisms that the administration is using to engage China, but these include senior dialogues, strategic economic dialogue, regular summit meetings and meetings on the margins of international conferences. So there's a lot of high level dialogue and that's being backstopped by bilateral cooperation mechanisms at a lower level that take some of these broad topics like responsible stakeholder and try to connect them with concrete policy issues and policy implementation.

I do want to point out some ambiguities in this concept and where I think Congress has a role to play. First, there is no clear definition of what is responsible behavior. If we say it's behavior that accords with our policy, that's not a concept that's going to be acceptable to China, and they rightly point out that the U.S. also has responsibilities.

A second point is I think it dodges some of the questions about China's long-term intentions and what interests they have that are really legitimate. The Zoellick speech says that China does have legitimate interests that ought to be respected, but I don't think there is any consensus inside the administration or more broadly in the United States as to what those legitimate interests really are.

It's also unclear whether we're willing to contemplate changes in international rules and norms to accommodate China's interests. So I think the administration is doing a good job of engaging China, especially at high levels, but that's insufficient. The government-to-government executive branch relationship is insufficient to reach understandings with China that will endure over time and across administrations.

So there is some need for greater congressional and public debate about some of the issues I raised. What are legitimate Chinese interests?

I was also asked to take a peek ahead at what are some looming challenges, and I'm going to do this very telegraphically. Despite a lot of cooperation, I think there are a number of potential challenges ahead over the next five years or so. One is the potential for domestic instability in China. If China cracks down for political reasons or has an economic slowdown, that might lead to use of force against their own population and it might also lead to increased efforts to export their way out of a problem. That would cause tensions with the United States.

A second challenge obviously is Taiwan. Here I have a little bit of a contrarian view. A lot of people think things are going pretty well there. I see trends that are starting to erode the stability of the status quo and the one-China policy framework that we've had for more than 25 years.

This includes China's military modernization, which is giving it new capabilities, Taiwan's increasing economic dependence on the mainland, and the efforts by some political leaders in Taiwan to highlight Taiwan's separate status and try to formalize that in various ways.

So I see a United States that is getting drawn deeper into this issue just to maintain the status quo. And I think the fact of the Taiwan issue, the possibility of conflict, complicates other strategic issues.

One of them is the interaction between China's strategic modernization as they start to deploy a new generation of intercontinental ballistic missiles on both land and sea and our efforts to develop and deploy ballistic missile defenses. There is a relationship between those two things. They do interact. How that interaction goes and the extent to which it spills over into broader relationships is going to be a challenge to manage, and in this light, I think the China ASAT test is another illustration of this.

A fourth challenge I want to mention is China's expanding regional and global influence, and I've provided the commissioners a copy of my study looking at this at a global level. We have a China that's starting to play a greater role around the world. Its economic strength is the main part of that, but that complicates our life in a lot of ways.

And then the biggest one--I want to get to the challenge that Jim raised--what do we do if we have a strong China that does not democratize; what if we have an authoritarian China that's behaving more aggressively?

I think this is a factor, but there are several things--or a possibility at least--there are several things that aggravate this. One is that China's military capabilities are improving more rapidly than we expected, not necessarily that there's all that many surprises, but we thought that it would be a relaxed time line and maybe it is moving faster than expected.

A second factor is that as China has become integrated into the world economy and international organizations that is giving it leverage. It's not only constraining China; it's empowering it in some ways. And that's a consideration.

And a third is, as Jim said, we've seen a lot of economic growth

and integration with the world economy. We haven't seen dramatic changes in the Chinese political system. So there is some greater degree of freedom in daily lives, but the basic institutions of the Communist Party and the military haven't been much affected. Nevertheless, I still think engaging China is our best option.

Let me stop there.

[The statement follows:][3]

Panel III: Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Thank you very much. Commissioner Blumenthal.

VICE CHAIRMAN BLUMENTHAL: Thank you both very much. I think, Jim Mann, you've hit it exactly where we want to go with our hearing today which is we had this, the United States had this great bet, or maybe "bet" is not the right word, but that if we constructively engaged China, we promote China's ascendancy into the WTO, that that would then lead to political liberalization, and then, as Phil Saunders and you mentioned, then external behavior would change. There's an assumption I think among most Americans that once there's a politically more liberal country, there's less to worry about externally, and I think both of you have, at least implicitly, said that.

But if you are correct, that's not going to happen, then would be implications for China's external behavior, and we have to step back and take a look at what we're doing in terms of our China policy, and I would imagine then that it's difficult. If you change the paradigm, then you start to see things in a different light; right?

So you start to see certain Chinese behaviors, whether it's more military muscle flexing or other types of things, and you say to yourself, we can't explain this away in a soothing scenario. China won't become a responsible stakeholder because part of the Zoellick speech has within it that China will change domestically and that's what a responsible stakeholder does.

I guess the question that I had really for both of you, but mostly for Jim Mann, is if you are correct, that then at least I would take that to mean a pretty significant change of course in our approach to China based on the fact their external behavior won't change in ways that we want it to. I wonder if you can provide us with your thoughts on how our change in policy should then be affected if the assumption is no longer that we're engaging China to become a responsible stakeholder?

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[3] **Click here to read the prepared statement of Phillip C. Saunders, Senior Research Fellow, Institute for National Strategic Studies, National Defense University, Washington, DC**

MR. MANN: Several points. First, we should be explicit on what the main problems are: whether China, which is not politically changed, is a stronger authoritarian government?

It's been implicit in what we've said, but I think we should say explicitly one of the problems is China's support for other governments around the world which are not only undemocratic but deeply repressive, and I have in mind Burma, Zimbabwe, for example, and I think you all have looked into that.

The second problem is--as it affects China internally--they've gone through a reasonably successful political succession about three years ago, but there is no process for succession that guarantees stability.

So all of these are problems. I have no detailed policy to recommend. I think that when we change our view of China, that we can begin to work out the policy, and I think that the idea of a China which is changing has been regularly used in order to produce public support or congressional support for certain policies, and I use the example of the trade legislation of the '90s.

You can make plenty of arguments economically, and you've been through many of them, on all sides, but the fact is that in order to get the legislation passed, the argument was made that this was going to change China both economically and politically.

VICE CHAIRMAN BLUMENTHAL: Do you believe that we're not changing that paradigm because it's just simply too difficult for us to do as a nation? In other words, if you are correct, then we have to say to ourselves we are facing an authoritarian, stronger, richer, probably more assertive China that supports dictatorships, and do you believe that we're prepared as a nation to do that? Is it just too difficult to do?

MR. MANN: No, and I would view that historically in two ways--I think that this country has had for a couple of centuries a desire to be essentially hopeful about China, all things being equal, which gets in the way of our thinking about things that are not hopeful, and more specifically, the policy that we have now was a reaction, began as a reaction to the McCarthy era of the '50s, and really the generation which has guided China policy for the last 30 or 40 years has been preoccupied, and originally it made sense, with not going back to the '50s. And I think that has become something that gets in the way of our thinking about a policy today.

VICE CHAIRMAN BLUMENTHAL: Thank you very much.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Reinsch.

COMMISSIONER REINSCH: Thank you. I think I want to go in

a slightly different direction from that last dialogue, but I want to continue the conversation with Mr. Mann. You've asked a provocative question. I guess my view is I think it's a little bit of a straw man. I'm sure there are people out there that think that they're going to become an American democracy. I don't know any of those people, but I suppose they're there.

I don't think that's the prevailing view. I'd like to ask you to think about it in terms not so much of Western style democracy, in terms of their government evolving, but in terms of accountability. It seems to me you've got a lot of pressure inside the country to deal with corruption and to deal with essentially nonaccountable officials at every level, particularly local levels of government.

Do you think those pressures are all going to come to nothing and the regime isn't going to change at all?

MR. MANN: First, let me correct the accusation that what I'm in favor of is Western-style democracy.

COMMISSIONER REINSCH: I don't think you said you were in favor of it.

MR. MANN: Okay.

COMMISSIONER REINSCH: I think you've accused other people of expecting that that's going to happen. That's what I'm taking issue with.

MR. MANN: The argument that's made in the public debate has been that our trade and investment will open up China's political system, and that's--

COMMISSIONER REINSCH: Yes. We're going to be smarter than that going forward.

MR. MANN: Pardon?

COMMISSIONER REINSCH: We're going to be smarter than that going forward.

MR. MANN: Okay.

COMMISSIONER REINSCH: Let's talk about accountability.

MR. MANN: Now, yes, on corruption and accountability, yes, I agree with you that there are pressures building up in reaction to it. There are also tremendous pressures in favor of maintaining the current system or of limiting accountability. And, yes, I would love to think that the pressures building up against corruption are such that they will produce systemic changes. But I'm skeptical that they're going to amount to a systemic change.

COMMISSIONER REINSCH: So you think the existing regime, not the individuals--

MR. MANN: Right.

COMMISSIONER REINSCH: --but the existing regime will be

able to perpetuate itself essentially in its current form for the indefinite future?

MR. MANN: In its current form. Not necessarily its current name. I can see it--over 30 years I can see as drastic a change as the Chinese Communist Party renaming itself, but I think that the essentials of a one-party state without an organized significant political opposition, yes, that's what I'm raising.

COMMISSIONER REINSCH: Okay. Well, we probably don't agree on that, but let's take that a step further and go back to something that Dr. Saunders said and perhaps you can both comment on. Let's assume that you're right about that. Where does that lead us in policy terms? It seems to me the administration is articulating a policy of hedging. I guess we could discuss what that means, but it seems to me preparing for unpleasant scenarios as well as pleasant ones.

We've also seen the responsible stakeholder doctrine, which I think Dr. Saunders more or less endorsed. I don't want to put words in your mouth.

It also seems to me the last seven presidents, I think, have ended up, despite rhetoric at various points, particularly when they were running for office, pursuing policies that have differed only within a fairly narrow range.

If you're right, what do you want us to do that's different?

MR. MANN: Do you want me--

COMMISSIONER REINSCH: Start with you and then let him comment on your answer.

MR. MANN: I have no problem with the idea of hedging. I think that makes sense. It's taken a long time--people say that the last seven presidents have all agreed, and that may be true in the broadest possible sense. All of them with the possible exception, and I think I won't bog down in, of the Nixon administration, the Nixon-Ford years, have felt compelled to come up with some rationalization, some concept that would explain to the American people that Chinese political repression is less important than they might think, and they're all different in different ways. It cuts across both parties.

This started in the late, the late '70s, with the Carter administration--when the Democracy Wall campaign began--came up with the idea, and these are all concepts, that things are better than the Cultural Revolution.

COMMISSIONER REINSCH: You're talking more about what they say than what they do; aren't you?

MR. MANN: Let me come back to I think that it is possible to conceive that the administration or all of these administrations have a

policy which is different from what they say, and it's possible to envision a policy which is very coherent, which is we want to do business with China, we have to do business with China, and China's not going to change, but the less we say about it the better.

It may be that that is a private policy different from all of these public statements, but then the fact is that the American people are making decisions and Congress is making decisions based on a public policy which is different from the private policy.

So each time there is a necessity for either legislation or there is a political campaign, the American people are told our China policy is the one we need to open up China, and if people don't think that privately, I think that's a problem.

CHAIRMAN BARTHOLOMEW: Sorry. Time.

COMMISSIONER REINSCH: I was just going to ask Dr. Saunders if he wanted to say something, but go ahead.

CHAIRMAN BARTHOLOMEW: Perhaps he can move that into the next. Commissioner Wessel.

COMMISSIONER WESSEL: My questioning is along some of the same lines as has already gone on, so maybe, Dr. Saunders, you can continue with some response to Mr. Reinsch's questions.

It seems that we've pursued this policy based on or our current approach based on the faulty assumptions that--and I remember our discussion--I think it was Jim Fallows' book “More Like Us” or “Just Like Us,” I think it was, with regard to Japan, that we look at everyone through our own blinders, that they want to be like us.

Have we seen any evidence leading into the PNTR debate, leading into where we are today--and we talked earlier on the previous panel about understanding Chinese intentions regarding its military build-up--is there any reason to believe that China's leadership is not looking to simply sustain, maintain and expand its current political power?

DR. SAUNDERS: Of course that's what they're trying to do. Elites always try to keep themselves in power. That's not unique to communist systems. Where I guess I have a little trouble with some of what I've heard here is the assumption that China is not changing. Jim is correct that the core institutions of the party and the way, that that has not changed, and the current leadership is committed to that.

But its relationship with the economy, the role of a lot of different economic actors with different interests, China is a very, very different place today than it was 25 years now, and that makes a big difference.

COMMISSIONER WESSEL: With the goal, however, of sustaining, maintaining and expanding their own power. They're

looking at different policies to fulfill those goals; correct?

DR. SAUNDERS: Yes, but part of that is requiring them to be more responsive to society. One of the things you see with Hu Jintao is he's worried about economic inequality in the countryside and that farmers that are not benefiting from economic growth, and so one of the sets of policies is to try to address that.

Now, one can say that's a self-interested policy to keep the party in power, and that's certainly true, but it's probably also having some positive benefits for the farmers.

One of the problems in China is for the leadership at the top in Beijing to keep track at what its officials are doing at the bottom. Sometimes that's corruption. Sometimes that's self-dealing. Sometimes it's stealing the peasants' land and selling it yourself.

The difficulty is we would like to solve those problems through transparency, democracy, a free press, and those are mechanisms that work pretty well. They are trying to solve them through the old communist-style mechanisms such as campaigns, rectification campaigns, auditing officials, and so that's where a disconnect is. The question, the big-picture question, is that going to be a force for change or pressure for change because I think many people don't think those mechanisms are really going to be effective.

COMMISSIONER WESSEL: Should we be viewing the democratization and the change to more than single-party control as one of the goals of the policies because it doesn't seem to be working?

DR. SAUNDERS: It's a long-term goal of our policy and properly so, but I think there's a lot of short-term things that have happened. You have a government that's not trying to control how its people think. That's a big change from the 1960s. You have people that have greater freedom to make choices about their lives, choices about their business. Those are all positive signs.

And you have a somewhat more pluralistic society that even has some impact on government policy. So I guess my answer to that is, democratization ought to be our long-term goal, but there are shorter-term goals in terms of liberalization, a more responsive and accountable government, rule of law, that are short of liberal democracy, but are positive things for us and for people in China.

COMMISSIONER WESSEL: Jim, any comments?

MR. MANN: Yes. I would phrase this as a question: the issue is do the lower level changes lead to the larger change of a change in China's political system? There are people who argue that they do. I don't see that they do. But, yes, people are vastly freer to wear what they want, completely free, than they were in the '80s.

The Internet is a profoundly important change. I think you all

have looked at the limits on that change, but it means that you can't really keep information out of China in the way that you could so people know what's going on in the Ukraine or in Georgia, for example, and the government is very scared about that, but people, if you want to have a meeting of 12 people to discuss what happened in the Ukraine, that's a problem.

COMMISSIONER WESSEL: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Wortzel.

COMMISSIONER WORTZEL: Thank you both for your testimony. Dr. Saunders, I detected I don't know whether to say regret or concern as you began to discuss the way that the United States is more involved in the Taiwan issue, and since I infer maybe a combination of regret and concern, what do you recommend that the United States do? What policy adjustments would you make or would you tell the Congress to take another look at the Taiwan Relations Act?

Jim, if you want to comment on that?

DR. SAUNDERS: Well, it's a tough issue because I think one of the consequences of us becoming more directly involved is it lets Taiwan free ride, and gives them a sense that they have more of a blank check to be adventurous or irresponsible. So you have a Taiwan whose military budgets in real terms have been declining.

Yet, we look across the Strait and the PLA capabilities are increasing pretty tremendously and are increasing in ways that pose a pretty direct threat to Taiwan. So it's our increased involvement there that lets Taiwan be irresponsible.

I think one can also see that maybe politically, that in several recent trips to Taiwan, what you see is the focus of politicians on both sides are on domestic politics and the 2008 election, and everything seems to be refracted through that prism, and that can have some negative consequences. So I guess my point is that us getting more deeply involved in some ways is not making the situation more stable.

Then if one looks over the long term where China's military modernization is going, the economic dependency, you have to ask can the status quo endure indefinitely, and I think those are questions we need to look at. I don't have a specific policy answer, but the point is that things are not as stable as they seem.

CHAIRMAN BARTHOLOMEW: Commissioner D'Amato.

COMMISSIONER D'AMATO: I may be beating a dead horse here, but I just want to continue this dialogue that we've had with Commissioners Reinsch and Wessel and others. If it's true that we're hedging because the assumptions that some of the Congress operated on when we gave them most favored nation treatment were that the political system would evolve as a result of the development of

capitalism and eventually become open and if we assume that that's not happening, that's not going to happen, that the political system might improve on the margins to accommodate certain interest groups, let's say, but essentially it's going to remain repressive, dictatorial and growing stronger for let's say the next ten years, now what does that mean in terms of how the United States and China will relate to each other ten years from now assuming that that patina of assumption is gone?

Do we maintain the same kind of business as usual relationship or is there going to be a fundamental shift of some kind? How do you foresee the relationship evolving over a longer period of time--ten years--assuming that there is no political change of any qualitative nature that we were going to expect but it didn't happen?

MR. MANN: Simply my own sense of things is that the main factor on that will be the Chinese leadership's sense of its own stability. To the extent that they are nervous about internal stability, they will be evermore testy with us. They do see us as a political threat, and if the threat, in fact, is internal, they make that link no matter what, and that I think will be the main factor would be my guess.

CHAIRMAN BARTHOLOMEW: Dr. Saunders, any comment?

DR. SAUNDERS: I guess I want to qualify that a little bit. There are two different factors here. One is the policy assumption that China will develop economically and will democratize and that's going to solve whatever China problems we have.

There's another strand to this argument that's worth mentioning, which is that China is going to integrate itself into the world economy, its interests are going to change, the cost of conflict are going to go up, and therefore, you might not get democratization or it might be a century-long process, but what you will get is a change in behavior because its interests will change, and the costs of military action are going to go a lot higher.

I think that's actually a plausible explanation for what we've seen over the last decade, which is a China that is not militarily aggressive. It's building its capabilities and that's something we have to watch very carefully, but it hasn't been using them. So I think you need to remember that side of things, too, and that's a consequence of how China is growing. It's growing by opening itself up and integrating itself in the world, and one consequence is there's a greater degree of restraint on how they behave internationally.

The other side of that coin is they have greater resources and some new options internationally so it's a double-edge thing, but the cost of conflict, I think, definitely has gone up for them.

CHAIRMAN BARTHOLOMEW: Are you finished?

COMMISSIONER D'AMATO: Yes. I'd just make a comment. I think that there's been always this underlying tone in the writings of the Chinese that we need to be patient because we're vulnerable and we're growing stronger. I guess my question is what happens when the vulnerability is substantially less, they're stronger, and they don't have to be patient?

It seems to me that we have to worry about how the relationship evolves at that point.

CHAIRMAN BARTHOLOMEW: Thank you, gentlemen. We have some more questions. This is a very interesting and thoughtful discussion that we're having. Dr. Saunders, I'm a little surprised at this concept of restraint and how the Chinese government is behaving internationally. Jim mentioned Burma; he mentioned Zimbabwe. I'll add there Sudan, and we've been looking at this concept of responsible stakeholder. But first I guess I'll ask several questions, but if you think that those are examples of restraint in behaving internationally?

And then I thought I heard you say that we might need to change international rules and norms to accommodate China. Now, again, looking at this concept of responsible stakeholder, one of the pieces of being a responsible stakeholder is that countries should abide by the commitments that they make multilaterally or bilaterally. Some people have heard me say this in and out every year: when China joined the WTO, there were serious questions about whether the WTO was going to change China or China was going to change the WTO?

If indeed you believe that we need to be changing these norms and rules to accommodate China, what is the point of getting the Chinese government to sign on to any of them in the first place?

DR. SAUNDERS: Good question. That's not exactly what I mean. First, let me say what I mean by restraint. The pattern that I see in Chinese foreign policy and international behavior is they're very cautious about doing things that might have a negative effect on the economy. That's one reason they want to maintain a good relationship with the United States. It's one reason as Sino-Japanese relations worsened in 2004 and 2005, the leadership wanted to step in and correct that before it had an impact on the economy.

So when I say "restraint," I mean particularly in the use of military force and particularly in not doing things that might interfere with economic modernization. That's China's self-interest, but I think it has produced a fair degree of restraint in policy.

That's not to say, of course, that there is not a host of things they're doing internationally that are worthy of concern. Sudan, some of the ways in which they have protected Iran and North Korea from

Security Council action, those are certainly legitimate areas of concern. But looking at the big picture things, in terms of using force, I think we have seen restraint.

With respect to changing rules and norms, I'm not advocating that, but from the Chinese viewpoint, they have entered into a system where the rules and norms were written by other actors, especially by Western actors, and in some cases, they feel they don't meet their interests as well.

I think lurking under the responsible stakeholder concept is the question, is there some kind of accommodation of interest possible with China, and I think this is an area where that concept doesn't really flesh it out. So I'm not advocating that we ought to change rules and norms to accommodate China, but I'm saying that we ought to expect that in some areas, China is going to look for that, and we have to think whether that's something we're willing to say yes to, we're willing to say no to, and that relates to this issue of how do those norms and institutions shape Chinese behavior.

So I think it's not something that I'm advocating changing, but I'm saying we should be prepared for those kind of requests and think about how we respond and what it means.

MR. MANN: I just want to make the point, I also think China has become much more sophisticated about the use of force. The classic example would be Taiwan where in the mid-'90s, it was a sort of minority viewpoint in Chinese think tanks to say, we really should rely on the long-term and an economic approach in dealing with Taiwan, and the majority viewpoint, which was what the PLA did, which is to fire missiles. And they became more sophisticated.

I don't see the issue as simply whether China uses force or it doesn't because for any country including China, military strength is one part of an overall strategy, and so it's not whether it does or it doesn't, but the implications of what it does and what its goals are as it develops down this road.

CHAIRMAN BARTHOLOMEW: I would add in your questioning of the paradigms the questioning of our definition or the prevailing definition of the fact that this relationship has been a success in terms of looking at the state of our economic situation here in the United States, in terms of looking at Chinese human rights practices, proliferation practices and political reform. So when one starts questioning, I think it's important to question the whole thing rather than just assuming this has been successful and how did we get there.

Commissioner Houston.

COMMISSIONER HOUSTON: Thank you, Madam Chairman. I hope I'm not beating a dead horse, but I have a question that's a little

bit more specific. Mr. Mann and Dr. Saunders, I'd be very interested to hear what you say.

There is this little-known economic theory and it's little known because it's basically my economic theory. I call it the "Starbucks factor." Everyone in the world wants to be able to afford three bucks for a cup of coffee, and being in China last year, we saw Starbucks pretty much on every corner. You mentioned generational change a little while ago, and we've talked a lot in all our hearings about military modernization, economic liberalization, but we haven't talked much about how the cultural changes in China could possibly affect the U.S.-China relationship vis-à-vis the political structure over there.

As we mentioned before, no one is running around in Communist Party pants anymore over there, and they're creating their own music videos, the retail industry has certainly changed, and mostly I'm speaking of the urban areas. So you see this huge social and cultural liberalization going on over there.

So my question is, the generation of Chinese right now who are--just picking a number--between say 15 years old and 30, at some point they are going to come to political and economic age and will be basically running the country as our youth will be in 20-30 years.

What expected changes would you see in the political or economic structure, if any, based on this sort of cultural liberalization of the Chinese youth and how should we or would or could the United States change its policy to react to that change if you do believe that there would be one?

That's a lot of could-have, should-have, would have's, I know.

MR. MANN: Commissioner, you're asking a very important question, one we haven't talked about, and I do have my own views on that. In fact, they're in a chapter of my book which is called "The Starbucks Fallacy."

COMMISSIONER HOUSTON: Really?

MR. MANN: Yes.

CHAIRMAN BARTHOLOMEW: Is that based on Tom Friedman's "the McDonald's theory"?

MR. MANN: The argument that because China is bringing in McDonald's or Starbucks or wearing clothes from the Gap, that that is going to change its political system, it's one which is commonly made, and I just don't see it. I don't think that McDonald's changes. It's very heartening to us--there are deep historic roots on this. There was once a United States senator in the '30s or '40s, I think, who said we're going to lift up China till it becomes--Shanghai, I think-- till it becomes just like Kansas City.

I think it's a mistake to assume that, to infer anything about

China's political system from Starbucks.

The other point which I think you're making, which I question the overall assumptions that tend to be made, is that a generation of young urban residents, the sort of advanced elite of China that we tend to see when we visit Beijing or Shanghai, is going to be in favor of, necessarily in favor of changing the status quo and the political system.

And to the extent that the current system evolves as it is now, they have a strong stake in maintaining the current system, I think. And the way to think of that, if you think of the American political map, we all think of Red States and Blue States. If the Chinese cities were like gold stars, they would be surrounded by a sea of red. I mean if the Chinese policy tends to favor and has tended to favor urban dwellers, and if you actually liberalized to the extent that there was one man/one vote, and I realize that's, to say the least, quite a stretch, the cities would be outvoted.

The people wearing the Gap clothes in Shanghai, are a tiny percentage of China's overall population. If you add together the population of China's ten biggest cities, you get like 60 or 70 million people which is a staggering number if you're thinking of marketing. It's a country the size of France, but for China's overall population, it's like five percent.

CHAIRMAN BARTHOLOMEW: Dr. Saunders.

DR. SAUNDERS: Just very briefly. I think two points worth touching on. One is that you mentioned the aging of cohorts. You're going to start to get people who have studied in the U.S. and the West moving into positions of power, and that's already happening. They have a broader set of views. Some of my friends who I met while they were studying in the U.S., some of them have looked at the democratic system in the U.S. and want something like that from China. Others look at it and say, well, that's not really going to work for us in the same way.

So that's one factor, but you definitely have people who are more exposed to the outside, more sophisticated, and that's a potential force for political change. What's happening that is sort of more to the point is you get an individualism. It's “I'm out for me.” Nobody believes in communism anymore. Nobody really believes in that stuff so I'm going to do the best I can for me and for my family within the system.

Does that wind up some kind of accommodation between the elites and the government? That's a possibility, and it's something worth studying and worth thinking about.

CHAIRMAN BARTHOLOMEW: Thanks very much, and we should just point out probably what did we think the average age of the

standing party is? Probably 65 maybe. Just to point out to Commissioner Houston that for the young people, they've probably got another 30, 40 years of waiting before they even get to move into positions of power.

COMMISSIONER HOUSTON: They're probably like my mother, they can't use their cell phones.

CHAIRMAN BARTHOLOMEW: Commissioner Brookes.

COMMISSIONER BROOKES: Thank you. Good to see both of you again. Jim, you're welcome to comment on these, but these are kind of directed more towards Phil Saunders. I have two questions, and it probably would take more time than we want to spend on them, or we may want to spend more time on them in the future.

But one is that you talked about the challenge of ICBMs. It's my view that the United States because of the threats that are arising from North Korea and Iran today, that missile defense is something that needs to be done. How are the Chinese reacting to that, if you could just answer that quickly? I'm sure you're probably written a dissertation on it or two.

The other question is, I think we both realize that the rise of a new power in the international system has often been a disruptive occurrence, and I was just wondered if you could quickly tell me about this hedging strategy. I've heard it many times myself. Has that ever been a successful hedging strategy for managing the rise of a new power? I'll stop there.

DR. SAUNDERS: Good question. First, with respect to BMD, I think we're already seeing the outlines of what China is doing. It's modernizing its nuclear arsenal; it's going to double or triple the number of warheads that can reach the U.S. They're going to be on mobile ICBMs on the land and submarine-based on the water.

Basically what they're trying to do is build a survivable deterrent, and that will, in their view, put the U.S. in a position where it doesn't feel it can strike China with nuclear weapons or use the threat of nuclear blackmail against them.

That's the main direction. But the point is I think it's very unclear what size ballistic missile defense the U.S. will ultimately build. We have a very limited one that we're doing spiral development of and it's got a limited capability now, but where is that going to go in the future? Are there going to be space components of that? How big is it going to get? How much are we going to spend on that?

All of those are open questions. The point I want to make is that we can expect China to do whatever it feels it needs to do to maintain that nuclear deterrent relationship with the United States.

How do we deal with that? Is that something ultimately at the

end of the day we have to accept or is it something we view as a very big threat to the United States and an indicator of hostile intentions?

Again I think the Taiwan scenario and the possibility of a conflict over this is what really gives this issue bite. We don't have that same kind of issue in our relationship with Russia even though we have a lot of political and international problems with them because we don't have that scenario where both our militaries have to plan for what they would do if a war broke out.

As you know very well, the issue of the rise of a new power is a very difficult one for the international system and there aren't many success stories. The one that's cited most often is the United States and Britain where Britain basically accommodated the U.S. rise and stepped aside or worked out a partnership arrangement which worked carefully.

So there isn't really a successful example of the hedging strategy being tried partly because the international conditions were pretty different. We're in a different environment now where you have factors such as nuclear deterrence which makes using force a very costly and potentially devastating thing; economic interdependence where you've got a different set of relationships going.

The short answer is there aren't many successful examples of a rising power being accommodated. And therefore there's not really a test case for the hedging strategy.

CHAIRMAN BARTHOLOMEW: Jim?

MR. MANN: Nothing to add there.

CHAIRMAN BARTHOLOMEW: Nothing. Okay. Commissioner Fiedler.

COMMISSIONER FIEDLER: Yes. Thank you. Jim, I'd like to address a couple of points from your testimony and ask you to expand, and I'm going to ask Dr. Saunders' indulgence because I'm going to use something you said to make the point that I want him to respond, but please do respond to mine, that you're saying really that it's important the words we use to describe either the current situation, what we're looking for, and what our policy is. For instance, words like "change" in and of themselves are meaningless. China has changed. Yes. So what? Changed how, very specifically?

Dr. Saunders, in terms of your use of words, you said that we should continue to engage China as if the alternative is not to engage China, and I actually know no one any longer who argues that we should not engage China. Yet, the phrase continues to creep into our lexicon and our debate.

So precision is I think what you're arguing about, Jim, precision in the use of words. Let me just give one more example. You said

China no longer controls how people think. I'm not sure China ever did control how people think. They controlled how they speak, write and act, and they still do that. So it's a nice thing to say, but I'm not sure that it's particularly meaningful when we're trying to enlighten or to shed light on particular strategies and policies that the United States should enter into vis-à-vis China.

MR. MANN: That's exactly right. I try to look in my book at the meanings of various words and "change" is the very first one because I think in the general sense that when people--it's the first word association that people come up with respect to China. China is changing and that's economically. First of all, it's true economically, but what does that mean politically, and even when you talk about political change in China, you get people saying, well, China is changing politically and you have to pin down what exactly do you mean by that because in the largest sense it's not.

Just to give one other example of interest to policy. Sometimes the argument is made that the United States has to avoid a Cold War mentality in dealing with China, and people seem to think that that makes intuitive sense, until you think about it, and you realize economics and trade were a part of the American Cold War policy towards the Soviet Union.

The United States is running a deficit with China of over $200 million a year. Just in point of fact, whatever you think of that, there is no one across the entire debate in the United States that is in favor of cutting off trade with China or thinks that American policy towards China is like the Soviet Union or has been or should be. So it's the inability to reexamine words that I think is a problem.

DR. SAUNDERS: Just two points. I'll take the correction because my intent is not to pose engagement against a straw man argument. Really the precise focus is how we engage them and for what purposes.

COMMISSIONER FIEDLER: That was my point, yes.

DR. SAUNDERS: And how do we do that in a way that makes good sense. So I'll take that correction under advisement. When I say--I think actually China in the 1960s did have some success in influencing how people think, and that's a difficult thing to assess, that you have had belief in communism and socialism sort of seep out of the Chinese political system. You do still have the same political institutions, and Jim's correct, and his thesis is an interesting one to look at, but there no longer is this belief that they're really building a Marxist utopia or perhaps even a socialist society.

As that belief has seeped out of the system, you're left with something that's much more based on power relationships and also on

the classic economic issues, who benefits and who profits and how is that shared? So I think the belief dimension does matter.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Blumenthal for another round. We've got about another ten and a half minutes.

VICE CHAIRMAN BLUMENTHAL: Thank you. I wanted to come back to something that Dr. Saunders said about Taiwan, and I tend to agree that I don't think the trends are good. On the particulars, I think I disagree a little bit. The way I see it is that it's not so much a question of miscalculation or misperception. It's a true conflict of interest there in the sense that trends on Taiwan are that they're democratic and sovereign and all, and they're not about to give that up, and China doesn't want to cede it.

Then I go back to something that is Jim Mann's basic point, which is that our great policy bet was that China would liberalize, and I think this matters most of the Taiwan issue because that's really a question of war and peace. I think our Taiwan policy is or cross-Strait policy is thus based on the fact that we're going to wait all of this out, we're going to be ambiguous with both sides, until China liberalizes and then somehow the solution will come. Either Taiwan will decide that it will confederate or China won't care anymore.

But I suppose if Jim Mann is right, then that policy--and Dr. Saunders is right--then that policy can't hold, and I wonder something else Dr. Saunders said about Taiwan free-riding. I wonder if we take your basic assumptions, don't we want to get more involved.

We've had lots of partners and allies before that have gained a free ride off of us, but we benefited from that, whether it's NATO allies--we had a little bit more control over what they did. There are some very good reasons to want a country to have somewhat of a free ride. I think you probably agree with the statement that if we didn't support Taiwan's defensive capabilities or allow them to free ride, we may face some other bad options. Either they would not be able to defend themselves at all and sort of Finland dies in the Soviet sense, or perhaps they would lash out on their own in some very dangerous ways.

So I guess the basic question to both of you is, am I drawing the right conclusion from your grand assumption? Am I drawing the right conclusion about cross-Strait policy, and am I drawing a more, particularly with respect to our involvement on the issue, am I drawing the right conclusion there?

MR. MANN: You're raising the right issue. I'm not quite sure if I understood the conclusion itself. The issue of China's political future is crucial on Taiwan policy because from almost every quarter

one hears a groping towards a formulation. There are people on at least one side of the debate in Taiwan who say we could envision some kind of common understanding. There would be some federation--take your pick--when China's political system changes. And there are people in the United States who have suggested that.

I've heard people, sort of reformers from the PRC, throw that out privately, and you can get even more specific. There are people who say, gee, maybe the president of Taiwan could become a president of the PRC, and there are all kinds of formulations. None of them go anywhere because they founder on the fact of China's political system.

VICE CHAIRMAN BLUMENTHAL: But I guess what I'm saying is if China's political system is not going to change, then doesn't that mean that our cross-Strait policy has to change?

MR. MANN: To?

VICE CHAIRMAN BLUMENTHAL: It's premised now upon China's change over time. In other words, we're just sitting here in a holding pattern waiting, waiting for China to change, become more democratic, but if you were right--

MR. MANN: In formal terms, the policy is not based on change; it's based on preserving the status quo as long as possible; right?

CHAIRMAN BARTHOLOMEW: With the presumption that the situation solves itself.

MR. MANN: Yes. Fair enough.

VICE CHAIRMAN BLUMENTHAL: From what you're saying is if you're correct, then the situation will not solve itself?

MR. MANN: Right; correct.

DR. SAUNDERS: So trouble ahead. I think the U.S. does have a strong interest in preserving Taiwan's democracy, but there's potentially a lot of ways that can be done. One other point to bring out is it's also not clear that democratization of China--when and if it occurs--solves that problem because in many states as you go through a period of democratization, you have a more intense nationalism and it's not clear that a democratic China would deal with Taiwan all that differently necessarily.

VICE CHAIRMAN BLUMENTHAL: So if that's the case, then, do we not want some free riding on Taiwan's part, in a sense that we want a measure of control over the situation.

DR. SAUNDERS: It's a question of how much control do we get? Are we preventing Taiwan from doing things that might provoke a war or irresponsible behavior that might get us into a situation we don't want to be in? So, yes, we do get some measure of control, but how much and is it enough to make sure those kind of bad things don't happen?

MR. MANN: I guess I would disagree with the idea we want free riding from Taiwan.

VICE CHAIRMAN BLUMENTHAL: You would rather arm them to the teeth and--

MR. MANN: I'm thinking specifically of the current defense debate--that to me is free riding--with failing to approve a budget for systems that came up through the process of United States and Taiwan together.

VICE CHAIRMAN BLUMENTHAL: Yes, just a comment. I always say be careful what you wish for because if Taiwan buys everything that we sell them, we actually may have a different--in some ways, we're off the hook by the fact that they're not buying everything that we're providing.

CHAIRMAN BARTHOLOMEW: And in some ways they're off the hook by not buying it, I think. I'm going to have one final question and then we'll let you go. Gentlemen, you've been very generous with your time and with your thoughts.

Jim, in particular, you started out by talking about how Taiwan and South Korea might not be the appropriate models, but mentioning both because the U.S. did a fair amount with goading with both of those countries, and that there were size differences. But a lot of people seem to think that China might be trying to adopt a Singapore model of economic liberalization and repression of its own people. I wondered, there must be size issues that go along with that, too. Do you--

MR. MANN: Yes, I agree with you, and in fact it was Jiang Zemin, not the current president, who kept putting forward the idea of a Singapore model. And the size issues there are far worse, and I think really that the leaders in China understand that. They can't really think that they're going to produce Singapore with 1.3 billion people.

CHAIRMAN BARTHOLOMEW: Thank you very much for your testimony. We look forward to talking with you more throughout the year.

We'll clear the room for lunch break and resume business at 1:30. Thank you.

[Whereupon, at 12:30 p.m., the hearing recessed, to reconvene at 1:30 p.m., this same day.]

A F T E R N O O N S E S S I O N
[1:30 p.m.]

PANEL IV: THE U.S.-CHINA ECONOMICS & TRADE RELATIONSHIP

VICE CHAIRMAN BLUMENTHAL: We're going to get started with our panel this afternoon where we will discuss the economic and trade relationship. We are very pleased to have Ms. Thea Lee of the AFL-CIO, who's the Director of the Legislation Department and has extensive experience in researching international trade issues and their impact on the U.S. economy and the labor force. She's co-author of A Field Guide to the Global Economy.

We also have Dr. Peter Navarro, professor of business at the School of Public Policy at the University of California, Irvine. Dr. Navarro writes frequently on economic, energy and environmental issues. He has recently published The Coming China Wars, which argues that China's economic growth does create and has created conflicts within the world economy that our country and other countries must address.

At 1:45, we will be joined by Grant Aldonas, who is the William M. Scholl Chair in International Business at the Center for Strategic and International Studies.

He previously served in the Commerce Department as Undersecretary for International Trade and has an extensive career in international economic policy, litigation and trade.

With that, I open it up to Ms. Lee. Each of you has seven minutes to speak, and statements will be accepted for the record as well.

STATEMENT OF THEA MEI LEE
POLICY DIRECTOR, AFL-CIO, WASHINGTON, D.C.

MS. LEE: Thank you so very much. It's a tremendous pleasure to be here, as always, and I wanted to start by thanking and commending the Commission for the great work that you all do year after year and for the terrific reports that you put together that have been a tremendously valuable resource for the labor movement, for scholars and for policymakers.

I really appreciate the opportunity to come here today. As you all know, this issue of China's economic and trade relationship with the United States is of huge importance to our members, to working men and women here in the United States, and also to workers in

China. Sometimes there's a misunderstanding about the fact that we in the labor movement and the AFL-CIO have been very critical of our own government and of the Chinese government in terms of our bilateral trade and economic relationship.

But it isn't because we don't wish prosperity and stability and fairness on China. That is one of our overriding goals as well as the goal of protecting the interests, the jobs, and the wages of our members. But we raise these issues in solidarity with Chinese workers and in concern that their rights aren't protected. Our two governments have let us all down.

The government of the United States and the Chinese government have let down working people by failing to put this relationship on a very different footing. We hope that this hearing will be a first step in putting forward in a more compelling way the policy solutions that are available to the Bush administration and to Congress as we move forward.

I think we all agree that the U.S. trade relationship with China is enormously imbalanced and problematic. The Chinese government has violated its international obligations with respect to workers' rights, human rights, currency manipulation, export subsidies and intellectual property rights, among many other things. All of these things contribute to the growing U.S. trade deficit with China, which we all know will exceed $230 billion in 2006.

I was looking at the trade figures, and I measured the imbalance between our imports from China and our exports. We all know that that's a very imbalanced relationship. Our imports from China exceed our exports by 5.3 to one. I compared that to a lot of our other trade imbalances, and it's so far out of whack that I think it is interesting. It does focus this conversation a little bit. If you look at Europe and Canada and Mexico, our other major trade imbalances, that ratio is about 1.5 to one, the excess of imports over exports.

Our imports from Japan exceed our exports by 2.5 to one. Even in OPEC countries where we have a tremendous need to import oil, where we don't have the same kind of export opportunities, the trade imbalance is only 3.7 to one.

So this relationship with China is completely out of scale with our other trade relationships. That enormously lopsided trade relationship has concrete consequences for the workers that I represent.

Many have lost their jobs, of course, which is always the top note, the thing that we mention first, but the impact goes much deeper and broader than job loss. The "China threat," as we call it, affects wages, benefits and even the prospect of forming a union, as employers

wield the threat of moving jobs to China to stave off union organizing drives, stave off first contracts, and impose wage or benefit cuts.

We hear the same story when we talk to workers in other countries and even when we talk to government officials from in both developing and industrialized countries. They ask us these questions: how does a struggling democracy in Africa or Latin America meet the China price? How do they get their prices, that is, their wages, as low as those in China? By dismantling their own democratic freedoms, busting their unions, gutting their labor laws, trashing their environment and manipulating their currency?

If that doesn't sound like the right answer, if that isn't the kind of direction we want to give to developing countries around the world, then we need to put a different set of trade policies in place that create a much more coherent framework for our trade with China and indeed with the world.

The same kind of questions arise at home. What do we tell American workers and businesses that are thrown into evermore direct competition with China in ever-expanding areas? Work harder. Be more efficient. Of course. But American workers are already the most productive in the world, have more education and training than they've ever had, and as a nation work longer hours than those in any other developed country.

I know from talking to many businesspeople that our domestic producers are also working hard, they're innovating and scrimping and pulling out all the stops to explore global markets as well as domestic markets.

The problem isn't that they're not working hard enough, it's not that they're not efficient enough, it's not that they don't have enough training and education to compete with China. The problem is that our own policymakers have not provided the support they need to compete on anything remotely resembling a level playing field. Sometimes people throw up their hands at this question and say the extent of China's cost advantage over the United States is so enormous that there's no point in tackling any one piece of it. It's just hopeless.

But this is illogical. What we need to do, and I hope today's hearing will be a good start in that direction, is to identify one at a time the sources of unfair competitive advantage and address each one of them in turn.

In order for us to be successful, we need our government to take this issue seriously, to be honest about the magnitude of the problems that we face, and to begin to use the policy tools at its disposal to wield effective economic leverage in our bilateral relationship. What we don't need is another round of ineffectual and insincere diplomacy

with no clear benchmarks and no consequences for repeated failure.

The Chinese government has charted out an economic growth strategy that relies heavily on export-led growth primarily to the U.S. market. This strategy makes sense for China. They've also charted out a political agenda that requires repression of free speech and free association, and the prohibition of independent unions or other non-governmental organizations that might challenge the government's power.

Labor in China is not just cheap. It is deeply disenfranchised and disempowered, which leads to horrible abuses of workers' individual liberties, but also to dangerous and unsafe working conditions, unpaid wages and abuse of prison labor.

We've had this conversation many times, here at the Commission, with the Congress, and with the administration. Our deep frustration is that the administration's response is always to initiate yet another round of strategic dialogue, or conversation, or cooperation. We need to move beyond that stage and start taking some concrete actions that have economic consequences. The Chinese government should understand that there will be economic consequences to repeated failure to address the currency manipulation, the worker rights violations and illegal subsidies, among many other things.

Thank you so much for your attention. I look forward to your questions.

[The statement follows:]

Prepared Statement of Thea Mei Lee, Policy Director
AFL-CIO, Washington, D.C.

Madam Chair, Vice Chair, Commissioners, thank you for inviting me to testify today on behalf of the ten million working men and women of the AFL-CIO on the trade and economic relationship between the United States and China.

I want to start by commending the U.S.-China Commission (USCC) for the great work you have done and are doing: the research you have commissioned, the diversity of voices and perspectives you have brought together, and the cogent policy recommendations you have put forth. Your annual reports are a tremendously valuable resource for policymakers, scholars, and activists, and I would like to convey the appreciation of the AFL-CIO for all the hard work that goes into those reports.

Much is at stake in getting the basic elements of our trade and economic relationship with China on a sounder footing. China is already a major global player politically and economically, and will be even more important in the future. The AFL-CIO, like the rest of the global labor movement, would like to see China become more prosperous, stable, and fair – but that can't happen if it continues on its current path of repression, dictatorship, and unfair trade practices. We need our own government to get its priorities straight with respect to China, and we look forward to working with the China Commission, the Administration, and the Congress to develop and implement appropriate policies.

Many of us in this room – and outside it as well -- agree that the U.S. trade relationship with China is

enormously imbalanced and problematic. The Chinese government has violated its international obligations with respect to workers' rights, human rights, currency manipulation, export subsidies, and intellectual property rights, among other things.

All of these factors contribute to the growing U.S. trade deficit with China, which will probably exceed $230 billion in 2006. Our imports from China exceed our exports by a factor of 5.3-to-one, which represents an extraordinary degree of lopsidedness compared to any other major trading relationship. By comparison, our other major trade imbalances – with Europe and our NAFTA partners – represent an excess of imports over exports of only about 1.5-to-one (using trade figures through the first eleven months of 2006). Our imports from Japan exceed our imports by 2.5-to-one, while even our OPEC trade imbalances are only at 3.7-to-one.

This enormously lopsided trade relationship has concrete consequences for the workers I represent. Many have lost their jobs, of course, but the impact goes much deeper and broader. The "China threat" affects wages, benefits, and even the prospect of forming a union – as employers wield the threat of moving jobs to China to stave off union organizing drives, first contracts, and wage or benefit increases. We hear a similar story from our union counterparts, and also from governments, around the world, in both developing and industrialized countries.

How does a struggling democracy in Africa or Latin America meet "the China price"? By dismantling its own democratic freedoms, busting its unions, gutting its labor laws, trashing its environment, and manipulating its currency? If we don't think that is the right answer, then we need to put policies in place that create a more coherent framework for our trade with China, and indeed, with the world.

Similarly, at home, what do we tell American workers and businesses thrown into ever-more direct competition from China in ever-expanding areas? Work harder, be more efficient? American workers are the most productive in the world, have more education and training than they've ever had, and – as a nation – work longer hours than those in any other developed country. And I know that our domestic producers are innovating and scrimping and pulling out all the stops to explore global markets as well as domestic. The problem is that American workers, farms, and businesses have not had the support they need from policymakers to face this competition on anything remotely resembling a level playing field.

Our trade relationship with China is a little bit like the Agatha Christie mystery, *Murder on the Orient Express.* A group of people jointly commits a murder, each stabbing the victim in a dark train compartment so that no single one can be held accountable. The truth is there is no single factor that explains the U.S. trade imbalance with China.

China experts often say the extent of China's cost advantage over the U.S. is so enormous that there is no point tackling any one piece of it. That is simply illogical. We need to identify the sources of unfair competitive advantage and address each of them in turn.

In order to be successful, however, we need our own government to take this issue seriously, be honest about the magnitude of the problems we face, and begin to use the policy tools at its disposal to wield effective economic leverage in our bilateral relationship. We don't need another round of ineffectual and insincere diplomacy, with no clear benchmarks and no consequences for repeated failure.

The Chinese government has charted out an economic growth strategy that relies heavily on export-led growth, primarily to the U.S. market. The elements of the strategy include maintaining an undervalued currency through massive intervention in the foreign exchange market, an industrial policy of targeting favored or pillar sectors through cheap loans and subsidies, and protection of domestic markets through overt and covert trade barriers. This is well-documented in the China Commission's annual reports, as well

as elsewhere.

The Chinese government's political agenda requires heavy-handed repression of free speech and free association, and the prohibition of independent unions or other non-governmental organizations that might challenge the government's power. Labor in China is not just cheap: it is deeply disenfranchised and disempowered, leading to horrible abuses of workers' individual liberties, but also to dangerous and unsafe working conditions, unpaid wages, and abuse of prison labor.

The Chinese government's political and economic strategy is coherent and rational from the point of view of China's leaders – as long as the U.S. government is willing to go along with it.

Up until now, our government has acquiesced to this strategy, with only occasional and ineffectual protests, for several reasons. First, this strategy happens to serve the interests of an economically and politically influential segment of the U.S. business community: multinational corporations that import from China for sale in the U.S. market or produce in China for sale in the U.S. market. These corporations' interests are closely aligned with those of the Chinese government – although not so well aligned with those of American workers or domestic producers. Artificially low prices on Chinese products – whether caused by currency manipulation, subsidy, or repression of workers' rights – are a competitive advantage for companies importing from China.

Geopolitical concerns also contribute to our government's acceptance of China's export-led growth strategy, even in the face of protests from domestic producers and workers.

What can and should our government do differently?

Yesterday, AFL-CIO Secretary-Treasurer Richard Trumka testified before the Senate Banking Committee on the question of China's currency manipulation, certainly a key element in the economic and trade imbalance between our countries.

The AFL-CIO belongs to the China Currency Coalition (CCC), which is made up of several dozen industrial, service, agricultural, and labor organizations that have come together to press our government for an effective policy response to this problem. In 2004, the CCC filed a Section 301 petition alleging that China's currency manipulation was an unfair trade practice and a violation of China's obligations under both International Monetary Fund and World Trade Organization rules. The Bush Administration summarily rejected the petition within a few hours of its filing – apparently without taking the time to read the several hundred pages of analysis, documentation, statistics, and tables. The Administration was no more receptive when members of Congress refiled the same petition in September of 2004 and again in April 2005.

At yesterday's hearing, Treasury Secretary Paulson presented the 2006 Report to Congress on International Economic and Exchange Rate Policy (IEERP). Once again, the Treasury Department has determined that "no major trading partner of the United States met the technical requirements for designation [as a currency manipulator] under the terms of Section 3004 of the [Omnibus Trade and Competitiveness] Act [of 1988] during the period under consideration."

During the last several years, the Chinese government has intervened repeatedly and one-sidedly in exchange-rate markets to prevent the value of the yuan from responding to market forces, accumulating more than one trillion dollars worth of foreign exchange reserves ($200 billion in the last twelve months alone) and running a current account surplus of more than 8 percent of GDP.

As Secretary Treasurer Trumka said yesterday, "Either there is something wrong with the criteria Treasury

is using to determine currency manipulation, or there is something wrong with the Treasury Department's math." Treasury's failure to take this one simple and straightforward step of designating China as a currency manipulator undermines U.S. credibility, deprives the government of leverage in ongoing negotiations, and sends a message to the Chinese government that no serious action is required.

Secretary Paulson described the Administration's new initiative toward China, the Strategic Economic Dialogue (SED). The SED is meant to be a "forum for addressing critical economic issues and planning for long-term cooperation." Issues to be addressed include developing efficient innovative service sectors, health care, cooperation on transparency issues, and a joint economic study on energy and environment, among other things.

This SED offers too little, too late. The proposed forum, dialogue, and cooperation are grossly inadequate, given the magnitude of the economic problems we face with respect to China.

When pressed by several senators for what action the Treasury Department would take if the SED failed to produce results, Secretary Paulson said he would go back to the table and talk some more, explaining to the Chinese government why "more currency flexibility" would be in China's interest and how important it is to the American people.

With all due respect, the time for talking is long past.

Here are several key steps the Bush Administration could take tomorrow to move beyond "bilateral consultation" and continued dialogue.

First, the economic agenda laid out by this Administration vis-à-vis China is way too narrow. Workers' rights appear to have fallen off the list of key economic topics to be addressed, whether in the SED or the Joint Commission on Commerce and Trade (JCCT).

Violation of workers' rights is just as much an economic issue as currency manipulation, violation of intellectual property rights, or illegal subsidies. In 2004, and again in 2006 (with bipartisan support from Representatives Benjamin Cardin and Christopher Smith), the AFL-CIO filed a Section 301 petition alleging that the Chinese government's brutal and systematic repression of its own workers' fundamental human rights constitutes an unfair trade practice under U.S. law. (In 1988, Congress amended Section 301 to explicitly include egregious violation of workers' rights as an actionable unfair trade policy when it "burdens and restricts U.S. commerce.") We calculated the economic impact of the Chinese government's repression and estimated that it contributes to the loss of hundreds of thousands of U.S. jobs in addition to the suffering inflicted on Chinese workers.

The Bush Administration rejected both worker rights petitions without the courtesy of a substantive reply.

A first and obvious step would be for the Administration to accept both the worker rights petition and the currency manipulation petition. Accepting the petitions simply commits the Administration to investigating the claims and, if warranted, to take appropriate action through the WTO. More important, it signals the Chinese government that real economic consequences will ensue if acceptable progress is not made toward complying with international obligations to respect workers' rights and a substantial revaluation of the yuan does not take place (our estimate is that the yuan needs to appreciate by 40 percent in order to reflect underlying market fundamentals).

Second, whether or not it responds to the 301 petitions, the Administration can and should initiate WTO dispute resolution immediately in several areas, including currency manipulation and violation of workers' rights.

Third, the Administration should work more aggressively to generate multilateral support at both the IMF and the WTO. Both institutions have crystal clear obligations with respect to currency manipulation, but seem uncertain – or unwilling – about actually enforcing them. Similarly, the Administration has not taken full advantage of International Labor Organization and United Nations pressures on China with respect to human and workers' rights.

Fourth, the Administration can clarify without delay that countervailing duty remedies can be applied to non-market economies.

But Congress cannot wait for this Administration to act.

We urge Congress to give immediate consideration to the Fair Currency Act, which was introduced with bipartisan support yesterday as H.R. 782

This bill clarifies the definition of currency manipulation, identifies currency manipulation as an illegal subsidy, and ensures that countervailing duty laws can be applied to non-market economies. It does not apply exclusively to China, but is broadly applicable. It is a crucial first step in addressing the urgent economic problems we face today.

I thank the Commission for the invitation to appear here today, and I look forward to your questions.

VICE CHAIRMAN BLUMENTHAL: Thank you very much. Dr. Navarro.

STATEMENT OF PETER NAVARRO
PROFESSOR OF BUSINESS, THE PAUL MERAGE SCHOOL OF BUSINESS, UNIVERSITY OF CALIFORNIA, IRVINE, CA

DR. NAVARRO: Thank you, Mr. Blumenthal, and it's a great honor and pleasure to be with you all today. The overarching theme of my discussion today is that Washington, D.C. basically seems to be totally preoccupied with events in the Middle East, and China, in my judgment, over the longer-term is a much greater threat to the economic, financial and political security of this country.

This Commission is an outlier in Washington because it is the one entity that is doing extremely good and incisive work in bringing this issue to the attention of the American public, but so far the tide has been turning more towards attention towards the Middle East.

What I'm going to do for you today is to give you a brief summary of my more extended written remarks. The testimony basically is in four parts. Let me give you the top lines first for each of these four parts.

In the first part, what I do is basically parse the China price, which Ms. Lee referred to. I'm surprised nobody has done this. What I do is I examine the eight major drivers of Chinese competitive

advantage that include things like currency manipulation, cheap wages, export subsidies and the like, and I actually quantify the relative relationship of each one of those, and what is remarkable about that is that five of the eight drivers of Chinese competitiveness are clearly unfair trading practices that should be cracked down upon, and the other three have elements of mercantilism as well.

The second theme I'll address today is the march up and across the value chain. It's not about toys and cheap electronics and heavy manufacturing anymore. In five years from now, we won't have just the AFL-CIO here. We're going to have white collar representation as well talking about unfair trading practice. We're moving from tube socks to automobiles to biotechnology. I'll expand on that.

The third is in some sense the most alarming theme because I will argue that by the process of China recycling their export dollars into U.S. financial markets, we are losing our economic, financial and ultimately political independence.

The final theme I'll touch upon is the relationship between the rapid economic growth and the even faster growth in the Chinese military budget and military build-up. That's the overview.

Let me address each one of these points now in a little bit more detail. The "China price" is a coinage from Business Week that came from a cover story done some years ago which refers to the ability of Chinese manufacturers to undercut global competitors by 50 percent or more across a wide range of primarily manufacturing products, and the question for this Commission and policymakers is how do they do that? Is it free trade which is fair or is there something else going on?

The popular perception is that it's basically an advantage driven by cheap labor, but Guatemala has cheap labor, Cambodia has cheap labor, Mexico has cheap labor; there's something else going on. So what I did with a team of about 100 MBA students at the University of California is actually go through the exercise of trying to determine the relative contribution of each of the elements of the China price after we identified what those were.

They are as follows: we have the Washington obsession, which is the currency manipulation. It's important but not as important as you might think. The big item in the unfair trade practices is the export subsidies. We've got subsidized energy, water, virtually free capital to underperforming industries because the banks don't call in the loans, VAT tax rebates. There's just a whole web of complex subsidies that should be subject to WTO complaints and other types of complaints, but for some reason this town is silent on that.

The third element is counterfeiting and piracy. The cost advantages vary by sector, but they include things like not having to

pay for IT, not having to pay marketing expenses to market your brand, and not having to do things like R&D which for pharmaceutical companies and industries like automobiles is particularly important.

When you sum all of this up, you see clearly that almost half of the China price advantage is unfair mercantilist beggar-thy- neighbor policies which, in effect, are transferring jobs in a zero sum game between the U.S. and China, and if anything comes about in terms of my contribution to this debate, it will be the quantification of this China price and to illustrate that this is unfair trade advantage.

Theme two is the value chain issue. As I said, it's not tube socks and toys and TVs anymore. China is moving strongly into autos. They're going to be moving into aircraft. Most alarming, biotech and pharmaceuticals. We now have over 300 biotech and pharmaceutical firms that have offshored to China.

Politically what's happening is as corporations outsource and offshore to China, we lose the political will to lobby against unfair trading practices. It used to be hand-in-glove five years ago: business sat right beside labor. It's not like that anymore because it's now in the interests of a lot of American corporations to stay over there. If we lose our white collar base to China as well as our blue collar base, that will be a very, very difficult story for us.

The third theme, the loss of independence is simply that China funds our budget deficit now by recycling surplus export dollars. They just announced last week they're moving into our equity markets, and the third stage of that is going to be an accelerated campaign to acquire companies in the U.S. What that's going to mean is technology transfer. It's going to affect decisions about offshoring and outsourcing. It will also affect political activities of these corporations.

We are in a position now where I believe the Treasury Department is cowed by the prospect of China dumping greenbacks on international markets. So last December they did not come back with anything. They did not even meet what were very low expectations for that December trade summit.

This is a dangerous trend which only gets worse as foreign currency reserves accumulate in China because of their mercantilist policies. We are losing our economic, financial and political independence.

Finally, this is a theme which others have touched on today and will touch on tomorrow--I'm not going to go into it deeply here--but the unfair trade practices which drive the economic growth are funding the military build-up in China at a rate faster than the economic growth.

Thank you.
[The statement follows:][4]

Panel IV: Discussion, Questions and Answers

VICE CHAIRMAN BLUMENTHAL: Thank you very much. Commissioner Reinsch, you get the first question.

COMMISSIONER REINSCH: Thank you. I'm sorry Grant's not here, but he'll get here eventually, and let me go with the two of you at this point. I appreciate the testimony. I don't think there's a lot of disagreement on the analysis of the problem. There is, I think, some disagreement between the two of you on what to do about it, and Professor Navarro, you didn't get to the very end of your testimony where you talked about your strategy.

DR. NAVARRO: Yes.

COMMISSIONER REINSCH: And perhaps later on, you might want to elaborate on that. But let me focus on Ms. Lee for a second. I'm going to ask you a variation of the same question I asked somebody else this morning. Let's assume for the moment that we do bring WTO cases on both currency and worker rights as you suggested. Leave aside the petition. Let's just go to the WTO and see what happens. And supposing we win--okay--what is the remedy that you would expect in each of those cases?

MS. LEE: Thank you, Commissioner Reinsch. The starting remedy is the threat of a tariff and the hope that the initiation of a WTO dispute resolution process would convince the Chinese government to take action. I think on currency, it's a lot easier for the Chinese government to take action than it is on worker rights, and I'll get to that in a moment.

The Section 310 petition that we filed with the China Currency Coalition laid out in great legal detail why the Chinese government's currency manipulation at its current level constitutes a subsidy under TWO and IMF rules.

Faced with the prospect of an across-the-board tariff, I think it would be in the interest of the Chinese government to revalue the yuan. There are certainly a lot of advantages to the Chinese government of revaluing the yuan. It increases Chinese purchasing power. It could rebalance their economy towards more domestic consumption and away

[4] **Click here to read the prepared statement of Peter Navarro, Professor of Business, The Paul Merage School of Business, University of California, Irvine, California**

from over-reliance on export-led growth.

So I would think that the threat of a tariff in that situation would elicit the reaction that we want, which is substantial near-term revaluation of the yuan.

On worker rights, it's more complicated because that the Chinese government's repression of worker rights goes right to the heart of the power of the Communist Party and the dictatorship. No dictatorship, no autocratic government, wants a real independent union movement. It's a threat to any undemocratic government, and therefore it's difficult for the Chinese government to voluntarily make that choice.

On the other hand, it's also important, just as it was important to pressure the apartheid government under South Africa with external sanctions, to show that there is an economic consequence to being so far out of line with international human rights obligations. That threat should be made, and maybe that will change the balance of power within the Chinese government towards those who recognize that some reform is needed and is overdue and will elicit that change. I imagine that would take longer, but I also think that a threat of tariff is what's needed in both cases.

COMMISSIONER REINSCH: You should have been here this morning for Mr. Mann. I think he would be skeptical that anything would influence them, but Professor Navarro addressed this question late in his testimony where he attempts to demonstrate that if they revalued in the range of 40 percent, which is big, that for reasons he can explain, there would only be a ten percent improvement in the ability to compete against the "China price."

Do you agree with that?

MS. LEE: I don't have a strong opinion on that. I think that it probably wouldn't be a dollar for dollar improvement in the ability to compete. There is some evidence that exporters will swallow some of the loss that comes about from the redressing currency manipulation, but nevertheless it's where you need to start. When you have a currency that's so far out of whack, you need to start by getting it closer to market values.

COMMISSIONER REINSCH: But it sounds like you don't see a significant impact on the trade deficit in the short term from that measure?

MS. LEE: I think you would see an impact. It wouldn't close the trade deficit in a year, but it would certainly chip away at one problem and brings you closer to where you need to be, which is at least getting the trade deficit moving in the other direction from where it's going now, which is a galloping increase year after year.

COMMISSIONER REINSCH: Professor Navarro, do you want to

comment on that last piece?

DR. NAVARRO: Yes, please. I would actually. Just to explain the issue. China has a very high import content for their exports. So in order for them to buy their imports, whether it be energy or sub-assemblies for computers, if their currency is undervalued, they're basically spending more money than they otherwise would to buy those imports. And then they sell the exports cheap. They buy imports dear and sell the exports cheap. So after you account for that, that 70 percent import content, you get a much smaller currency effect on the trade balance.

I wish this town would stop being singularly focused on the currency manipulation. I think it's important, but as my China price analysis shows, there's a lot of other fish to fry that are equally or more important.

VICE CHAIRMAN BLUMENTHAL: Commissioner Wortzel.

COMMISSIONER WORTZEL: I wanted to draw you out on the concept of clustering of businesses that you referred to in your written testimony when I think you talk about some electronics down in South China. Your parallel was Detroit is the motor city here as a hub, but in so many areas, the conscious state policy in China was to avoid clustering and in a very inefficient way distribute key industries around the country as a hedge against nuclear attack or invasion.

Now, you seem to be suggesting here that that state policy is indeed changing, and that they're beginning to, for purposes of efficiency, direct and cluster things in other ways. Is that your understanding?

DR. NAVARRO: Yes, that's a very insightful remark, and you have your history absolutely right. Under Mao Zedong, the decentralization of industry was a very inefficient way of organizing. Right now, this phenomenon of industrial network clustering, which I refer to in the China price analysis, it's like, as you say, Detroit as the "motor city" or New York as a financial center or Las Vegas as a gambling center.

What's different here is the scale and scope. It's like nothing we've ever seen. The special economic zones that the Chinese government put in the coastal areas basically allowed green fields to be rapidly turned into industrial centers, and it wasn't by design that these clusters sprung up. It was more just basic economic processes, but you have whole towns that build either single products or single components that go into products.

And so, what it does is it generates information and supply externalities. It generates tremendous transportation cost savings, and it's the only one of the eight drivers to which I take my hat off to the

Chinese and say this is something we all can learn from. So that's the whole notion of clustering, Commissioner.

VICE CHAIRMAN BLUMENTHAL: We're very pleased to be joined by Grant Aldonas, and we're going to turn to him now for his testimony and then come back to questions.

STATEMENT OF GRANT D. ALDONAS
WILLIAM M. SCHOLL CHAIR IN INTERNATIONAL BUSINESS
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES
WASHINGTON, D.C.

MR. ALDONAS: Mr. Vice Chairman, I don't feel the need necessarily to go through the ritual. I've provided a written statement. It might be easier just to go to the questions. That's usually where the fun of the hearing is.

VICE CHAIRMAN BLUMENTHAL: Why don't you make a few minutes of a presentation so that people can actually have questions to ask.

CHAIRMAN BARTHOLOMEW: We'll also give our audience the benefit of your expertise.

MR. ALDONAS: Happy to do it. Sure. First of all, I wanted to say thank you. I think the work of the Commission is incredibly important. I do think that China represents some very, very significant challenges. I tell you the gist of my testimony was fairly simple. It was, number one, don't sell the United States short as a part of this. I worry that in any one of these discussions because we focus so intently on China and the challenge it represents, we sometimes underestimate our own strength in responding to those challenges.

We also fail to realize that in grappling with most of the challenges we face, we have the tools in our own hands to grapple with those changes. Oftentimes our competitiveness is driven far more by things that we do here at home than it is by the challenge that China or any other trading partner represents.

Good hearing at Ways and Means a couple days ago, where I know Michael was there, and frankly it focused on how do you raise the productivity of the American worker? How do you recognize the fact that our biggest challenge is demographic, fewer workers per retiree? We can't afford to really leave anyone, not just children, but anyone, behind as a part of that process.

So the first thing is don't sell the United States short. Let's focus on that as well and understand the dynamic that we control to be able to address both global challenges and then China specifically.

The other thing was not to oversell China. Happy to get into

more of it in terms of the question and answer period, but China faces real challenges, and I think that what we need to do is highlight the challenges it faces so we understand them and where their policy emanates from because oftentimes I fear that what we do is demonize China and we read what they're doing with some malign intent, when in fact it's driven by some very specific interests they have, oftentimes the Communist Party trying to stay in power frankly, but beyond that it really is something where I think it behooves us to try and understand the dynamic from their perspective, as I hope they will from our own, because what I'd like to see is as constructive a dialogue as possible between ourselves and the Chinese.

The last thing really is to debunk some myths, most particularly the trade deficit and what drives it. I think that what we have to do is get past that debate if what we're really going to do is focus on the challenges that China legitimately does represent.

For example, I have spent a lot of time with Thea over the years. Frankly, the unions are right about something that I think we all ought to be honest about. The hukou system, for example, in China represents a massive subsidy. If you restrict any economic actor from trying to obtain the value of its services or the highest value for that particular commodity or service including labor, you're necessarily going to subsidize the domestic producers of that product.

In fact, when you have a system that ties individuals to specific enterprises where they're not free to bargain with whomever they'd prefer to be able to participate fully in the economy, you're both limiting the chances for development significant in China's own interests, but you're also doing something that fundamentally shifts employment out of the United States, economic activity out of the United States, and elsewhere in the region.

It frankly does much more damage to their trading partners in Asia than it does to us in the United States.

But bluntly, those are things that we should tackle, and what we shouldn't worry about is methodology. We ought to focus on what's happening and confront the real challenges. That's really the sum and substance of it. Thank you very much.

[The statement follows:]

Prepared Statement of Grand T. Aldonas
William M. Scholl Chair in International Business
Center for Strategic and International Studies, Washington, D.C.

Chairman Bartholomew, Vice Chairman Blumenthal, members of the Commission, I want to thank you for the opportunity to appear before you and discuss the U.S.-China economic relationship and

its implications for our economy and our national security.

I have been working on trade with China for over 25 years – since my early days with the State Department, as a lawyer in private practice, as the Chief International Trade Counsel of the Senate Finance Committee during the debate over China's accession to the World Trade Organization ("WTO"), as one of the lead U.S. negotiators on trade and investment issues under the U.S.-China Joint Commission on Commerce and Trade ("JCCT") and the administrator of our unfair trade laws while I served as Under Secretary of Commerce for International Trade in the current Administration, and now as a scholar, and investment adviser, and as an investor in my own right. I hope I can offer some perspective that will be useful to you in your deliberations.

I want to emphasize at the outset that there has never been a more urgent need to get our relationship right with China, for our own benefit, for China and Asia's benefit and for the benefit of the world trading system. When I say getting our relationship right, I do not mean the ritual prostration before the emperor known as the kowtow; nor do I mean demonizing China and creating needless friction and suspicion. China's rise economically does present us with challenges, both from an economic and security perspective, but that challenge does not necessarily imply a malign intent.

We are likely to have far easier time understanding China and addressing the real challenges posed by its rapid rise if we do so with an understanding that China's actions are taken in their own self-interest, rather than consciously to challenge the United States. Our response should be in kind – assertive about what is in our own self-interest, without suggesting any suggestion of conspiracy, conflict or confrontation. That is, after all, asking that we do no more than consciously adopt domestic and foreign policies that are most likely to ensure peace and a rising standard of living, both here and abroad, because of the contribution that makes to our own security.

That should be the measure of our policy toward China as well and a measure I would suggest for any analysis or recommendations made by the Commission.

Avoiding the Tendency to Sell the United States Short

When ever I discuss China, and particularly the United States' place in the world relative to China, I am always reminded of an economics profession I had at the University of Minnesota. He started his courses by saying that his favorite economist was Marx – Grouch Marx – because of Groucho's famous question, "Who are you going to believe, me or your own eyes?" In this case, I would paraphrase that by asking, "Who are you going to believe, Lou Dobbs or your own eyes?"

Any honest appraisal of the United States would say that it is, by far, the single largest, most productive, most competitive, most adaptable, and most resilient economy in the world. Our economy is more than twice the size of our nearest competitor, Japan. Our productivity gains over the past decade and half have outstripped every other developed country and virtually every developing country.

Our economy actually raised its growth rate this past year in the middle of an extended period of growth dating from the end of the bursting of the high tech bubble and the 2000-2001 recession. More Americans own their own homes than ever before and more Americans are graduating from high school and benefiting from post-secondary education.

Unemployment is below 5 percent – well below the 6 percent average that the previous administration defined as full employment and well below the historic average of the last 30 years. And, that is despite sustained increases in our population and a steady flow of immigration, both legal and illegal.

There is one other set of statistics that I like to cite because they do such a wonderful job of putting our relationship with China in perspective. The United States economy this past year produced roughly $ 12.5 trillion in goods and services. Of that total, our manufacturing sector accounted for roughly 11 percent. China's economic, by contrast, totaled $ 2.2 trillion at official exchange rates. A rough comparison would show Lou Dobbs that, despite all the stories he has produced about the demise of American manufacturing, our manufacturing sector alone would amount to more than half of the Chinese economy as a whole and would represent the 8th largest economy in the entire world.

In short, despite some serious challenges in terms of an aging population, wage compression for unskilled workers, lower social mobility, rising health care costs, and government debt, the economy itself is doing incredible well. I know that any measure of our economic health done at a macroeconomic level can obscure problems within different sectors of the economy, but the overall economic picture is incredibly bright and considerably brighter for a boy or a girl born today in the United States than it is for a boy or a girl born to day in China.

Equally important and the message I most want to leave with the Commission is the fact that the economic challenges we do face lie squarely in our own hands to solve. We control our own economic destiny. Fingering China as the source of much of what ails us economically ill serves the political debate, which would be better focused on what really matters and on building the political consensus needed to tackle those problems.

My point is that the Commission should put the challenge presented by China's rise in perspective and never, ever sell the United States short. We have the wherewithal to shape our own future and the terms of engagement with China and the global economy as a whole if we are wise enough to use it.

Avoiding the Tendency to Demonize China

There is a tendency to demonize China of late, which is unfortunate for at least three reasons. First, treating China as a threat will become a self-fulfilling prophecy if we stay at it too long. I had several interesting conversations with Chinese officials in the aftermath of President Hu's recent visit to the United States. You recall that there were a number of hiccups in the President's visit, including the assignment of press credentials to a Falun Gong protester for the arrival ceremony, that led the Chinese officials to ask seriously whether or not the screw-ups were part of a concerted effort to embarrass President Hu and undermine U.S.-Chinese relations.

I explained that, as Americans, we are good at many things, but that we are not good enough at conspiracy (and don't aspire to be) to be able to coordinate such an effort. I also emphasized that, because of the blessings (and I do mean blessings) of an open and skeptical press, no conspiracy of that sort could remain hidden from public view. But, the incident does underscore the risk of letting the tone of crisis and conflict where there is none overwhelm what might otherwise develop into a stable and productive bilateral relationship.

Second, those who treat China as a threat often call anyone who disagrees with them naïve, but my own experience is that their bluster about the Chinese threat often obscures far more serious issues from examination and public debate here in the United States. The debate about currency manipulation offers a prime example.

There is no doubt that China's renminbi is undervalued – under certain assumptions. There is also no doubt that the Chinese have to intervene massively in the currency markets in order to maintain their peg to the U.S. dollar. And, there is no doubt in my mind that the intent is mercantilist – they do want to keep

exporting to the United States because of the employment that their export production provides in an economy where they have to create many millions of jobs every year just to keep up with the growth in their population.

At the same time, it is not clear to me that if we got all that we generally ask for – a floating currency and a lifting of all capital controls – that the renminbi would actually rise. China's savings are roughly equal to the size of their economy. That is an extraordinary number and that savings rate goes a long way toward explaining the Chinese trade surplus – indeed, it goes farther toward explaining the surplus than does either Chinese competitiveness or American uncompetitiveness.

At present, the Chinese pool of savings and investment capital is locked in China. Like any restriction on exports, the capital controls have a tendency to lower the cost of the commodity (in this case, money) available to domestic producers. But, if the controls are removed, that capital can seek a higher rate of return elsewhere and much of it would flow out of China with the result that the renminbi would fall against the dollar, rather than rise.

The reason that seems counterintuitive is the tendency to confuse China's growth rate with the profitability of investment in China. China's growth suggests that the investment capital would stay home because it could earn a high rate of return with all that economic growth going on. But, the truth is producing in China is not terribly profitable for a host of reasons and the capital markets are not terribly safe, which means that a relatively safe investment in the United States could generate a higher rate of return for the Chinese investor while also diversifying their portfolio's risk profile.

My point in walking through that example is two fold. The first is to underscore that a focus on China's currency may turn out to be counterproductive in real terms – a case of be careful what you wish for – if the assumptions about the post-float situation are altered even slightly.

The second is to highlight the fact that a focus on currency obscures a far more significant problem from the perspective of manufacturing. That is the massive subsidy available to Chinese enterprises, particularly state-owned enterprises or enterprises in which the state or certain powerful Communist Party leaders have a stake. That subsidy flows from a capital market that does not price risk accurately, finances projects on a political rather than economic basis, and does not oblige the well-connected to repay their debts.

A high non-performing loan rate among Chinese state-owned banks translates into a zero cost of capital to their well-connected borrowers. It also, incidentally, translates into a lower rate of return for the average Chinese depositor, which, of course, reinforces my earlier point that there could be considerable capital flight from China in the absence of the capital controls. But, for purposes of its impact on our economic interest, that sort of subsidy tends to draw investment and employment artificially towards China at the expense of the United States, to be sure, but of even more damaging effect on the growth prospects of the Chinese neighbors in the region.

As a matter of trade policy, we would do much better to focus on the problem at the heart of the Chinese capital markets that distorts investment decisions and affects employment prospects even in an economy as larger as the United States. We should treat it as the trade- and investment-distorting subsidy it is and ensure that the Chinese understand it and address it in those terms.

Finally, treating China as a threat betrays an insecurity about America's position in the world economy that is unjustified and, perversely, dangerous by handing those in China who want to see the United States as a threat in order to justify actions and policies that are, in fact, inimical to our interests. In that sense, demonizing China is self-defeating.

One does not have to scratch the surface very far in China to tap into some massive insecurities about China's place in the world. That translates into an assertive nationalism reminiscent of the trends that led toward conflict early the last century. That nationalism is manipulated by politicians in Beijing in order to preserve their grip on power to be sure, but it is also a potent force that would exist even without that manipulation. In other words, there are plenty of people within the Communist Party and throughout China that will tend to see China's rise as coming at the expense of the United States and they will take some satisfaction in that view. It will reinforce the tendency to see the United States as an enemy.

If, out of our own insecurity, we respond in kind, we are simply feeding that tendency in China. All the more troubling if we respond in kind when we do not need to feel insecure about our own economic future relative to any other nation in the world.

China's rise can be enormously productive for the United States and the rest of the world if we are shrewd enough to see that and develop our own economic and foreign policy in ways that would reinforce that effect on both the global economy and our own. If, on the other hand, we let our own insecurities about America's place in the world cloud our judgment, we could find ourselves in precisely the unhealthy circumstance that Great Britain, Russia and France did in responding to the economic challenge that a rising German and Japan created at the turn of the last century.

It is worth underscoring, as we debate whether globalization is inevitable, that the result of conflict that arose from getting the relationships between rising powers and those already on top was the division of the world into warring camps for the better part of the last century and untold grief and suffering for most of humanity throughout that era.

Debunking Myths

I think the most important contribution that the Commission could make is to debunk a number of myths about China and our economic relationship with China. We need to debunk those myths precisely so we can focus on what really does matter and do something about it with a strong bipartisan political consensus behind any actions we take.

One myth is that China – and Chinese unfair trading practices – are responsible for the trade deficit. Another is that the trade deficit means that we are falling behind and becoming less competitive in the global economy and that China is the principal beneficiary of our decline. Our current account deficit, both in total and bilaterally with China, has hit all time highs in the past year before abating recently due to a surge in demand for U.S. exports. There are two points worth making about the deficit, both of which underscore how wrong it is to rely on our trade deficit as a measure of our competitiveness or China's strength.

The first point is that it is not China's competitiveness, fairly or unfairly gained, that is driving the deficit; nor is it a lack of American competitiveness. Consider this, the deficit has fallen sharply in recent months. No one would say that China has done anything new to open its markets or end subsidies to its own producers in that time, least of all those with the greatest stake in making the argument that the deficit reflects Chinese unfair trade practices. Nor would anyone say that American competitiveness improved for some significant reason.

And, yet, the deficit has fallen. The appropriate conclusion to draw from that set of facts is that there are other forces driving the deficit and any answer to the deficit is likely to come from actions other than those we might take in the trade sphere relative to China.

This was just as true when we had such trade conflict with Japan in the late 1980s and early 1990s. Our

bilateral trade deficit exploded for a time, but then narrowed significantly in 1991. Again, no one would assert that Japan suddenly opened its borders to trade at that point. What, in fact, happened was that the U.S. economy had tipped into a recession and slower growth in the United States meant a lower appetite for imports from Japan and elsewhere.

Now, we could attempt to address the trade deficit in the same way by ratcheting up interest rates and driving the economy into recession. The question is why would we engender that kind of economic misery to change a statistic that has nothing to do with either China's our own competitiveness or lack thereof?

The second point is that we do know what really drives the deficit and, to the extent it does reflect weaknesses in our approach to economic policy, those weaknesses are domestic, rather than foreign. Unfortunately, we do not seem capable of facing them for what they are – home grown – or appear willing to tackle them.

The current account deficit reflects the difference between our production and our consumption. We are borrowing to consumer more than we produce. We can either cut consumption or increase savings to address that gap. China's relative competitiveness has nothing to do with that equation.

Now, where do we stand in terms of that equation? We have a tax code that provides a deduction for interest payments and subjects income generated by equity investment to what amounts to double-taxation. In other words, the tax code favors debt – indeed, provides an economic incentive to go into debt, rather than save.

At the same time, we have massively under funded pensions and health care funds, which imply another significant liability and financing need on our national balance sheet. The looming crisis in Social Security adds another dimension to that problem because it too represents future financing needs. The same holds true for the lack of budget discipline in the Federal government.

We are swimming in debt that has nothing whatsoever to do with China. That debt represents a drag on our economy and our competitiveness, but it is absolutely home grown. In short, we have the means to reduce the trade deficit in our own hands and it does not involve raising tariffs on Chinese goods that would hurt folks on the low end of the income ladder in the United States most. But, we do nothing to tackle the underlying problems in the tax code, the federal budget, Social Security and other entitlements, or the pension system, both public and private, that would restore some balance to our national accounts.

Yet, we wonder why we have a heavily leveraged economy and tend to blame foreign unfair trade practices for the ostensible result, the trade deficit.

Significantly, all this seems much more obvious and transparent to the Chinese in Beijing than it does to us here in Washington. It is not lost on Chinese economists what our situation is financially. You can imagine how seriously they take our complaints about our trade deficit as a result. They do so because they are concerned that we might shift markedly toward protectionism, but not because the argument about the trade deficit holds any economic merit. That was borne out again and again in my own discussions with the Chinese in the context of the JCCT.

None of which is to say that there are not massive distortions in the Chinese economy and that those distortions do not have deleterious effects on the United States and its economic prospects. My point is that focusing on and perpetuating mythology obscures the nature of those distortions, misleads the American public, and distorts the political debate about what to do about the real economic challenges we face.

The Commission could do an enormous amount of good by debunking that mythology and focusing Congress' and the Administration's attention on what really matters.

Thank you.

VICE CHAIRMAN BLUMENTHAL: Larry, you get a bonus minute.

COMMISSIONER WORTZEL: I get to finish up. You hit one of my hot buttons. And frankly you also touched on it in your oral testimony, but this idea that the United States demonizing China and treating it as a threat will become a self-fulfilling prophecy. I hear that a lot, and I think it's pure garbage.

So let's talk about a few things. Did the Chinese blow a satellite out of the air and demonstrate their anti-satellite warfare capability because we demonized them? Did they run an airplane into our EP-3 aircraft and take the reconnaissance aircraft's crew and hold them hostage for a couple of weeks because we demonized them? Did the Chinese shut down the computer systems at the Bureau of Export Control at Department of Commerce because we demonized them?

Did Chinese government control hackers penetrate our military computer systems and shut down several of those including the National Defense University and the Navy War College because we demonized them?

MR. ALDONAS: Are those rhetorical or do you want an answer?

COMMISSIONER WORTZEL: They're pretty rhetorical.

MR. ALDONAS: I'd be happy to answer those questions.

COMMISSIONER WORTZEL: Or is it the nature of the state and the totalitarian Communist Party-controlled people's democratic dictatorship makes it take the types of action it does and our wariness is over the fact that we can't infer the intentions of how that state will behave? So, are we demonizing them or are they taking actions that create concern in this country?

MR. ALDONAS: Larry, I have to say if, in fact, you look at their military budget, of course it's a concern, and if you have a totalitarian state, of course, it's a concern. What I'd suggest, though, is that we think hard about what the Communist Party is trying to accomplish, which is to stay in power, and ultimately when we look at what they do in the economics sphere, we'd be wise to remember that's the overall motivating force, and I don't disagree with you about that.

But that means that what they're doing won't necessarily be driven by the sorts of economics we would recognize. It also means that they have to grapple with the fact that they're fundamentally on the back of a tiger and they don't know how to get off it. And I think

that we would develop a better strategy with respect to China if we focus on that because that's the weak point, and we do have to find ways in the military sphere, I think, to confront what China may represent.

It would only be prudent to do that, but at the same time, I don't want to overplay it. I think you would agree with me, Larry--we've talked about this before--their ability to project force is not that extensive right now. So as a consequence, what we need to focus on is what do we do ourselves to make sure that we've addressed that threat?

So wariness, I don't quarrel with; we live in a dangerous world. On the other hand, thinking that every instance is driven by some grander conspiracy, I don't buy. My own experience in government suggests that we can't hold a conspiracy together very long and I don't think you can in China any longer either.

But the fact of the matter is that just means we should be on our guard but not overplay that hand. And, of course, the point of my testimony, Larry--I hope I was putting it right--was to say, in fact, I don't want to tip too hard against the United States and think that everything in our economy is fundamentally weak. I have a tendency to make fun of Lou Dobbs, precisely because Dobbs would have you believe that every manufacturer in America is going to close down at three o'clock this afternoon, it's all over, and ignores the real fundamental strength of our manufacturing sector and the many, many people who have found their way in the global supply chains.

Equally on the Chinese side, I'd rather not overplay things rather than what I'd want to say is what are the real threats? Identify those. Because that's where I think you guys do a great job, and frankly inform the public debate in ways that are helpful, is by clarifying what the real threats are and not going overboard and sort of a government institution making a report that goes too far one direction or the other.

The last thing I'll say honestly about economic effects, particularly the trade deficit, the trade deficit is driven by factors other than China's competitiveness or our competitiveness. That's why I just don't think we should debate that any longer. Regardless of what that is, it's the consequence of something we should grapple with.

But the issues we have with China, like the massive subsidy implied and the fact that their capital markets don't work, like the hukou system, which essentially is indentured servitude throughout the Chinese system, particularly in the provinces where they're trying to develop the fastest, those are things really worth focusing on, and that's where I'd like to have the Commission focus their attention as well, and frankly that's where I'd like the administration to focus its attention most of all.

VICE CHAIRMAN BLUMENTHAL: Thank you. I'll take the prerogative of a question. It's striking as we try to clarify some of these issues that we do get--I'm loathe to quote Senator John Edwards--but the two America's, because the statistics that you gave are true about the American economy. In The Washington Post, we just have glowing economic figures, and then we get the figures that Dr. Lee and Dr. Navarro give us as well, and I'm wondering if all three of you help us distinguish between how much of this is a China price due to some of the unfair trade practices, to other types of subsidies, and how much of it is just the overall trend since the 1980s, or pick a date, in terms of the way that our economy has been reshaping within the global economy? Is it possible to even disaggregate? That's for any of you.

DR. NAVARRO: I think I'm going to have to disagree with my distinguished colleagues on the left here in terms of what's going on with the trade deficit.

CHAIRMAN BARTHOLOMEW: Not really on the left.

DR. NAVARRO: Right. Exactly.

MR. ALDONAS: You may be surprised.

DR. NAVARRO: I think this is fairly simple in terms of what's going on here. The U.S. has been running record trade deficits with China. China has been accumulating foreign currency reserves at a rapid and accelerating rate. They're over a trillion dollars now. And the way this equilibrium has stayed in balance is through currency manipulation which is to say that in order to maintain the fixed peg, China has to, by the trade identity equation, recycle as much capital back into the U.S. as it exports in terms of generating a current account surplus.

VICE CHAIRMAN BLUMENTHAL: Let me just interrupt for one second.

DR. NAVARRO: Yes.

VICE CHAIRMAN BLUMENTHAL: Because I really want to get to this question, which is I understand that that is a policy of China, but if China was not manipulating its currency or China was not offering subsidies, how much of this would just be a secular trend and a shift in our economy and how much of it would--

DR. NAVARRO: The two parts of the equation are the U.S. running budget deficits and an easy money monetary policy which facilitates consuming in the U.S. beyond its means. It could be with any foreign country. Okay. That's where the deficit begins. It begins with our own irresponsibility.

The fact that it's China that's generating the big surpluses with us is due to their mercantilist policy. So it's a joint responsibility.

VICE CHAIRMAN BLUMENTHAL: Mr. Aldonas.

MR. ALDONAS: It's a longer term secular trend. I mean the reality is, is you have three things that are driving us. One, you've got changes in technology and transportation and communications. The problem is once you can run a global supply chain, as a competitive matter, you have to run a global supply chain, and so the world you're living in was going to integrate those things. The barrier that geography once presented to trade doesn't exist the way it once did. It doesn't have the same bite. So more trade is possible, under any given condition, China or not.

In addition, China is no longer a low-cost producer. I think it's only the massive distortions in the Chinese system that keeps a lot of the investment flowing to China at this point, to be honest. I think what we're going to see in short order, like Intel did this past year, is you're going to start to see investment elsewhere in Asia, not necessarily in United States, but I'm not sure we're going to see it in China.

Then the other trend that you see, of course, is that the world economy has been fundamentally divided for a century, and like any system that's constrained, first by World War I, then the inter-war period, then the Cold War, you develop an awful lot of capacity on both sides of the divide that wouldn't exist in an integrated market, and a lot of that, coupled with the fallen demand in the post-Soviet Union, means you got an awful lot of supply and an awful lot of labor coming into markets that were already--thank you very much--in equilibrium before the end of the Cold War, and so you start to see huge downward pressure on prices, on price of labor in particular.

Then the second or the third thing I think that you see is the result of trade policy, and there I would say that although some part of globalization is a consequence of trade policy, the real answer on trade policy is how aggressive can you be in going out and trying to solve the problems that present themselves to you. You would see that trend regardless of whether China is there.

With China there's no doubt that it is its mercantilist policies that drive its presence, but it's also the fact that for some long share of time it had been the low-cost producer over the last 20 years and had become the final assembly point for things that were originally made or a large share was made somewhere else in Asia. And at this juncture, what we're starting to see is that receding because prices of wages and a lot of other things are going up in coastal China. Moving to the interior of China, it actually doesn't work because logistical supply chains don't work for most international businesses.

So in fact there is a practical limit in some respects to what China presents.

VICE CHAIRMAN BLUMENTHAL: Okay. Thank you. I would have liked to hear from Ms. Lee--but we got to move on. Maybe you'll have a shot.

MS. LEE: I'm sure I'll have another chance.

VICE CHAIRMAN BLUMENTHAL: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you all for being here. Grant, it's good to see the front of you this week today rather than the back of your head although that's attractive as well.

Professor Navarro, I want to thank you for your study on the China price. I read it when that came out some time ago, and the quantification of the various inputs, that was very helpful.

DR. NAVARRO: Thank you.

COMMISSIONER WESSEL: And the first time that I had seen that. I have two questions for the panel. The first is the question of what role do U.S. and other multinationals play in this? It seems that we're helping to fuel the problem ourselves as well, if I remember. Roughly 60 percent of China's exports to the U.S. come from foreign invested enterprises. What do we do about that? Are we fueling? Are we in fact creating much of the problem Grant talked about, demonizing? Are we the cause of that ourselves? That's number one.

And number two, from the panelists--Grant, specifically, some thoughts from you here--that the question of non-enforcement of our own policies. Currency we continually talk about how bad it is and then we get no results and we stop action.

On Section 421 cases. The ITC says relief is granted in each of the cases. The White House denies relief. When we were in Ohio two years ago, business leaders said they felt betrayed by their own government for the lack of enforcement. Are we simply saying to businesses you're right to go to China, you're right to import, because we're not going to stand by you? Please.

DR. NAVARRO: Let me address the multinational issue. It's clear that multinationals are going to China. They're attracted by the cheap labor. They're attracted by the prospect of a big market and they want to be in on the ground floor. At the same time, it's equally clear that they're going to China because they want to leverage some of the mercantilist practices of China. It's a big draw.

As I indicated to you earlier, the tragedy here is that labor and business are no longer united politically on the issue of trade relations with China. It's become a schism where as more and more companies offshore to China, it becomes in their interest to preserve the status quo which is not in the interest of the United States.

So in terms of what you can do about that, that's clearly a policy question, and it relates to issues of whether or not companies should be

allowed to go where environmental and health and safety and worker regulations are outside the realm of international standards? It's a much harder problem, though, sir, to leverage than taking it head on in terms of congressional policy with respect to addressing the five points of the China Price compass I addressed earlier.

COMMISSIONER WESSEL: Just as a quick interjection. Having done this for almost 30 years now, I don't remember too many business leaders standing arm and arm with Thea over the years, so I might disagree that--

CHAIRMAN BARTHOLOMEW: She hasn't been doing it for 30 years. She's much younger.

MS. LEE: Maybe more than five years.

DR. NAVARRO: The AFL and the National Association of Manufacturers five years ago, they may not have stood side by side, but you couldn't tell much difference between what they were saying in terms of the impact of China on manufacturing, and now you're hearing less of that from businesses.

MS. LEE: Actually, if I may, what we are seeing is the split within the business community in the United States between multinational corporations, whose interests I believe are very much aligned with those of the Chinese government in some of these areas, and domestic producers.

Subsidies, currency manipulation and repression of worker rights are good for a company that's producing in China and selling in the United States of America. That is why we see the schizophrenia of our own government, because the government listens to the voices of the multinational corporations and designs policies that are designed to be ineffective with respect to currency manipulation. You have some jawboning, but you have no action, and that is because the big campaign contributors and the big companies are on that side.

But it is true, also, that domestic manufacturers and domestic farmers and labor have been aligned, and we are increasingly working together. Just this last summer, we put on a trade conference with small and medium-sized manufacturers, who are still producing on American soil, and labor and family farmers, not the big corporate groups. I think that can be and will be a powerful domestic political alliance, aimed at changing the focus of our own government away from putting in place tax policies, trade policies, and currency policies that are designed to increase the advantage of companies that move offshore. Rather, we should be asking ourselves every morning the question: what would it take to keep good jobs here in the United States?

What would it take for American manufacturers to be

competitive, to survive and thrive in the global economy, producing on American soil? And that's the set of questions we need to focus on.

VICE CHAIRMAN BLUMENTHAL: I'll let this go a little bit over because we have some time.

MR. ALDONAS: Thanks. Yes, I'm always amazed whenever I sit with Thea because I agree with so much of what she says. The end result might be different. So, for example, I would say with respect to tax policy, I agree completely. What we do with our tax code is an abomination.

We ought to do something about it, but I would also say that we have the highest tax rates among all the developed countries. People are always surprised when I say that, but that's a huge incentive to move offshore. We ignore the fact that companies are tax collectors more than taxpayers and they take it out of their workers' salaries.

Part of what we have to do, I think, is look all the way through our economic policies with exactly the focus Thea has in mind. If what we want to do is see high quality manufacturing jobs in the United States, you got to design a tax code that's designed to create that, and if what you want to do is ensure that you're trying to drive productivity through our services sector, particularly in health care, so that you're limiting the costs and gaining efficiency, you got to design a tax code that's designed to do that.

That's all true. I would say with respect to multinationals that I want to be clear that they also deliver an awful lot of value as part of this that helps people on the low end of the economic ladder as well. So I do want to be very careful about vilifying a Wal-Mart or something like that because you don't have to go into a Wal-Mart to figure out that what they deliver is an awful lot of value to people at the low end of the economic spectrum. So I want to be careful about that.

Now, having said that, are the incentives what Thea described? I think they are and I think one of the problems of our trade policy is we don't focus hard, Michael, on those points. The distortions, the massive distortions, and subsidy, the incentives, in a system of capital markets that produces at 60 percent non-performing loan rate, which translates into a zero cost of capital for manufacturing investment, that's a powerful incentive for anybody, large or small, to move to China and stay in China even though wage rates and other conditions may be better in Vietnam, Indonesia, elsewhere or in the United States. But we don't focus on those issues.

We think that's somehow beyond the range of our trade policy, and let me use that as the segue to your last point, Michael, which is that we fundamentally have to rethink the trade laws. The trade laws

as they stand right now are not tools that are capable of addressing these sorts of problems.

So, for example, I'd like to see USTR bring a case with respect to the hukou system or the capital market system within the WTO even if we lost, just to highlight the fact that this ought to be on the agenda in any trade negotiation that we enter into.

VICE CHAIRMAN BLUMENTHAL: Thank you very much. Chairman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you. Usually when you ask questions this far down the list, most of your questions have been asked already. So I'm in a bit of dilemma because this time they haven't been. Thank you to all of you for coming here. Some of you have traveled great distances from the wonderful state of California, so welcome to winter in Washington, D.C.

Mr. Aldonas, I'm having a little bit of trouble reconciling your recognition that the Chinese Communist Party is using economics to hold itself in power and what you've just said about rethinking our trade policy, the sense that you thought that our economic policies were actually good policies and they should be continued.
Essentially what's happening is that the trade situation as it is, it is our money through all of these unfair trade practices that the Chinese Communist Party is using to hold itself in power.

How do we reconcile economic policies or different policy goals, recognizing that they're using the status quo and they're using subsidies and they're using things to build their own economy? How do we take advantage of opportunities without allowing them to hold themselves in power?

MR. ALDONAS: Let me first say what I wouldn't do, which is I would not restrict the freedom of somebody at the bottom of the economic pyramid in the United States to use their income to put jeans on their kids or put bread on the table or whatever it is. And we got to understand that that's what tariffs oftentimes mean.

So the solution probably isn't going to lie in our trade tools at the end of the day directed at that sort of particular problem. On the other hand, in the context of trying to use the trading system to grapple with China, I frankly think that we have to after things that are on the boundaries. Taking a case to the WTO about the hukou system is something that a lot of people in the WTO system would object to. That doesn't mean we shouldn't do it.

The same is true frankly about something that takes on capital markets as a whole inside the manufacturing sector in China. So I want to be very clear. I said the economy is doing well in the United States. I didn't say that I thought our economic policies added up to be

all they should be, and I also think that particularly with respect to trade policies, some of the things that we've forgotten is you have to focus on solving these sorts of problems if you want to develop a strong consensus behind trade liberalization, and for me that's what's at risk as a result of China and as a result of not taking care of the individual problems that China and many others represent.

It's currency. Japan intervenes just as much as China does. We need to be addressing those sorts of issues with all our trading partners, not just with China. Thanks.

CHAIRMAN BARTHOLOMEW: I'll open this up to all of you because I think we'll have a little debate here about our trade policies. But if you put out the concept of rethinking our trade policies, it seems to me that one of the main problems that we're having with China is that they have not abided by any agreements that they have already made with us.

So we can rethink international trade rules or rethink trade policies, but if there is no compliance with the agreements that are made, where does that ultimately get us?

DR. NAVARRO: What's troubling about that is that the Chinese hold the hard line that they are complying. If you look at some of the statements made last December by the Chinese delegation when issues like these were raised, they said no, we are in full compliance. I think the only way that China will begin to be held accountable is through actual actions taken by the U.S. within the WTO framework.

One comment on the Japanese manipulation of currency: one of the issues with China manipulating its currency is that it sets in motion a dynamic where Japan, Taiwan, and South Korea all have to engage in the same kind of currency manipulation because if they don't, then their currency will rise relative to the Chinese, to the dollar, the Chinese currency, and that will put them at a disadvantage to China, and so we don't talk about a glut of Chinese capital into the U.S. We talk about a glut of Asian capital, but the bottom line it's because China manipulates its currency.

CHAIRMAN BARTHOLOMEW: Ms. Lee, any comments?

MS. LEE: Yes. Just briefly, I think your point is exactly right. We have rules, we have disciplines within the international trading system on things like subsidies for very good reasons, because it's inefficient and it's unfair if countries are allowed to compete by subsidizing exports. If we're going to follow the rules and we're going to compete with a country that doesn't follow the rules, it puts us at a tremendous disadvantage.

That's why I think our own government's failure to enforce the laws that are on the books is an easy place to start. The government

could accept the 421 cases. It could use WTO dispute resolution much more aggressively than has been done on a subsidy case.

We need to address this issue of the countervailing duty laws applying to non-market economies. That can be done very simply. It could have been done years ago. In addition, we need to clarify where those rules are inadequate. For example, we do have Section 301 provisions in this country to address egregious abuse of worker rights, but we need to use them.

We need to go to the WTO. We need to challenge China to defend use of forced labor and child labor and its repression of the right of workers to associate, and that is our right under the global trading system.

These are important questions that we need to be addressing. I think it goes to the question that Commissioner Blumenthal raised about how much of this is just the natural trend of things and how much is a result of conscious policy choice? You can make a distinction between prices that are low for perfectly normal natural comparative advantage reasons and prices that are low for illegitimate reasons. In the labor front in particular we make that distinction. There is nothing wrong with cheap labor for a poor country that doesn't have a lot of capital, that doesn't have a lot of training.

There is something wrong with cheap labor when that represents the government stepping in, using the full power of the police state, to prevent workers from associating freely, from forming unions, from standing up for themselves, from even asking for their wages.

CHAIRMAN BARTHOLOMEW: Just one comment. Thank you.

MR. ALDONAS: Or even to look for another place to work.

CHAIRMAN BARTHOLOMEW: Chinese government officials like to say to us that we need to educate ourselves more and learn more about China. I'm really struck by the comments you made about the discrepancy between what Chinese officials say and what is actually going on. We experienced that firsthand last year when the Deputy Director of the Ministry of Commerce told us in a meeting in Beijing that intellectual property rights' violations were negligible and, of course, we could walk right out the door and see it, so, you know.

DR. NAVARRO: Into the markets. Yes, the Iron Lady--that's their nickname--in December gave us that lecture about how we didn't understand China.

CHAIRMAN BARTHOLOMEW: Yes.

VICE CHAIRMAN BLUMENTHAL: Commissioner Fiedler.

COMMISSIONER FIEDLER: Thank you. Let me ask you, Grant, a short question, actually a short series of questions. Do you believe that Chinese workers should enjoy the right of independent unions?

MR. ALDONAS: I think they should be free to bargain with whomever they want to.

COMMISSIONER FIEDLER: Workers joining unions?

MR. ALDONAS: I think they should be free to bargain with whomever they want.

COMMISSIONER FIEDLER: Okay. Do you think the U.S. government as a matter of policy should favor the existence of independent unions in China?

MR. ALDONAS: I think that the United States government should stand up for the right for people to freely bargain for the price of their labor in any market.

COMMISSIONER FIEDLER: Do you think that the--

MR. ALDONAS: And I'll tell you honestly why. It's no more than the expression of freedom of association under our own Constitution. If we're not willing to stand up for those values, we cease to stand up for the values of the United States.

COMMISSIONER FIEDLER: Do you believe that the existence or the establishment of independent unions in China is tantamount to overthrowing the government?

MR. ALDONAS: Given the many and varied ways the Chinese government asserts control, I would say no.

COMMISSIONER FIEDLER: Because many people in the United States government have expressed exactly that to me in the past in both administrations, that if independent unions exist, the party can't maintain power, period, and the government will be overthrown. So that this gets to the stability question that everybody sort of talks about but nobody gets their hands around, which is stability for whom?

And stability always seems to me to mean stability for the party as opposed to stability for anybody else. I'd like you to comment on the question of the role of how our government views the existence of unions in China and stability, in the first instance?

MR. ALDONAS: Honestly, I've never heard it expressed from one of my colleagues when I was in the administration or when I was on Capitol Hill quite the way that it was phrased to you. If by that, you mean that advocating independent unions would be tantamount to intervening so heavily that we would be advocating the overthrow of the Chinese government, I don't even think that's accurate. So I'm a little surprised at the extreme nature of the statement because the reality is, is if they want to be considered to be a market economy, thinking in terms of our trade laws but more generally, one of the things that you have to do is allow labor freely to negotiate.

And under those circumstances, it's very difficult to see how in China how that's going to overthrow the Chinese government given

they have a lot of other ways of asserting control under these circumstances.

COMMISSIONER FIEDLER: It's what the Chinese government refers to as the Polish disease.

MR. ALDONAS: Oh, sure, yes. I know that's why they resist it, because they think it's going to overthrow them. That I don't disagree with.

COMMISSIONER FIEDLER: I'm getting to the point that we accept their perception of it. Ms. Lee, you mentioned earlier that Wal-Mart recently accepted the ACFTU into its stores which was most written about. I want one question on your views of the ACFTU at this point, but also why do you think they did that, and what is lesser known is that they also accepted party branches and branches of the Communist Youth League to exist in their stores, which is a very interesting phenomenon vis-à-vis U.S. business. I wonder what you think the implications are and the meaning of that?

MS. LEE: The All China Federation of Trade Unions, the ACFTU, is the single legal labor organization in China. It does not meet the definition of a union by ILO standards or by our standards because it is a government-controlled and dominated organization by its own constitution, and by the laws that set it up. It goals are to serve the interests of the Communist Party, not to represent the workers, who don't have the right to democratically elect their leaders and control the policy.

So it is an interesting irony that Wal-Mart was pushed by the Chinese government to accept the ACFTU in its Chinese branches when, as we know, Wal-Mart in the United States would much rather close a store than allow it to unionize. But I guess I would say it's a symbol of just how meaningless the ACFTU is as a legitimate labor body that it's a problem on paper maybe for Wal-Mart, it's an oddity, but it is not a significant development.

In terms of the Communist Party branches being opened in Wal-Mart, I don't really know what the significance of that is or whether that will make any difference whatsoever to Wal-Mart's functioning. It does show, the odd alliances that are formed between American multinational corporations and the Chinese government, the accommodations that are made by American businesses.

VICE CHAIRMAN BLUMENTHAL: Commissioner D'Amato. I know you'd rather be chairman.

CHAIRMAN BARTHOLOMEW: Chairman emeritus.

COMMISSIONER D'AMATO: Thank you very much. I couldn't help but notice the remarks that Grant made about the tax code, and I just thought it's too bad you weren't able to stay for another term on

the Finance Committee staff to get that cleaned up down there.

But I do notice that on your watch this Commission was created so we do attribute some value to your service on the Finance Committee.

MR. ALDONAS: He knows it was over my wishes.

COMMISSIONER D'AMATO: But actually that last question that Commissioner Fiedler asked Ms. Lee was what I was going to ask her and I just wanted to thank you for, as usual, your very articulate and focused and persuasive testimony.

I do have one question, though, for Professor Navarro. I think it was a very interesting breakdown and analysis that you and your students did on this price breakdown. But you were unable to get into what your formulation of the policy prescription should be. What is it that we are supposed to do about this now?

DR. NAVARRO: Yes. At the end of my testimony, I do discuss a dual track approach to the China problem. I believe that a lot of this is being fueled, as I said earlier, by fiscal and monetary irresponsibility in this country. The tax cuts that we got from the Bush administration early on were tax cuts that have induced what's called the structural budget deficit, which is different from a cyclical budget deficit.

We didn't need those tax cuts than for any other reason than political reasons. It put us in a bind. I think that the Federal Reserve in the wake of 9/11 overreacted in terms of monetary policy, and they had an over-easy monetary policy, and we created a period of three to four years where this country basically turned their homes into ATMs and we went on a consumption binge and it basically accelerated the China problem.

I think that if we live within our means, and we balance our budget and trade deficits, then globalization will take its course, but it won't be as harmful as it has been. So we need to get our own house in order.

That said, the important policy recommendation for Capitol Hill is to formulate a more expanded version of Schumer-Graham which does not singularly focus on currency manipulation and which does not specifically name China. There is really no need to name China. What you need to do is hit all points of the compass I addressed in the China price, all the drivers that are mercantilist in nature, formulate a policy that has responses if countries do not abide by fair currency, by WTO compliance, by intellectual property protection, by minimum wage issues, by environmental health and safety issues.

You formulate an omnibus policy which addresses those issues and has punitive measures if need be. At the same time, you move

forward within forums such as the WTO and you make the appropriate complaints, and you do so.

My problem in terms of why this is not being done is that it really seems to be a puzzle. But I believe the Treasury Department is cowed by the fact that China is holding so much of our [government bond] paper and I believe that the political will in corporate America is waning because of the rapid offshoring and outsourcing, but that, in my ideal world that would be a good start.

COMMISSIONER D'AMATO: Thank you.

DR. NAVARRO: Thank you.

COMMISSIONER D'AMATO: A comment on that, Grant?

MR. ALDONAS: Yes, sure. I can't let the point go by about tax cuts. We were running a budget surplus in the middle of the most severe recession in manufacturing in about 70 years. This was just orthodox Keynesian economics to try and do something about an extraordinary time at the end of 2000 into 2001. We lost six percent of manufacturing capacity at that point. The idea that you wouldn't respond with fiscal policy tools seems to me to be a bit surprising under the circumstances, particularly since the policy tools we used were orthodox liberal economics.

DR. NAVARRO: Those tax cuts were sold to the American public initially as--

VICE CHAIRMAN BLUMENTHAL: Let's finish.

MR. ALDONAS: The second thing is, probably more profoundly, is you're looking at the Treasury Department. The Treasury Department isn't cowed by the amount that's going on. This is one of those instances where I think you really do have to look at what the Chinese want to do. The Chinese want employment that goes along--and I agree--with these mercantilist trade policies. That's the goal.

There is the old saying that when you owe $100,000 to the bank, the bank owns you. When you owe a billion dollars to the bank, you own the bank. In this circumstance, we own the bank. I'm not happy about that. Because I think that's a dumb thing for them to do and a dumb thing for us to do, but having said that, we're in a situation where the Chinese need to keep lending us money to keep people employed. Why do they want to keep people employed? Because they're resisting the economic changes in their own economy which would destabilize them politically.

Now, is that a good thing for us to try and foster? I don't think so. I really do think what we ought to try and do is encourage as much freedom in Chinese society as we possibly can, and the one thing I do know is that the exercise of economic freedom is absolutely essential based on our own history to the exercise of political freedom. And so

if there is a way we tune our economic policies, including trade, not limited to trade, but designed to try and reinforce that with the Chinese, I'm all for it.

VICE CHAIRMAN BLUMENTHAL: Thank you. Commissioner Houston.

COMMISSIONER HOUSTON: I can't let the tax comment go either. But it will specifically go to China and what you have said earlier in the hearing today. My feeling is that cash in the hands of the citizenry is always well spent, and that cash from the tax cuts went back to the citizenry. So I suppose the only argument I could make in my head why that was bad is because we now have more of our own money to spend on Chinese goods.

I have a concern always about labor, to ensure that increased wages accrue always to the workers and not to a blob. I worry about blobs. There's government blobs. There's union blobs. Let's make sure the money goes to the workers.

I think it's an important point to make that there are fiscal economic monetary policies that do need to be changed in the U.S. as far as the China relationship goes. I have no quarrel with that. But I would really like to know if the three main problems coming out of China that we need to deal with are currency manipulation, subsidies and cheap labor. How does our individual tax policy negatively or positively affect those three things for us here in the U.S.?

I just don't understand that. Maybe you can explain it.

DR. NAVARRO: Let me say first that the China price analysis indicates five drivers that are unfair trade practices. It is currency manipulation, the export subsidies, it's piracy and counterfeiting, it's the issue of environmental and health and safety standards, and there's elements of mercantilism in its wage policy. That's what's driving the export machine.

I didn’t want to hit the third rail of an ideological debate [with the tax cut remark].

COMMISSIONER HOUSTON: You already did.

DR. NAVARRO: I hit it accidentally. I'm a little new to this game. But the point, the broader point, here is whether or not those tax cuts were needed and whether or not that easy money was needed. It had the effect over the past five years of accelerating consumption of Chinese exports and exacerbating the trade imbalance, and the fact that we're running a record trade deficit and the fact that we're struggling with a structural budget deficit at full employment suggests that fiscally and monetarily in terms of policy, in terms of discretionary policy, it's a contributing factor to the issue which we are talking about today.

So then the question is, how do we address that, and I say that it would help to get our house in order to deal with this problem that you all are struggling with mightily.

COMMISSIONER HOUSTON: I'm still not with you. Are you saying that it is bad for Americans to have more money to spend on exports? I said that facetiously in my comments, but is that what I'm hearing?

DR. NAVARRO: I am saying that if in the process of spending beyond our means, we basically create a situation where we lose jobs and therefore the ability to earn wages and we lose assets, both financial assets in terms of bonds and stocks, as well as ownership of our own companies, Ms. Houston, I say, yes, that's bad for America. It feels good. It feels good in the short run; it's been a nice five years. We've had a lot of fun, but it's created a process where we've begun to lose our economic, financial and political independence, and over time—I mean if you look at how we make money in America, we make money by wages and we make money by returns to capital and rents.

If we lose our assets to foreigners, one of those major income streams goes away, and all we become is a nation of wage earners, and then if we lose both our blue collar and white collar jobs, where do we work?

VICE CHAIRMAN BLUMENTHAL: We have 50 seconds for anyone to respond, but please keep it on the issue of how China is affecting us and not on questions of tax policy.

MS. LEE: I just wanted to say one quick thing to the first point you raised, that increased wages should go to the workers. One of the most extraordinary things that we found looking at the Chinese labor market is that Chinese workers really have no advocate or protector. They don't have a union, as we've established, the government is not on their side, and the employers are there for the cheap labor. We've seen this problem of wage arrears, where at any one moment in time, there is on average several months' worth of back wages that are due to Chinese workers, and those are the official figures that we've been made aware of.

And so Chinese workers are working harder and harder, sometimes they're working many more hours than is legal in China, and they're not getting paid for it. When they go to the boss to ask for the money, they might get fired. If they go to a local government official and ask for help dealing with their employer, they might get deported, sent back to their village, or put in jail, arrested. They're just as likely to be arrested as they are to be helped.

This is an extraordinary situation, which goes to the very heart of the problem: the lack of political power, the lack of freedom of

association that Chinese workers have. The government has made a deliberate choice to compete in the global economy by keeping labor artificially cheap, not just cheap because it's poor, but cheap because they have no legal recourse, they have no protection.

Even lawyers who help Chinese workers sometimes find themselves in jail or intimidated or harassed. That's an extraordinarily problematic situation both for the Chinese workers and for people trying to compete with Chinese business.

VICE CHAIRMAN BLUMENTHAL: Thank you. Mr. Aldonas, did you have--

MR. ALDONAS: I did, but it actually is to say that tax policy is terribly relevant to this. Because if you simplify the tax code that translates into competitiveness, and what it would mean is eliminating a lot of loopholes and expanding the base. That's always what you have to do with our tax code. You could junk it all and go to a VAT and try and grapple with the lack of progressivity somehow, but you need to find a simpler way to do this because it's a huge cost to American companies including small companies of which I run one and now get to experience this with full force.

I have to say honestly it is deeply troubling to think that we're going to compete with China with all the things that Thea said and penalize ourselves at the same time. So that's one.

The second thing I'd say is honestly, and this really goes to the professor's point, doing one simple thing which is eliminating the incentive for debt in our tax code would help a lot. You'd be encouraging entrepreneurialism, on the one hand, and you'd be lifting one of the vehicles that provides an incentive to do exactly what the professor is worried about.

So in one sense, if this were a fair fight, I wouldn't worry about any person, particularly at the bottom of the economic ladder, having the money in their hands and spending it on that import. But there are distortions in the market, and at the same time we're providing incentive in some respects for the sorts of behavior that the professor was describing. Some if it does flow back to tax policy.

Again, that's why I think we have a lot of this in our own hands.

VICE CHAIRMAN BLUMENTHAL: Thank you. We're going to go to round two of questions because we have a little bit of time. I'm going to ask the first of round two, and that's this very interesting discussion that Commissioner Fiedler had with Ms. Lee.

I'm wondering if on the issue of the formation of unions in China or the ability of labor to organize or to bargain in China, what can the U.S. government can be doing more of in that regard?

MS. LEE: Thank you for the question. There are a lot of things

the U.S. government could do beyond accepting the 301 petition that we filed. One of the things we've noticed, is that the U.S. government has really dropped the issue of worker rights from its top tier issues that it raises with China.

It's not mentioned in the strategic economic dialogue. It hasn't been mentioned in the Joint Commission on Commerce and Trade in terms of the key issues that our government conveys to the Chinese government. Some might say, well, this doesn't have anything to do with the Treasury Department or the Commerce Department, but we would argue that the violation of workers' rights, is, in fact, an economic competitiveness issue. When a government is as egregiously out of compliance with international standards as the Chinese government is, it becomes an issue that needs to be raised to the economic level, not left as of a social issue on the side that can be addressed in a couple of weeks at the ILO in Geneva. I'm not sure our government even raises it there in any kind of effective way.

So we should start with raising the profile of the issue, and, second, we need to look at what the available economic tools are. Congress amended Section 301 in 1988 to include repression of worker rights as an unfair trade practice. This is Congress's intent and understanding, that violation of worker rights can, in fact, give an unfair trade advantage to a government and should be addressed by U.S. trade mechanisms.

The threat of economic sanctions is the only thing, as we see it, that the Chinese government takes seriously, and that's what is needed to catalyze change within the Chinese government. Enormous changes are needed. The Chinese government needs to rewrite its labor laws, rethink its labor market institutions, and move in a very different direction from where it's going.

Is it going to do that without external economic pressure? Not very likely. The United States has this $230 billion trade imbalance with China. What other country is in as strong a position to raise this issue forcefully with the Chinese government? Our government can and must do that, and if it did so, at least it would start a conversation, which is not happening in China. We don't even have the kind of freedom or openness in China right now to have a dialogue about independent unions.

VICE CHAIRMAN BLUMENTHAL: Are you talking about a dialogue at the government-to-government level, or are organizations such as yours also not permitted from having any sort of dialogue within China?

MS. LEE: It's very difficult for us to openly work in China. We are in China. We're trying to do work with NGOs in China that

represent workers, but the truth is that it's dangerous for people in China to work openly with the AFL-CIO, and that shouldn't be the case. That's a really sad statement.

So we have to be very careful that we don't endanger our partners in China. We want to do more of that work. One example, I know this happened with the China Commission, but John Sweeney, the president of the AFL-CIO, had a visa to go to China for a conversation about multinational corporations through the OECD. That visa was revoked by the Chinese government maybe one week before the meeting was to take place and that meeting was never rescheduled.

So we've had a hard time. We've also had dialogue with the Chinese government about going and having access not just to the ACFTU, but to the labor dissidents and to unscheduled factory visits, and we've never been able to get those kinds of assurances from the Chinese government.

VICE CHAIRMAN BLUMENTHAL: Mr. Aldonas, in your experience in the government, have you had the opportunity or have your colleagues had the opportunity to encourage the bargaining or the bargaining power of workers in China?

MR. ALDONAS: Yes. One of the reasons why I thought the JCCT was a pretty powerful tool was that the focus was on getting things done. I worry a little bit about dialogue for dialogue's sake. What you need is a venue where you force a meeting once a year, and then you say we have to have deliverables.

In the context of one of those meetings, it was our conversation with Wu Yi that led to the invitation originally for John to go to China, and no follow-up frankly on the Chinese side--I agree with that. I then left government. I can't say why there was no follow-up in the next JCCT.

But from my perspective, that was exactly the right sort of venue. With Wu Yi, you have someone who is going to make things stick if she agrees to them, and she did agree to open this dialogue. That's the sort of thing where you should go back the next JCCT and say what about that conversation about workers' rights? Right? To keep highlighting it until what you do is you start to get the concessions.

Now, I will say that in any sort of trade going forward, I think the major shift in our trade policy has to be bargaining for rights across the board. If you want development, you got to be bargaining for economic rights, not just a reduction in tariffs.

VICE CHAIRMAN BLUMENTHAL: Chairwoman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you. I have a couple of questions, but in the interest of time, I wonder if you would mind if I

ask one that you can then answer on the record, and then I'll move to one which is going to sound a little off the wall, but we haven't had an off-the-wall question here today.

So the question that I'd love to get your thoughts on for the record would be about the impact of the decline in our manufacturing base on our defense industrial base. Are there consequences as we conduct a war for us to be able to manufacture the goods that we need to for our troops in order to help them on the battlefield? If any of you have any thoughts, I would love to have that submitted for the record.

This is not an issue that has been raised by any of us before, and we didn't ask you to answer it, so if you can't, that's fine. But much of the focus in the past few years about Chinese acquisition of assets in the United States has been focused either on some of our manufacturing companies, some of which, of course, they disband with Chinese labor and take over to China and reconstruct, and some of it has been on natural resources, for example, on CNOOC.

But several months ago, a Chinese company acquired an independent U.S. financial research company, and I wondered if you had any thoughts if this is something that we should be concerned about?

This is a research company that provided information to shareholders on proxy fights and was providing, I think, quite useful information within the business context in the United States. Does it have consequences for us if Chinese companies are holding these kinds of businesses?

MR. ALDONAS: No.

CHAIRMAN BARTHOLOMEW: Thea?

MS. LEE: Go ahead.

DR. NAVARRO: I would say that that type of action goes hand in hand with what I describe in my testimony as kind of the second stage in Chinese acquisition of power over the U.S. If they are going to be a big player as it looks like they intend to be in our equity markets, it would be a natural for them to acquire the capability to better analyze our financial markets in a more sophisticated way.

It's clear that the Chinese strategy in terms of acquisition of companies involves many points of the compass. It's financial information. It's technology transfer, which will, in white collar industries, have an even greater effect on our military capabilities than what's gone on so far. It's decisions about offshoring and outsourcing, and it's issues relative to the political posture of particular companies.

So you raise a very interesting point. It's hard to plumb the depths of it, but it's consistent with a lot of the themes that I've

touched upon today.

CHAIRMAN BARTHOLOMEW: And can I actually ask Mr. Aldonas--since you had a firm answer there. Yes.

MR. ALDONAS: If there was no other research firm in the United States, maybe I'd be concerned about this. But is it access to the services that firm provided that we're worried about the Chinese controlling? There's plenty of competition at market. I'm not worried about that at all.

If it's the tools of how you plumb publicly available securities filings over at the SEC, I can do that on my computer at home. I'm not worried about the Chinese doing that. They can do that at home.

If, in fact, what that firm does is create something that makes the capital markets work better in China, trust me, that's a net benefit for the United States, not a net deficit.

CHAIRMAN BARTHOLOMEW: Yes. I don't think that the information that they were providing was information that was going back to China, but I think the question that it raised for me is, within China itself, there are restrictions on the free flow of information and timely information, and people have been imprisoned because they have been journalists who have reported on economic information, and is this something that we need to be concerned about?

It might be that the answer is no, but--

MR. ALDONAS: But then is your question really one of equity? In other words, should we expect greater transparency out of the Chinese capital markets including the ability of firms like Dow Jones to put a reporter and report on anything? The answer is absolutely yes, and I think, if I'm not mistaken, they owe us that under the WTO.

CHAIRMAN BARTHOLOMEW: It might be another thing they're not complying with.

MR. ALDONAS: Wouldn't disagree.

VICE CHAIRMAN BLUMENTHAL: Ms. Lee, you have something, 30 seconds if you want.

MS. LEE: I don't have a strong opinion about this. It's not as though they're acquiring all the independent financial research capacity in the United States. There's always the ability for someone else to provide a service which is lacking.

But the issue within China around the Internet freedom and academic freedom and journalistic freedom is hugely important to the United States, and it should be more important to American businesses that are operating in China. On this front, I think American businesses have been sadly negligent. They have not raised these issues because they don't want to irritate the Chinese government. That's a case where their profit motive has interfered with what they know is right

and what they know, in fact, is necessary for them to do business effectively.

VICE CHAIRMAN BLUMENTHAL: Thank you. We have time for one last question. Commissioner Fiedler.

COMMISSIONER FIEDLER: I would just like to hear your views on how you view the American capital market supporting Chinese state enterprises as they're receiving these subsidies and as they act as instruments of government policy in their international investments? Do you think we should do it or not?

MR. ALDONAS: There's a real value they would provide if there was greater access for American financial firms across the board to drive a lot of the distortions out of the Chinese economy. So while I don't think that we're helped much by them participating solely on behalf of the red chips as they expand into the global market, and I worry very much about what non-transparent economic actors in the global economy mean, and they're growing, whether it's Russian energy, whether it's Chinese red chips, whether it's Indian family-owned companies. They don't play by the same transparent rules that we expect in our market.

That's bad economics as well as bad law, but frankly, I'm a little uncomfortable about saying I wouldn't want them there because I also know that opening up that market to our financial services firms is probably the key toward driving most of the distortions out of the market that affect our manufacturers. So you can see I'm a little caught betwixt and between in terms of how I would respond to that because I can see a very profound good from having that. On the other hand, the circumstances you describe, I feel uncomfortable with.

VICE CHAIRMAN BLUMENTHAL: Thank you. Actually Commissioner--

COMMISSIONER VIDENIEKS: A real brief one.

VICE CHAIRMAN BLUMENTHAL: Yes.

COMMISSIONER VIDENIEKS: One brief question to Professor Navarro and maybe others. Isn't our trade deficit attributed to the PRC really with Southeast Asia and what is the value-added that China contributes? And is not the $220 billion really a Southeast Asian deficit, trade deficit? We have a negative trade balance, not just with China, and how does that translate into jobs?

DR. NAVARRO: That's a great point. I think the most important dynamic to reiterate here is the fact that China manipulates its currency, and thereby creates a situation where Japan, Taiwan, South Korea have to do the same in order to be competitive, and by recycling Asian capital back into U.S. capital markets, that creates an Asian and Southeast Asian skewed trade deficit.

So the core problem, as I indicated at the very beginning of this hearing, is a set of mercantilist trade practices by China that create deficits that, over the longer run, give China power over our own institutions.

COMMISSIONER VIDENIEKS: Yes, but if they, let's say, add a 20 percent value-added to the imports that we get from them, what do we argue then, how many jobs do we lose to China if they're basically an assembler? That's my question.

DR. NAVARRO: Oh, I see. Well, in the second part of my testimony, I discussed the movie as opposed to the snapshot. The movie here is a movement up and across the value chain, so that you're absolutely right. If we stop at this point in time, maybe the concern isn't that large. But if we see this more as a process where we gradually lose jobs, not just blue collar jobs, but white collar jobs, and we lose control of our assets because we're spending beyond our means, that to me, that's the big problem here. That's the big problem.

It's the future. That's the biggest problem, not the right now. It's the way we're moving towards a loss of our jobs base and a loss of ownership of our resources, and that should be troubling to every American.

COMMISSIONER VIDENIEKS: Understood.

MR. ALDONAS: If I could, your instincts are right. It's an Asian deficit. A lot of the investment in China made by U.S. companies is for the Chinese market, a lot of the investment that is made by other Asian manufacturers to have that final assembly point.

The impact on employment is right as well. That's why when I think about China I want to focus on the distortions that are created by the Chinese policies because that's where they're literally taking jobs out of our market. Right. If this was just the market operating, I'm not sure any of us would have so much trouble with it despite the political difficulty of having a Chinese entity doing what it does.

But the reality is, is that they do things that actually take jobs out of our market and out of the Asian markets, which is why I'm always surprised that there isn't much of a stir among the Asian trading partners as well.

COMMISSIONER VIDENIEKS: But the deficit with Asia, Southeast Asia, actually the balance of trade, is improving in U.S. favor over the years.

MR. ALDONAS: Exactly, because what you're seeing is, is that the final, the final point under the rules of origin of trade is now China. But the smarter thing would be to look at that as just saying you've changed the complexion of it, but you haven't actually changed the volume of it in that context.

So, in that sense, it's not as much as a China as an Asia phenomenon, and I would say about the currency point, the reality is I'd feel much more comfortable with the argument if I didn't know the Japanese were investing heavily in our bonds and manipulating the currency long before we were worried about China.

If this was just China--if this was just Japan reacting to China, that would be one thing, but this has been a phenomenon in Asia for a very long period of time. That's why I say I don't think that what you can do is focus just on China with this currency issue. That is a problem in Asia generally and we should treat it as such.

VICE CHAIRMAN BLUMENTHAL: I'd like to thank all of our speakers and witnesses for a very enlightening session and we will adjourn until tomorrow. I believe we have an announcement about weather.

CHAIRMAN BARTHOLOMEW: This being Washington, D.C., and people get panicky about the weather. Since we're supposed to have some snow tonight, should the federal government be closed tomorrow, we won't be holding a hearing. But we will be starting at 8:30 tomorrow morning even if there is a delayed opening of the federal government.

Thank you very much.

[Whereupon, at 3:04 p.m., the hearing was adjourned, to reconvene at 8:30 a.m., Friday, February 2, 2007.]

THE U.S.-CHINA RELATIONSHIP:

ECONOMICS AND SECURITY IN PERSPECTIVE

FRIDAY, FEBRUARY 2, 2007

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION
Washington, D.C.

The Commission met in Room 562, Dirksen Senate Office Building, Washington, D.C. at 8:30 a.m., Chairman Carolyn Bartholomew and Vice Chairman Daniel A. Blumenthal (hearing cochairs), presiding.

CHAIRMAN BARTHOLOMEW: Welcome to the second day of our hearing entitled "The U.S.-China Relationship: Economics and Security in Perspective." Yesterday, we heard testimony from the U.S. Departments of Defense and Energy and a number of private sector and academic experts gave us their views about the state of U.S.-China relations and the U.S.-China economic and trade relationship.

Today, we focus on the U.S.-China military and security relationship and U.S.-China diplomacy and political cooperation. We are especially pleased that representatives from the U.S. Department of State are participating in today's hearing. We look forward to the testimony of Mr. Norris who is replacing for today's purposes Secretary Christensen who is still out in the region.

I'd also like to thank the U.S. Trade Representative for submitting a written statement. Unfortunately, a representative from the USTR was unable to attend the hearing, but the office has offered written remarks. I'd like to express my disappointment in the fact that the Treasury Department, who had somebody scheduled to participate today, notified us late yesterday that that person would not be able to participate. We do not know whether they will be submitting a written record or not.

I'll now turn the microphone over to the Commission's Vice Chairman Dan Blumenthal for his opening remarks and for his introduction of our first distinguished panel.

VICE CHAIRMAN BLUMENTHAL: Thank you very much, Madam Chairwoman, and thank you to our distinguished panel. It's my

pleasure to introduce the speakers for this first panel on the U.S.-China Military and Security Relationship.

Our first speaker, Dr. Thomas Ehrhard, is a Senior Analyst at the Center for Strategic and Budgetary Assessments and a retired Air Force Colonel. His recently published works include "Unmanned Aerial Vehicles in the United States Armed Forces: A Comparative Study of Weapon System Innovation."

It's my pleasure next to introduce Army Colonel Charles Hooper, a former colleague at the Department of Defense. He is the Army Chair for Foreign Area Officer Training and Development on the Military Faculty of the Naval Postgraduate School, and previously served as the Weatherhead Fellow at Harvard University and as an Assistant Army Attaché in Beijing.

Finally, our third speaker is Mr. Kenneth Allen, a Senior Analyst at the CNA Corporation who served previously as Executive Vice President of the U.S.-Taiwan Business Council, and as an Assistant Air Attaché in Beijing.

He has done extensive work and is well-known on his writings on China's foreign military relations.

I'm sure this panel will give us greater insight into the military and security issues between the United States and China and provide us with a solid foundation for future analysis on the topic. Thank you again to all of the panelists and for your testimony, and we'll begin with Dr. Ehrhard.

PANEL V: THE U.S.-CHINA MILITARY & SECURITY RELATIONSHIP

STATEMENT OF DR. THOMAS P. EHRHARD
SENIOR FELLOW, CENTER FOR STRATEGIC AND BUDGETARY ASSESSMENTS, WASHINGTON, D.C.

DR. EHRHARD: Thank you, Chairman Bartholomew and Vice Chairman Blumenthal, for the invitation to speak before your Commission, a commission charged with examining one of this nation's most compelling strategic challenges.

Today, I will discuss the complex accelerating security relationship between the United States and China, a relationship that has taken some ominous turns in recent months.

One determinant of U.S. behavior in the U.S.-China relationship will be the degree to which the national discussion can achieve some balance and integration between economic and security concerns. Today, that debate tends to lurch between vague fears about turning

China into an adversary on the one hand, and utopian wishful views about China rising economically but somehow remaining benign militarily, views which seem unshakable even with the recent anti-satellite test that created both figurative and literal space debris.

In short, the debate could use a solid dose of strategic pragmatism and balance and I very much appreciate the Commission's role in promoting that outcome.

Today, I hope to contribute to that pragmatism by discussing some fundamental issues impacting the U.S.-China relationship.

I cannot emphasize strongly enough the requirement for the U.S. and her allies to maintain a strong deterrent posture in East Asia. "Maintain" sounds static, but given the pace of Chinese military developments, maintaining an adequate deterrent requires that the U.S. and her allies account for the effects of these developments and respond accordingly.

Many key measures in the military balance vis-à-vis China are moving in a negative direction from a U.S. point of view, especially in the Taiwan Strait, and that movement is occurring at a pace that may expose this nation and our allies to more destabilizing Chinese actions in the future, generate greater capacity for coercion by PRC leaders, and presents an increasing risk of miscalculation owing to this erosion of deterrence.

Lost in much of the debate, however, is the opportunity through preserving a favorable military balance in a period of great military technical change to incentivize China to become a true regional partner when mutual interests coincide, such as in the War on Terror, peacekeeping operations, or humanitarian relief.

But this will also require an effort on China's part to include greater transparency in its military build-up. One of the best ways for China's military to become transparent, for instance, would be to engage in substantive talks with the U.S. military about how to operate together in humanitarian and peacekeeping efforts.

China clearly would benefit from such exchanges as evidenced by the September 2006 visit to the U.S. by the Chinese Air Force.

At that time, their aviators had difficulty filing appropriate international flight plans and had to receive assistance from their American counterparts.

This sort of cooperation and coordination in the context of internationally recognized conventions may help avoid unfortunate encounters like the P-3 incident and could lead to greater understanding and mutual respect.

Unfortunately, these positive developments remain overshadowed by the worrisome trends in the military balance chronicled in the

Defense Department's most recent Military Power of the People's Republic of China Report to Congress.

While some have criticized the report as overly pessimistic regarding Chinese intentions and capabilities, the recent successful test of a Chinese direct-ascent anti-satellite weapon represents a conscious and provocative act by the Chinese leadership.

Clearly, this test was designed for international consumption, knowing, as the Chinese do, that civilian space aficionados across the globe monitor satellite movements with the enthusiasm of trainspotters.

In fact, civilian space blogs noticed that the position of the target, an expired Chinese weather satellite, was not being updated by NORAD soon after the test.

What signal was China sending? It is likely a message consistent with other military maneuvers like the ongoing build-up of offensive forces across the Taiwan Strait, the P-3 incident, or the Song-class submarine that surfaced near a U.S. carrier strike group recently.

Despite official statements about its peaceful rise, China seems to be systematically challenging the internationally recognized sanctity and neutrality of the global commons--international waters, airspace, cyberspace and space itself--which the world relies upon to sustain the global economic infrastructure.

Rather than taking measured justifiable transparent efforts to defend its homeland and participate in internationally accepted ways of securing global security and prosperity, it appears that Beijing may prefer to challenge the international system as a means of asserting its status as an emerging regional hegemon and budding world power.

The United States and the international community must respond to these actions in a way that encourages the Chinese to understand that these provocations will lead to a loss of influence and respect. The Chinese must realize that they destroyed more than a defunct satellite with their tests.

They raised further doubts that Beijing can manage its rise without engaging in spasms of provocative, destabilizing behavior.

How should U.S. and allied force posture result in a more stable configuration vis-à-vis China over the long haul? In three words, it requires bases, range and stealth.

Basing issues have changed dramatically since the end of the Cold War, but as Chinese conventional and nuclear long-range threats proliferate, forward-deployed U.S. forces will find themselves increasingly vulnerable in ways that they have not been since the Cold War. Consequently, we may need to rediscover some fundamentals of a defensive posture demonstrated during our long competition with the

Soviet Union.

The, quote-unquote, "Big Four" characteristics required to protect a force that is increasingly falling under the kind of air and missile threat being developed by the Chinese are: first, dispersal, which is access to more bases and forces postured to scatter quickly; secondly, hardening, measures taken to reduce damage when under attack; three, warning, timely notification of attack; and four, active defenses, for example, forward ballistic missile defenses.

Air forces in the region in particular must come to terms with this requirement as more bases fall inside an increasingly dense PRC cruise and ballistic missile strike arc. Restructuring the United States' forward basing posture will require emphasis on consistent, long-term diplomatic and military engagement aimed at creating and preserving a new and more flexible U.S. base structure, one that relies less on old-style mega-bases of the Cold War era.

VICE CHAIRMAN BLUMENTHAL: Dr. Ehrhard, we're going to run over a little bit; I'll give you another minute or so to sum up.

DR. EHRHARD: Thank you. I make just a few separate points about long range and stealth and we'll go over that, and about the requirement for increased analytical efforts to monitor the Chinese.

But let me go to technology issues. I would like to share at least one last thought about technological breakthroughs in areas such as supercomputing, autonomous systems, directed energy, nanotechnology and biotechnology that will inevitably affect how East Asian military balance and the security environment evolves and how well deterrence is sustained.

Technological innovation can be disruptive and has a poor record of leading to greater security. For that reason, these areas require special attention both by Defense planners and intelligence analysts.

The real technological wild card seems to be nanotechnology, the manipulation of materials on a molecular scale that yields materials, devices and systems with novel properties.

The ongoing long-term challenge for the United States is to encourage China to cooperate in areas where the two states have common security interests and to convince Beijing that the resolution of its outstanding geopolitical issues should be accomplished within accepted international legal norms.

This means creating and maintaining a military balance favorable to the United States and its allies against the kind of contingencies that might tempt Chinese efforts at coercion and aggression. Bases, range and stealth constitute the linchpins of an effective deterrent posture in the Pacific, and we must also make analytical investments commensurate with the magnitude of the challenge.

Thank you and I look forward to your questions.
[The statement follows:]

Prepared Statement of Dr. Thomas P. Ehrhard
Senior Fellow, Center for Strategy and Budgetary Assessments, Washington, D.C.

Thank you, Chairman Bartholomew and Vice Chairman Blumenthal for the invitation to speak before your commission, a commission charged with examining one of this nation's most compelling strategic challenges. Today I will discuss the complex, accelerating security relationship between the United States and China, a relationship that has taken some ominous turns in recent months.

One determinant of US behavior in the US-China relationship will be the degree to which the national discussion can achieve some balance and integration between economic and security concerns. Today, that debate tends to lurch between vague fears about turning China into an adversary and utopian, wishful views about China rising economically but somehow remaining benign militarily, views which seem unshakeable even with the recent anti-satellite test that created both figurative and literal space debris. In short, the debate could use a solid dose of strategic pragmatism and balance, and I very much appreciate the Commission's role in promoting that outcome.

Today I hope to contribute to that pragmatism by discussing some fundamental issues impacting the US-China relationship.

The Issues

The Military Balance. I cannot emphasize strongly enough the requirement for the US and her allies to maintain a strong deterrent posture in East Asia. "Maintain" sounds static, but given the pace of Chinese military development, maintaining an adequate deterrent requires that the US and her allies account for the effects of these developments and act accordingly. Many key measures in the military balance vis-à-vis China are moving in a negative direction from a US point of view, especially in the Taiwan Strait, and that movement is occurring at a pace that may expose this nation and our allies to more destabilizing Chinese actions in the future, generate greater capacity for coercion by PRC leaders, and present an increasing risk of miscalculation owing to the erosion of deterrence.

Lost in much of the debate, however, is the opportunity, through preserving a favorable military balance, to incentivize China to become a true regional partner when mutual interests coincide, such as in the war on terror, peacekeeping operations, or humanitarian relief. But this will also require an effort on China's part, to include greater transparency in its military buildup. One of the best ways for China's military to become more transparent, for instance, would be to engage in substantive talks with the US military about how to operate together in humanitarian and peacekeeping efforts. China clearly would benefit from such exchanges, as evidenced by the September 2006 visit to the US by the Chinese Air Force. At that time, their aviators had difficulty filing appropriate international flight plans, and received assistance from their American counterparts. This sort of cooperation and coordination in the context of internationally recognized conventions may help avoid unfortunate encounters like the P-3 incident, and could lead to greater understanding and mutual respect.

Unfortunately, these positive developments remain overshadowed by the worrisome trends in the military balance chronicled in the Defense Department's most recent "Military Power of the People's Republic of China" report to Congress. While some have criticized the report as overly pessimistic regarding Chinese intentions and capabilities, the recent successful test of a Chinese direct-ascent anti-satellite weapon represents a conscious and provocative act by the Chinese leadership. Clearly, this test was designed for international consumption, knowing as the Chinese do that civilian space aficionados across the globe monitor satellite movements with the enthusiasm of trainspotters. In fact, civilian space blogs noticed that the position of the target, an expired Chinese weather satellite (FY-1C), was not being updated by NORAD soon after the test.

What signal was China sending? It is likely a message consistent with other military maneuvers like the ongoing buildup of offensive forces across the Taiwan Strait, the P-3 incident or the Song-class submarine that surfaced near a US carrier strike group recently. Despite official statements about its "peaceful rise," China seems to be systematically challenging the internationally-recognized sanctity and neutrality of "the global commons"—international waters, airspace, cyberspace, and space itself—that the world relies upon to sustain the global economic infrastructure. Rather than taking measured, justifiable, transparent efforts to defend its homeland and participate in internationally accepted ways of securing global stability and prosperity, it appears Beijing prefers to challenge the international system as a means of asserting its status as an emerging regional hegemon and budding world power.

The United States and the international community must respond to these actions in a way that causes China to understand that these provocations lead to a loss of influence and respect. The Chinese must realize that they destroyed more than a defunct satellite with their test; they raised further doubts that Beijing can manage its rise without engaging in spasms of provocative, destabilizing behavior.

How should a US and allied force posture result in a more stable configuration vis-à-vis China over the long haul? In a three words, it requires **bases**, **range**, and **stealth**.

Bases. Basing issues have changed dramatically since the end of the Cold War, but as Chinese conventional and nuclear long-range threats proliferate, forward deployed US forces will find themselves increasingly vulnerable in ways they have not been since the Cold War. Consequently, we may need to rediscover some fundamentals of a defensive posture demonstrated during our long competition with the Soviet Union. The four characteristics required to protect a force that is increasingly falling under the kind of air and missile threat being developed by the Chinese are:

Dispersal (access to more bases and forces postured to scatter quickly)

Hardening (measures taken to reduce damage when under attack)

Warning (timely notification of attack)

Active defenses (e.g., forward ballistic missile defenses)

Air forces in the region, in particular, must come to terms with this requirement as more bases fall inside an increasingly dense PRC cruise and ballistic missile strike arc. Restructuring the United States' forward basing posture will require emphasis on consistent, long-term diplomatic and military engagement and investment aimed at creating and preserving a new and more flexible US base structure, one that relies less on old-style mega-bases of the Cold War era.

Long Range. Long-range forces and a more dispersed basing structure will work in tandem to improve US deterrent capabilities while complicating an adversary's planning. China's enormous size (it is the world's fourth largest country) provides it with great strategic depth, a problem US defense planners have not had to address since the Cold War. US forces must possess enough endurance to cause difficulties for Chinese offensive forces aiming to keep them outside meaningful operating ranges (i.e., so-called "anti-access" forces), yet must also hold critical targets at risk throughout the depth and breadth of China's substantial landmass. Many of those targets will be mobile, adding to the requirement for persistence and endurance.

Failure to hold critical targets at risk would have the effect of creating sanctuaries for key Chinese political, economic and military assets, thereby eroding deterrence and encouraging potentially disastrous miscalculation on Beijing's part. The US Navy, for example, must come to terms with the growing vulnerability of its aircraft carriers, which for purposes of survivability may need to be stationed progressively farther from China's shores and from key US allies and partners in East Asia. But the short range of the current carrier air wing will limit their effectiveness at these "stand-off" ranges. As naval aviation expert Owen Cote' from MIT says, "There is no substitute for range in naval warfare." Although the Super Hornet and F-35 programs represent a modest increase in endurance over the legacy F-18C fleet,

even their endurance may need to double or triple in scenarios that require a 1,000 nautical mile carrier stand-off range. More capable missile defenses and improved carrier air wing endurance could allow for effective carrier operations in that more lethal, long-range environment. Under such conditions, fully funding current long-range surveillance and strike programs such as the Navy's unmanned, long-range UCAS-N and the Air Force's next-generation long-range strike system will likely prove to be wise investments as a hedge against expanding Chinese offensive strike capabilities.

Stealth. Stealthy submarine and aircraft systems are expected to prove increasingly valuable in encouraging China to take a more positive role in preserving and enhancing regional and global security. Because they diminish detection ranges, stealthy strike aircraft incentivize China to invest heavily in defensive systems, which in turn helps stabilize the military balance in the region. In order to counter that capability, air defense investments must expand dramatically, creating an opportunity cost that limits the amount of more dangerous, offensive systems Beijing might have otherwise fielded. Submarines will also arguably play an expanded deterrent role in the Pacific region. Not knowing where they are lurking in the open seas can often be a more effective "presence" than a surface ship, and could also serve to moderate Chinese behavior.

All of this requires prompt action. The expanding military threat posed by the PRC requires prudent, practical measures in the near term due to long developmental timelines. The irony is that our strategic myopia has seen the war in Iraq lead to a greater emphasis on our ground forces to the potential detriment of the Navy and Air Force, the two services most important to the defense of the Pacific Rim's principal flashpoint: Taiwan. This geopolitical shortsightedness risks creating an imbalance in our efforts to enhance America's global defense posture, both in the near and longer term.

In part, this stems from the lack of an adequate analytical base for monitoring and projecting the military balance in the Pacific region. As a nation, we tend to suffer from strategic attention deficit disorder, and I would like to turn to that issue now.

The U.S. Attention Deficit Disorder. The US suffers from a strategic asymmetry that influences how we deal with China. Beijing is like the proverbial hedgehog, who knows one thing very well—that the world's lone superpower is the United States. It is clear from the preponderance of their writings that they are focused on America, both as a model and as a potential adversary. We, on the other hand, are the fox trying to know many things, only one of which is China, and we keep getting distracted. In fact, the distractions at times become so compelling that wishful thinking creeps into the debate.

The resulting shallowness of our analytical base vis-à-vis China cannot persist in its current state, and must be addressed by the broader national security community. This Commission performs the Herculean task of analyzing this issue area with relatively sparse resources. While this is laudable, it is not unusual. Other China security analysts toil in dusty corners of their bureaucracies with relatively sparse resources and tenuous sources of funding. One particularly astute analyst, Dr. Lyle Goldstein at the Naval War College, runs a small, efficient operation that studies Chinese submarine developments. His group often steals a march on government analysts in accurately forecasting Chinese submarine advances. We have only one Lyle Goldstein, however, and we need fifty more.

The area most in need of attention, however, is not necessarily counting numbers of aircraft or ships, but doing the difficult interpretive work of trying to understand Chinese strategic behavior. Our understanding about Chinese strategic behavior and decision-making dynamics remains woefully short of what is required by their increasing global importance. At the height of the Cold War, we had a comprehensive, diverse set of Sovietologists and Kremlinologists who analyzed every hand gesture and *Pravda* nuance. We have nothing like that with China. Granted, China presents a daunting analytical target because she is half closed, making access problematic; and at the same time half open and monstrously large, presenting the problem of making sense out of a mass of information.

One must therefore take a classically American approach—generate incentives and intellectual competition between governmental and non-governmental agencies, think-tanks, and academic centers, the result of which is a body of knowledge that enhances our ability to shape the competition in ways conducive to our security interests. Our analytical deficit cannot be closed simply by creating institutions or divisions to

address each critical dimension of Chinese comprehensive military power. Rather, we should develop a comprehensive, competitive analytical enterprise where elements of the intelligence community must contend with (and benefit from) the formulations of numerous analytical groups from various extra-governmental organizations. The idea of an "optimal" analytical organization is a chimera, and some overlap and redundancy must be created as a natural part of a healthy, competitive analytical environment.

Technology Matters. I would like to share one last thought before I turn to the specific questions put before the group today. Various technological breakthroughs in areas such as super-computing, autonomous systems, directed energy, nanotechnology, and biotechnology will inevitably affect how the East Asian military balance—and security environment—evolves, and how well deterrence can be sustained. Technological innovation can be quite disruptive, and has a poor record of leading to greater security. For that reason, these areas require special attention, both by defense planners and intelligence analysts. The real technological wild card seems to be nanotechnology, the manipulation of materials on the molecular scale that yields materials, devices, and systems with novel properties. Nanotechnology should prove to be a critical enabler that will yield a variety of unsettling economic and security challenges, and as a result many nations are aggressively pursuing research and development in this area. It stands to reason that the US should both pursue its own nanotechnology initiatives and also closely monitor similar developments in China.

Now allow me to address some specific questions the Commission has put before the group:

Questions Before the Commission

What new security challenges should the U.S. military address in future exchanges with China? What recommendations can be made to improve U.S.-China military relations in the next five years?
As I mentioned, China's ongoing military modernization continues at a rapid pace across multiple domains, and is not being matched by the US and our regional allies. As a result, China continues to not only believe, but see in real terms that its power in the region is growing. As this happens, we should continue to emphasize security interests that coincide, such as the threat posed by radical Islam, humanitarian and peacekeeping operations, and the development of rules that depressurize US and Chinese military maneuvers when they occur in international airspace and waters.

How can the U.S. military more effectively assess Chinese military modernization and technological developments? How can China improve its transparency to allow a more accurate analysis of its modernization program?
China clearly does not want to promote transparency in their modernization program, because they have not yet accepted that transparency benefits them. Their military has not come to an understanding, as many advanced nations have, that their role is both to support diplomacy as well as prepare for the use of force. This attitude will not likely be changed over the short term, but may through consistent, principled engagement backed up by a military balance that consistently favors the United States, its allies and partners.
I have already mentioned some suggestions for increased assessment capability, but in addition there should be an elevated importance given to information from third parties such as Australia, Japan, South Korea, and India as an alternative means of assessing China's capabilities. Participation in multi-lateral activities with China and these third-parties may lessen the adversarial perception the Chinese have of the US military, especially if those third parties assume leadership roles, and may allow for greater insight into their motivations.
Transparency continues to be a major issue, and the lack of transparency coupled with aggressive behavior continues to jeopardize efforts to lessen tensions and promote peaceful, mutually beneficial economic competition. China's civilian leadership and the People's Liberation Army's senior leadership need to become less opaque and more forthright in addressing a number of areas to include:

Leadership intent
Leadership decision making processes
Relationship between civilian and military leadership
Notification of/purpose for testing new/advanced systems
Notification/purpose of large scale exercises
Intended applications of new and emerging technologies
How areas of modernization emphasis fit/support national aspirations

What effect will Taiwan's approval of any or all components of the U.S.-offered arms package have on U.S.-China military relations?
Taiwan's acceptance of US-offered arms packages is a necessary part of regional deterrence. One might fret over how certain systems could cross the line from deterrence to provocation, but as a practical matter it is not that difficult to make sensible choices. The weapons packages currently proposed (surface-to-air missiles, patrol aircraft, small submarines and anti-aircraft/anti-submarine warfare ships) constitute no more than basic security fences. These are entirely appropriate and well within the deterrence category, despite China's inevitable protestations that they are provocative.

What are the costs and benefits of military-to-military exchanges between the United States and China? What has the U.S. military gained from its exchanges with Chinese counterparts in 2006?
Military-to-military exchanges continue to be problematic for some of the reasons I have already mentioned. A visit to the Air War College by Chinese Air Force officials in September resulted in very little candid discussion from the Chinese, for instance. Chinese delegations are still heavily briefed on standard responses and are accompanied by political chaperones who restrict candor. Some opportunity for more open exchanges may be available with mid-level officers and NCOs discussing such non-threatening topics as aero-medical specialists, search and rescue, airspace control, humanitarian and peacekeeping operations and related tactics, techniques, procedures.

How can military-to-military exchanges be designed to ensure a more equitable sharing of information? What are the prospects for improving communication between the U.S. and Chinese military, and for ultimately improving military-to-military relations?
The US military might take a page from State Department-sponsored bilateral diplomatic exchanges—establish a firm agenda, agree to the topics of discussion and have each side brief their views; then provide social situations where personal relationships might emerge. Focus on topics China may see as opportunity to gain proficiency, such as support for international humanitarian missions. We must limit the one-way exchanges and demand at least surface-level reciprocity as the terms of any visit.
A Final Word
The ongoing, long-term challenge for the United States is to encourage China to cooperate in areas where the two states have common security interests, and to convince Beijing that the resolution of its outstanding geopolitical issues should be accomplished within accepted international legal norms. This means creating and maintaining a military balance favorable to the United States and its allies against the kinds of contingencies that might tempt Chinese efforts at coercion or aggression, and could lead to miscalculation and escalation. Bases, range, and stealth constitute the linchpins of an effective deterrent posture in the Pacific, and we must also make analytical investment commensurate with the magnitude of the challenge. Thank you and I look forward to your questions.

VICE CHAIRMAN BLUMENTHAL: Thank you very much and we'll submit your entire testimony for the record as well. So thank you.

Colonel Hooper.

STATEMENT OF COL. CHARLES W. HOOPER SENIOR LECTURER, FOREIGN AREA OFFICER, EDUCATION, TRAINING AND DEVELOPMENT, SENIOR ARMY REPRESENTATIVE, SCHOOL OF INTERNATIONAL GRADUATE STUDIES, NAVAL POSTGRADUATE SCHOOL, MONTERREY, CALIFORNIA

COLONEL HOOPER: Madam Chairman, members of the Commission, thank you very much for inviting me here. I have to begin with the obligatory caveat that the comments I make here today constitute my own personal opinion and do not represent the views of the Department of Defense or the Department of the Army.

On the 26th of October, only days before the arrival in China of the Commander of the Pacific Fleet, a Chinese Song-class attack submarine shadowed the aircraft carrier Kitty Hawk undetected and surfaced within five miles of the carrier.

And, of course, we're all aware on the 11th of January, China successfully launched an anti-satellite missile and destroyed one of their own weather satellites in space.

These recent incidents of apparent aggressive Chinese military behavior directed towards the U.S. have once again caused me to think about the nature of our bilateral military relations and the exchanges and what the goals, focus and objectives are.

When I talk to my friends, I often describe this relationship, which I think is cyclical, like one of those big roller coasters at a Six Flags theme park. We always start from a dead start, there's always a slow clinking ascent to the top of the first summit, which are representative of bilateral negotiations back and forth. We culminate at that summit with a bilateral ministerial meeting, and then we speed downhill in a flurry of activity--exchanges and those types of things. Everybody in the back is screaming, but you don't know whether they are screaming because they're afraid the Chinese are gaining an advantage or they're happy that we're having these exchanges.

As we negotiate these loops and turns, we finally get to that last jolting loop, Tiananmen, the Taiwan missile crisis, the EP-3 incident, and the ride and the relationship come to an abrupt halt. After a brief pause, we start the ride over again.

Now, the problem with the roller coaster is no matter how invigorating and long the ride, you always start and stop at the same point, not having made any forward progress. The question I'd like to address here is why is this so? Why would we want to continue with an apparently underproductive relationship and what can be done to make it more useful to the United States?

There have been many different motivations for these exchanges over the 20 years that we've had them. One was that exposure to the United States military would expose the PLA to professional values that would somehow stabilize the PLA and make Chinese military aggression less likely.

I've never really understood this one, how a more professional PLA would become less threatening. It would seem to me that a more professional PLA would become more effectively threatening. Regardless of this apparent contraction, even if the PLA incorporated a value system parallel to their U.S. counterparts, it would still be the Chinese Army. Its officers would still be hard-nosed patriotic professionals, just as dedicated at protecting their national interests as I am to protecting the interests of my country.

Some believe the relationship would improve mutual understanding, and that this mutual understanding would reduce the possibility for conflict. Well, I think this is a success story. I believe we have achieved mutual understanding. The PLA has made it very clear through their military build-up, R&D priorities, and actions such as the Kitty Hawk incident, that they consider the U.S. military to be their principal future challenge. We have made it very clear that we understand what they are doing. So I believe we have achieved mutual understanding of a kind.

There were others that believed the relationship might potentially forge lines of communication with the PLA leadership that could be used in time of crisis or potential confrontation. I think the EP-3 incident effectively dispelled any notion that this is possible in the near term, and although many might dispute this, no matter what we do, it is likely that the only phone call a PLA commander will ever answer in any present or future crisis is the one from Beijing, not the one from outside.

Still others believe that we could use the military exchanges to shape Chinese strategic and PLA strategic behavior in ways that do not threaten our interests. Every indication is over the past 20 years is that this has not taken place. As the 2006 DOD Report to Congress states and a recent ASAT test confirms, PRC defense budgets continue to rise, the research on niche capabilities to address U.S. weaknesses continues unabated, and the PLA continues to methodically improve their military capabilities.

Finally, there were those who believed the exchanges might at least deter current and future generations of PLA officers by exposing them to U.S. military prowess and resolve. I would argue anecdotally that these exchanges might have had the exact opposite effect.

Instead of returning home suitably impressed and cowed by what

they see during their visits to the U.S., I believe most PLA officers return home with a renewed resolve that the PLA must increase the resources and dedication necessary to challenge U.S. military superiority.

If we've learned anything about the new security environment, it is that the most likely response to an attempt to instill fear is anger and determination, not resignation and capitulation. Once again, I assume my PLA counterpart is at least as dedicated as I am, and my response to the apparent superiority of my counterpart would be to return home and work twice as hard to beat the other guy, not put my tail between my legs.

It's also become apparent that the PLA has done its best over these years to gain as much as possible in terms of information and insights from these exchanges. I'll talk a little bit about the twin issues of transparency and qualitative reciprocity in a minute.

Given these factors, once again, where do we go with this relationship? There are three myths that need to be dispelled here about this relationship. The first is the myth of PLA transparency. Everybody knows the story with PLA transparency: that they have been allowed access here and we have not been allowed access there. And this is despite 20 years of persistent requests on our part.

Inevitably, at the beginning of every exchange cycle, we have a first-ever visit to some secret installation. While I would not diminish the political, symbolic and metric significance of these visits, it seemed to me if we were learning anything of substance; we wouldn't still be discussing the issue of transparency.

Instead that although people might look at these first-ever visits and new units and briefings given, I think we are kind of being fed the illusion of transparency--and I can't shake that feeling--a more carefully selected and choreographed set of activities than in days past, crafted to respond to our persistent demands. We can visit the headquarters but not the units; we can receive a briefing but from a political commissar or staff officer; we can go to the school for foreigners but not the one for PLA officers.

China has always been a nation of walls, walled cities, walled villages, walled houses, and a Great Wall, all hiding and protecting the secrets within. One of the first lessons I learned about being in China is if I as a foreigner was shown something, there was a specific reason for me to see it, and the most likely reason they were showing it to me was to keep me from seeing something else.

As a result, I'm doubtful, although we should continue to press hard for transparency, that we will get beyond an increasingly realistic illusion.

VICE CHAIRMAN BLUMENTHAL: Another minute, please.

COLONEL HOOPER: The second myth is the myth of obligatory reciprocity. The fact that if we open ourselves up, the Chinese will respond in kind, feel guilted into responding in kind. Guilt-based decision-making is antithetical to Chinese culture and it will not happen. They will continue to take what we give them and not reciprocate. They feel no obligation to reciprocate.

The myth of the personal relationship, that we could somehow forge personal relationships with senior PLA officers. In some cultures that's possible. In Chinese culture, it is not, and 20 years of experience should have shown us that.

The Chinese military is process-oriented. For them having a perfunctory and superficial relationship is enough. We are results oriented, and if we achieve the results, current objectives of our military exchanges with China, they lose and we win.

Chinese culture, political culture is zero sum. So our goals are contradictory to their goals. The bottom line in terms of a way ahead, I believe, is to make the goals of these exchanges U.S.-centric. In other words, certainly we should communicate strategic intent in our senior and strategic level dialogues. We should focus on requesting access to people as well as places and things. For the past 20 years, we focused on requesting access to see places and things. We should focus on dialogues between people.

Sometimes discussions about innocuous subjects such as military history can reveal insights into the people who will operate and command PLA units.

And finally, I think we should educate U.S. military personnel about China, and if there is any other reason despite the flaws in these exchanges to do them, is to ensure that we educate and expose as many of our rising leaders and best and brightest to China and the Chinese situation as we possibly can.

Thank you very much.

[The statement follows:][5]

VICE CHAIRMAN BLUMENTHAL: Thank you. Mr. Allen.

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[5] **Click here to read the prepared statement of Col. Charles W. Hooper, senior Lecturer, Foreign Area Officer, Education, Training and Development, Senior Army Representative, School of International Graduate Studies, Naval Postgraduate School, Monterrey, California**

STATEMENT OF KENNETH W. ALLEN
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MR. ALLEN: Thank you. It's a pleasure to be here and a pleasure to listen to Colonel Hooper because I think we agree on a lot of things and maybe disagree on some things, but I think we're more in agreement than disagreement.

Chairman Bartholomew, commissioners, for someone who has been involved in the U.S.-China military relationship at both a track one and track two level for almost 20 or over 20 years, it's a pleasure to be here to talk about this topic.

I was given five questions, but rather than address each question, I would like to discuss seven specific issues. The first issue I'd like to address is a positive step that DoD and that PLA are doing to build a framework for the military relationship. It is my understanding that the two sides are now classifying exchanges into four categories: high level, functional, educational and policy. This framework is used as the foundation when the two sides meet at the end of each year to discuss the exchanges for the following year.

The two sides also meet at the desk officer level midway through the year to review the progress.

Within this framework, the U.S. side has been pushing for exchanges among officers at lower levels. For example, the U.S. has been sending delegations at the O-5 and O-6 level. The PLA to date has been reciprocating with O-6 and O-7 level. We're trying to get them to come down to the O-5 and O-6 level also.

The second issue deals with hosting visits. During the annual negotiations, one of the first questions that always arises is who will host each visit? Therefore, one important aspect of establishing a framework would be to have both sides create a formal comparison chart that shows equivalent organizations and personnel in the U.S. military and the PLA.

For example, at the national level, who are the PLA's counterparts to the Chairman of the Joint Chiefs and the Chief of Staff of the Army? Are they the Senior Vice Chairman of the CMC, Guo Boxiong, or the Chief of the General Staff, Liang Guanglie respectively?

The third issue concerns who gets to visit China and when? Most high level visits between China and the U.S. are reciprocal visits over a two-year period.

On the Chinese side, the PLA can host only a couple of high level U.S. defense leaders each year. These visits are divided among

the Secretary of Defense, the three service secretaries, the four service chiefs, and combatant commanders at PACOM. The choice sometimes comes down to a visit by a service chief or the combatant commander within the Pacific Command. As a result, not every high level defense official gets to visit China during their tour.

Furthermore, the timing of the visit is also important to maximize exchange of ideas. Specifically, should the U.S. or Chinese official visit during the first, second or third year of the tour? There are advantages and disadvantages to each of these. In addition, most senior PLA officers are allowed to travel only once a year. So they cannot visit the U.S. more than once if at all.

The fourth issue involves transparency, as Colonel Hooper discussed. I have a different view on this. In my view, the issue of transparency in the U.S.-China military relationship should be viewed as a 25-year perspective, not on a one-year basis. Each visit should be treated as one part of a long-term service-to-service relationship rather than looking at each visit as a separate entity.

For example, USAF delegations do not necessarily need to visit the PLA Air Force's Engineering University at Xian every year even though it's a convenient stop for seeing the Terra Cotta Warriors.

To accomplish this, I recommend that DoD work with the PLA to produce a matrix that shows every U.S. military and PLA visit for the past decade. The entries should include the date of the visit, the delegation leader, the purpose of the visit, and what locations were visited.

These matrices can then be used as a basis for negotiating the following year's exchange schedule to avoid redundancy and to select new locations.

The fifth issue concerns conducting pre-visit preparations, as Colonel Hooper mentioned. The U.S. side has some common criticism concerning their visits to China. The first criticism is that they're not often given their final agenda until the last minute. As a result, they may not be fully prepared for each stop of the visit.

The second criticism is that during their visit, many of the questions are not answered as fully as they would like. To help solve the first issue, perhaps the Secretary of Defense and the PLA's Minister of Defense could sign a formal agreement that each delegation would be given a specified number of days advanced notice so they can prepare accordingly. This could be incorporated into the overall framework mentioned above.

In my view, one of the ways to at least partially solve the second issue is to have each delegation submit a formal list of questions for each location to be visited in China. These questions should be

submitted through the respective military attaché offices as early as possible so the PLA can staff them properly through the right channels in Beijing.

For example, the PLA's regulations state that organizational structure information is classified and cannot be revealed to foreigners. Therefore, if a U.S. military visitor asks a question about a unit's structure, the PLA officer cannot answer without first having permission from Beijing.

The sixth issue deals with the types of delegations. Most U.S. military delegations that visit China have a broad agenda and travel to two or more cities over several days. In my view, the U.S. side should incorporate more focused delegations in the mix in order to better understand the PLA.

For example, the two sides could have a series of multi-day discussions on national and military strategy and doctrine. This could be a track 1.5 dialogue and includes non-government specialists on each side.

Each side could provide a specific set of questions several months in advance. Each delegation should be led by a flag-rank officer and the delegation should be composed of people who work doctrine issues on a daily basis.

To prepare for the discussions, the U.S. side should also learn as much as possible about China's doctrine before meetings begin so as to be able to ask relevant questions. I have personally escorted delegations, both when I was in the military and today, where people go over and they understand our system but they do not understand their system to be able to ask relevant questions.

My final topic concerns engaging the PLA's enlisted force. Since the U.S.-China military relationship began, it is my understanding that only a few enlisted members have been incorporated as formal members of U.S. delegations visiting China. To my knowledge, the U.S. has not sent a delegation composed solely of enlisted personnel to China to engage the PLA on enlisted force issues.

Therefore, I would like to encourage DoD to begin engaging the PLA over a period of time about the significant reform currently underway in the PLA's enlisted force. Most of our delegations focus on hardware and strategy and the officer corps. Very few people have ever gone and discussed the PLA's enlisted force.

When Admiral Fallon was in China a few months ago, he took his senior enlisted advisor, Sergeant Major Bill Kinney, with him, and I had the opportunity to discuss, and he said he had a great time because everywhere he went, he was surrounded by enlisted people asking him about our enlisted force. We know very little to almost nothing about

their enlisted force.

I'd like to conclude my remarks here and I would be glad to answer your questions. Thank you very much.

[The statement follows:]

Prepared Statement of Kenneth W. Allen
Senior Analyst, The CNA Corporation
Alexandria, Virginia

For someone who has been involved in the US-China Military Relationship for more than 20 years in both a track 1 and track 2 environment, it is an honor to be invited to present my views on this important topic to the commission.

Rather than answering each question individually, I will address seven issues and provide some recommendations.

Building A Framework

The first issue I would like to address is a positive step DOD and the PLA are doing to build a framework for the military relationship. It is my understanding that the two sides are now classifying exchanges into four categories: high-level, functional, educational, and policy. This framework is used as the foundation when the two sides meet at the end of each year to discuss the exchanges for the following year. The two sides meet at the desk officer level midway through the year to review the progress.

Within this framework, the US side has been pushing for exchanges among officers at lower levels. For example, the US has been sending delegations consisting of O-5s and O-6s to China, but China's reciprocal delegations consist primarily of O-6s and O-7s.

Establishing a Counterpart Chart

The second issue deals with hosting visits. During the negations for visits each year, one of the first questions that arises is, "Who will host each visit?"

Therefore, one important aspect of establishing a framework would be to have both sides create a formal comparison chart that shows equivalent organizations and personnel in the US military and PLA.

For example, at the national level, who are the PLA's counterparts to the Chairman of the Joint Chiefs and the Chief of Staff of the Army? Are they the senior vice chairman of the Central Military Commission and the Chief of the General Staff, respectively?

This is complicated, because the PLA's four General Departments serve as both the joint staff and the headquarters for the ground forces.

Who Gets to Visit China and When

The third issue concerns who gets to visit China and when. Most high-level visits between China and the US are reciprocal visits over a two-year period. On the Chinese side, the PLA can host only a couple of high-level US defense leaders each year.

These visits are divided among the Secretary of Defense, the three service secretaries, the four service chiefs, and organizations within the Pacific Command structure. The choice sometimes comes down to a visit by the service chief or a PACOM component commander. As a result, not every high-level visitor gets

to visit China.

Furthermore, the timing of the visit is important to maximize the exchange of ideas. Specifically, should the US person visit China during his first, second, or third year? There are advantages and disadvantages to each scenario.

On the other side of the coin, most senior PLA officers are allowed to travel only once a year, so they cannot visit the US more than once, if at all.

Transparency and Creating a Visit Matrix

The fourth issue involves transparency. In my view, the issue of transparency in the US-China military relationship should be viewed from a 25-year perspective, not on a one-year basis. Each visit should be treated as one part of a long-term service-to-service relationship rather than looking at each visit as a separate entity.

For example, USAF delegations do not necessarily need to visit the PLA Air Force's Engineering University in Xian every year, even though it is a convenient stop for seeing the Terra Cotta Warriors.

To accomplish this, I recommend that DOD work with the PLA to produce a matrix that shows every US military and PLA visit for the past decade. The entries should include the date of the visit, the delegation leader, the purpose of the visit, and what locations were visited.

These matrices can then be used as a basis for negotiating the following year's exchange schedule to avoid redundancy and to select new locations.

Pre-Visit Preparation

The fifth issue concerns conducting pre-visit preparations. The US side has two common criticisms concerning their visits to China.

The first criticism is that they are often not given their final agenda until the last minute. As a result, they may not be fully prepared for each stop of the visit.

The second criticism is that, during their visit, many of their questions are not answered as fully as they would like.

To help solve the first issue, perhaps the Secretary of Defense and China's Minister of Defense could sign a formal agreement that each delegation will be given a specified number of days advanced notice, so they can prepare accordingly. This could be incorporated into the overall framework mentioned above.

In my view, one of the ways to at least partially solve the second issue is to have each delegation submit a formal list of questions for each location to be visited in China. These questions should be submitted through the respective military attaché offices as early as possible, so the PLA can staff them properly through the right channels in Beijing.

For example, the PLA's regulations state that organizational structure information is classified and cannot be revealed to foreigners. Therefore, if a US military visitor asks a question about a unit's organization, the PLA officer cannot answer it without first having permission from Beijing.

Focused Delegations

The sixth issue deals with the types of delegations. Most US military delegations that visit China have a broad agenda and travel to two or more cities over several days. In my view, the US side should incorporate more focused delegations in the mix in order to better understand the PLA.

For example, the two sides could have a series of multi-day discussions on each side's national and military

strategy and doctrine. This could be a track 1.5 dialogue that includes non-government specialists on each side.

Each side could provide a specific set of questions several months in advance. Each delegation should be led by a flag-rank officer, and the delegation should be composed of people who work doctrine issues on a daily basis.

To prepare for the discussions, the US side should also learn as much as possible about China's doctrine before the meetings begin, so as to be able to ask relevant questions.

Engaging the PLA's Enlisted Force

My final topic concerns engaging the PLA's enlisted force. Since the US-China military relationship began, it is my understanding that only a few enlisted members have been incorporated as formal members of US delegations visiting China. To my knowledge, the US has not sent a delegation composed solely of enlisted personnel to China to engage the PLA on enlisted force issues.

Therefore, I would like to encourage DOD to begin engaging the PLA over a period of time about the significant reforms currently underway in the PLA's enlisted force.

I would be pleased to address any questions you have at this time.

Panel V: Discussion, Questions and Answers

VICE CHAIRMAN BLUMENTHAL: Thank you very much. Our first question is from Commissioner Wortzel.

COMMISSIONER WORTZEL: Thank you all. They are very different views and I've worked with all of you at one time or another. So I appreciate hearing from you, and you're all people that know what you're talking about. I feel like I'm listening to a critique of the script for "When Harry Met Sally." Everybody is interested in understanding and a good relationship and mutual respect. What I didn't hear from any of you, and I didn't see anywhere in your testimony--I might have missed it when reading your written testimony. I don't see the words "threat reduction" anywhere mentioned and I don't see the words "confidence building measures" mentioned. So I'd like to draw you out on what you would suggest or whether there could be any effective threat-reduction measures with the PLA?

Second, what do you think China's long-term military goals are after it attains comprehensive national power, when it calls, what it calls comprehensive national power?

And third, I'm interested in your views on the implications of the PLA's mastery of hypersonic cruise missiles and what effective defenses the United States might have against a mach 4 or a mach 5 cruise missile? How do the mass numbers of these types of missiles affect our technical superiority?

VICE CHAIRMAN BLUMENTHAL: I guess any one of you can jump in.

DR. EHRHARD: I'll start. Imbedded in my remarks are what I

believe to be issues of confidence building and threat reduction that have to do with cooperation with the Chinese military on a mutual mission. And within the confines of internationally recognized conventions like international flight rules.

It has to be a long-term project, and it has to be based on personal relationships—these Chinese aren't just puzzle pieces. They're individuals that we're dealing with over there, and there's always the opportunity for personalities within the PLA to really catch a vision for what's going on here. And their increasing sophistication really I think does matter a lot here. As the PLA gain more sophistication, they'll understand that the military has a diplomatic role as well as a hard threat-based fighting role, as our military understands.

And so once that begins to occur with certain individuals, and those individuals rise to positions of power within the PLA, I believe that will start to have an effect.

Let me go to the hypersonic cruise missile issue quickly because I would just say it's not just hypersonic cruise missiles. It's a whole suite of capabilities that the PLA is investing in to accomplish what I'm setting out here which is typically called anti-access, and that is to keep U.S. forces at a range where they cannot perform militarily meaningful tasks.

This isn't something that just happens within the context of a shooting war. This is an issue that can also contribute to coercion because our forces are fearful of going inside a particular threat ring and they aim to make that threat ring expand.

The biggest problem that you have with this concept is that in order to expand the threat ring out to a point where they can gain that kind of effect, that threat ring is going to follow over nations that are allies of ours like Korea and Japan. So those anti-access forces now become offensive power projection forces for those nations who are our allies. This is where you get into a real serious strategic issue with something that comes from the development of these hypersonic cruise missiles, which again they're much more difficult to defend against. They require much better warning systems as I mentioned. They require an investment in hardening and dispersal operations, and they really complicate our calculations about what we need to do to contribute to deterrence. And I'll just pass it on.

VICE CHAIRMAN BLUMENTHAL: Thank you. The other two will have a chance in other questions to answer. We've run out of time on this question.

Dr. Ehrhard, on the question of the breakout technologies, nanotechnology and biotechnology, gets to the heart of in some ways

of our mandate, which is where the economic and national security issues intersect, and I'm wondering if, first of all, if you can speculate as to Chinese abilities in those two areas?

Second of all, spell out for us what the breakout capabilities then translate to in military capabilities that are disruptive for us.

DR. EHRHARD: In each one of these areas, what matters just like in the military balance, it's not so much the absolute measure as it exists today, but it's the rate of closure that you see throughout Chinese industrial base and their high technology base. What we see is extraordinarily effective students coming out of Beijing University that are focused, for instance, whether it be directed energy, nanotechnology, biotechnology.

We have many of those extraordinary students coming to laboratories within the United States who are working on, for instance, nanotech, and I visited some of these facilities and the U.S. scientists there tell me they take the most qualified individuals, and many of those, the preponderance of those most qualified individuals, young Ph.D.s, are directly from Beijing University, not just China, but from those universities.

So the rate of closure is what is worrisome and the increasing diffusion of this kind of knowledge, global diffusion, and so it's not just that the knowledge exists in U.S. universities, it exists overseas, but also many of these scholars work in U.S. facilities as well.

So any of these can be problematic from a military point of view. Biotechnology, in particular, is particularly troublesome, and I would just add that nanotechnology needs to be more thought of as an enabling technology. So whenever you link two or more of these together, for instance, directed energy and nanotechnology, there are potentials imbedded within nano that will enable more effective directed energy or laser systems. The same thing goes for biotechnology.

There are more effective biotechnology vectors, as they call them, or ways of transmitting bio-warfare agents that have to do with this manipulation on the molecular scale, that potential that exists in nanotechnology.

VICE CHAIRMAN BLUMENTHAL: Is there any practical way for the United States to deny military applications to the Chinese in a sense that the scientific exchange is so open and diffuse as it is between not just the U.S. and China but worldwide? Obviously, these are concerns from a national security viewpoint, but is there any effective way to stop the diffusion that would then translate to military power, disruptive military power?

DR. EHRHARD: Well, there's the potential for classified U.S.

developments that obviously you would not want to allow to get out. That's just always one of the areas that you have to be concerned about, but the answer really is one of for sort of the open research and development that goes on, is one of diagnostic capabilities. We need to have the ability to monitor what they're doing, to see how and to try to interpret how the developments and frankly the innovations. We're not used to innovations coming out of China, but increasingly that's what we'll be seeing.

We need people who are fluent in that technology to be able to analyze it from a defense or security point of view and frankly even from an economic point of view because there is great potential there as well.

So it's a matter of protecting any efforts that have specific defense ramifications, but really a big issue is how well do we assess and diagnose what's going on in China and what access they have to those kinds of technologies that could convert to some kind of so-called "assassin's mace" or new kind of capability.

VICE CHAIRMAN BLUMENTHAL: Commissioner Videnieks is next.

COMMISSIONER VIDENIEKS: Colonel Hooper, a question about, we just talked about nanotechnology and confidence building in that area. What about the overall military budget? Their official budget is 35 billion. We're guessing either 70 or 105 billion. Seems to me that there is some confidence building needed in this area. Are we doing anything in that type of discussions at the secretarial level or wherever it is that they will take place? Probably not at enlisted mens' level.

COLONEL HOOPER: As far as I'm aware, concerning the differences between our estimates of the Chinese defense budget and their announced defense budget, it's common knowledge that this dialogue goes on every time a DoD China Military Power Report or PRC Defense White Paper is issued.

But in terms of the significance of whether or not the defense budget is one number or another, I refer to a bit of advice an old boss gave me. Rather than arguing over what the numbers are, we should see what they're buying and what they're doing with the money; in other words the military capabilities that are being acquired and developed. We could spend years and precious resources arguing over whether or not the exact amount of money the Chinese are spending on defense and not arrive at a figure everyone could agree on.

What is important is what military capabilities are being acquired as a result of the resources that are being invested. In terms of confidence building, I do not see what incentive the Chinese have to

be more transparent with us concerning their defense spending. They're going to continue to spend the money and there will always be hidden expenditures on classified projects that they will not disclose. We know this. So their assuring us that they are only going to build barracks and pay salaries with the budget increases is really a moot point. We would assume this to be incomplete information; only part of the story. There is, in my opinion, no confidence building measure that can be applied that would make us feel better about the money that they're spending on defense.

COMMISSIONER VIDENIEKS: The question I have, though, is that it appears to be pure guesswork on our part when we guess at either 70 or 105 when they state 35.

COLONEL HOOPER: Oh, I see.

COMMISSIONER VIDENIEKS: There must be some number within DoD which is developed with some thought.

COLONEL HOOPER: I can't speak for the Department of Defense or any of the agencies looking at this issue. Having said this I would like to reemphasize that we should be spending more time and the focus of our concentration should be on determining the capabilities that are being acquired, the platforms, the technologies and the weapons that are being acquired and developed as opposed to trying to fix the specific amount of money that is being spent.

COMMISSIONER VIDENIEKS: Thank you. Any other comments on that topic?

MR. ALLEN: I would agree with Colonel Hooper. Just to give you a specific example, when the PLA Air Force purchases an aircraft, they do not pay for the R&D costs of that. They pay only for the cost of that, the production cost, and they don't put a penny into that until it's flown to an airfield, but yet they have the aircraft; does it really matter how much it costs?

COMMISSIONER VIDENIEKS: Understood.

DR. EHRHARD: I would just add one idea to that, and that is it really matters in some ways more about the relative rise of the budget as well, so whatever method you chose to measure it, you want to be able to have some sense of growth, of what the growth is and where that might be going.

I think we continue to be surprised. One thing I am basically tired of hearing is the Chinese have developed X or Y much faster than we anticipated. You hear it all the time. And frankly, they are the only country for whom we say that. Almost everybody else, oh, well, it took them five years longer, ten years longer--not the Chinese.

So when you look at relative rise, that gives you some sense of the gaining function that I think, is very important in assessing sort of

the broad outlines of their military modernization.

COMMISSIONER VIDENIEKS: Thank you.

VICE CHAIRMAN BLUMENTHAL: Thank you. Chairman Bartholomew.

CHAIRMAN BARTHOLOMEW: Thank you. And thank you very much, gentlemen, both for appearing before us today and sharing your wisdom and for your distinguished service to our nation. We have benefited enormously from your careers that you've spent in the services and we continue to benefit from your wisdom.

Colonel Hooper, I was struck by your roller coaster metaphor because I think it isn't a metaphor that is just limited to military-to-military exchanges. It really characterizes the relationship that we go up and down and up and down and have illusions of making progress and end up in exactly the same place.

Jim Mann spoke yesterday about the need for a paradigm shift, and in a lot of ways, I think that that's also what you're talking about. We need to think differently about how we do military-to-military exchanges. Larry Wortzel and I have argued about the value of military-to-military exchanges in a number of countries over the years, and I almost wondered if you were going to come to the conclusion that perhaps we shouldn't be doing them, but that's not the conclusion that you came to.

A question for all of you, though, is how do we implement something as significant as a paradigm shift in a context where--and it builds on what Dr. Ehrhard mentioned in his testimony about we need a comprehensive diverse set--you said at the time of the Cold War we had one of Sovietologists and Kremlinologists--but China scholarship is so polarized, and how do we take the steps to make sure that people think differently, that it is not just one prevailing viewpoint that is determining what's happening?

How do we implement a paradigm shift and make sure that dissenting views are heard within the kind, just even the military structure that you're talking about?

DR. EHRHARD: I'll go first if you don't mind. I do address that in my statement. Basically my answer to that is we need to apply a classically American set of structures for this, incentives and diversification. Competition that is. We need to incentivize multiple sources of analysis. I don't think you have to make something new out of whole cloth. You just have to look at what we've done in the past where we really had comprehensive analytical infrastructures for this such as in the case of the Soviet Union.

And what you see is it wasn't just coming from some dusty corner of the intelligence community or from one or the other

commentator from the academic community. There really was a genuine dialogue, debate, contrarian views, that aired, that sort of penetrated to the polarity in the issue, and got people to understand where the boundaries of the debate might be.

Instead, it's symptomatic of the shallowness of the debate that we see this lurching debate and the sort of generalities and wishful thinking that leak into this. So my answer is there have to be some incentives to both deepen the government's ability to analyze but also to broaden that into other think tanks and academic institutions, not unlike what we had in the Cold War.

CHAIRMAN BARTHOLOMEW: Colonel Hooper.

COLONEL HOOPER: No, I don't, although I'm very skeptical as to the value of the military exchanges, and that's based on my own experience over the years, I think the paradigm shift that we're looking for is that there are certain things that these exchanges can accomplish, and I think we should have learned that over the past 20 years, but there are certain things that they cannot.

It must be left to the other elements of national power and other elements of the defense relationship, and I'm not talking necessarily cooperative, but in terms of confrontational to shape behaviors, to reduce threats and confidence building.

To answer Dr. Wortzel's question, I'm very skeptical as to the ability of these exchanges to elicit threat reduction or foster confidence building. China is a rising power. They haven't yet reached the limits of their economic growth or their own self-perceived limits of where they would like to go with their growing military. As a result, they're not particularly interested in either building our confidence or reducing the threat.

At best, they're interested in communicating an ambiguous nature of the threat they pose in order to keep us off balance and off guard. So why would they enter into confidence building and threat reduction agreements with us that would restrict the scope of their strategic behavior?

So these exchanges are not going to accomplish that. My own perception of a paradigm shift is with that understanding, let us use these exchanges to educate--and this also addresses your point--to broaden and raise the general education level of our military leaders concerning China. When in our history have we had an opportunity to expose our best and brightest to a potential adversary?

MR. ALLEN: I'd like to address this issue. I may not have expressed it as well as I wanted to in my testimony. I deal a lot with process. I don't deal with hardware and strategies. I deal with process and I focus a lot on the PLA's organization. I'm not privy to what goes

into trip books for any delegation that goes to China, but over the last few years, I've had the opportunity to go and brief some delegations, and my general sense is tell me everything you know about the PLA in ten minutes. I have a three-hour presentation that I call Tracking Pilot Wang. I have given this thing about ten times.

I had the opportunity to go down and give this at the Air War College a year ago before 15 students went over to China. Only a few of the students going on the trip came to this briefing, but over 30 faculty members showed up. The next day I gave a different presentation to the 15 students going on the trip. This to me is symptomatic of, oh; I don't really need to go down below that. When I go to China and I have the opportunity to sit at a table with PLA officers, most of us would look and say, oh, you're a lieutenant colonel, you're a colonel. I ask what is your grade? Their eyes light up and they say "grades are more important than ranks in the PLA, so let's discuss this." The point I'm trying to get at is my philosophy has always been the more you know, the more they will tell you. It's like layers of an onion. If you always deal at the outer layer, they're more than happy to deal with that, and the more you deal and you cut through those layers of the onion in your first sentence, they immediately open up to you.

And we have different experiences, but I think a lot of this is educating any delegation that goes beyond how many tanks and ships and planes have they got and how fast do they go. You need to cut below that and go beyond the executive summary.

Thank you.

VICE CHAIRMAN BLUMENTHAL: Thank you. Next up is Commissioner Wessel.

COMMISSIONER WESSEL: Thank you. This has been very helpful. I, like Chair Bartholomew, am struck by your Six Flags discussion. My view is if you don't like the ride, stop doing it. Try and find something else you enjoy a little more. Maybe it's--what is it--It's a Small World down at Disneyland.

VICE CHAIRMAN BLUMENTHAL: Sometimes your kids force you to that.

COMMISSIONER WESSEL: Five times in a row.

COMMISSIONER WESSEL: I'd like to get your views on a broader subject, all of it, of course, connected. Yesterday, we had a debate here about engagement where some said either you're for or against engagement. Everyone, of course, is for engagement in some way. We see the Chinese testing many of our systems, not only the Kitty Hawk, which was referred to, but also, of course, the cyber incursions that have been occurring on a frequent basis.

If the mil-to-mil contacts are yielding little, what should we be doing in other areas to understand their systems better, their capabilities better? Dr. Ehrhard, you talked at one point or referred to the question of resuming the defensive posture of the Cold War which, of course, was a policy of containment.

How should we be viewing that in the context of where we want to go with China now? If they continue to test our systems, if we have to infer a use of military power as part of their national power scope, should we be doing more to prepare and to test their systems?

DR. EHRHARD: The short answer is, yes, we should be doing more in that area, but this is a much more complex strategic challenge than the Soviet Union.

The use of the word "containment" vis-à-vis China, I think, is almost always misapplied or not inappropriate because the Soviet Union contained themselves. It was much more appropriate for a country that actively contained itself and cut itself off from the world, and the Chinese clearly are not doing that.

So they provide us much more complex problem because they're both closed and open. They're both closed and more secretive and the open part of China is massive and there's massive information to be gained from that that is hard to process. So we have that dual kind of problem here.

I brought up, for instance, in my remarks, about one of our analysts who just looks at unclassified data, and has done a fantastic job because he looks at it in one narrow military range, and he's looking for particular things. We have one of those, Dr. Lyle Goldstein, up at the Naval War College, but we need 50 of them, 100 of them in those different areas.

Let me just mention one other thing. One of the ways that we can gain some greater insight into their forces is through our allies in the region. We have very sophisticated militaries in India, Australia, Singapore, Japan, Korea, and I believe we need to do a lot more with them in terms of understanding what their analysis is of the modernization of Chinese forces.

They look at it from a different perspective, and that always takes analysis for you to be able to understand it from their point of view and to see that threat from their point of view, and so I believe in terms of mil-to-mil exchanges, one of the things we're not talking about is military-to-military exchanges with these allies on the subject of PRC military power, and I think this is just another avenue that we need to pursue if we had a much more comprehensive analytical framework for the PRC.

COLONEL HOOPER: I would agree in part with Dr. Ehrhard in

terms of, as I said, this is an issue of education and information. We have many of the mechanisms and procedures in place to learn more about Chinese military capabilities, and obviously I'm speaking in general terms here, and certainly more resources need to be allocated to those. So the short answer, I agree, is, yes, we need to allocate more resources to those.

Having said that, these military exchanges, I have always said, however flawed they may be, can serve to educate our military personnel on China and the PLA, I would be an advocate of increasing the education and exposure to China as much as the market would bear, both our market and their market, so that we are not continually surprised by events and so that by the time our best and brightest achieve the point where they have some responsibility for relations with China, they'll have some general level of knowledge.

During the Cold War, everyone was focused on Europe, and our best and brightest were Euro-centric. Now our best and brightest are Middle East-centric, and justifiably so because that's the current source of the most immediate threat to our security. So as a result, our Euro-centric best and brightest were shocked by events in the Middle East, and it is inevitable that our Middle East-centric best and brightest will be shocked by events in East Asia and China if we take no measures now to educate them.

We have to do a better job of comprehensively educating our best and brightest military officers on our security posture in Asia and the potential challenges posed by China. Long after our unfortunate challenges in the Middle East have been addressed, China will be there, and its comprehensive national power is growing while we are focused elsewhere.

VICE CHAIRMAN BLUMENTHAL: Thank you. Commissioner Fiedler.

COMMISSIONER FIEDLER: Thank you. What message do you think that the Chinese were sending to us with the Kitty Hawk and the ASAT incidents, one? Two, what role does the military sense of inferiority play in the Kitty Hawk and the ASAT incidents? Sense of military inferiority on the part of the Chinese. If you agree there's a sense of inferiority in the first place.

VICE CHAIRMAN BLUMENTHAL: Let's start with Colonel Hooper.

COLONEL HOOPER: My personal opinion, and this is my personal opinion, is that the message being sent by both the Kitty Hawk and the ASAT test is they, the PLA, can challenge our strongest military resources in the Pacific; aircraft carriers and our satellite communications network. Now, there are many observers that argue

that the submarine incident, especially occurring so close to the Pacific Commander's visit, was a simple mistake or miscalculation on the part of the PLA Navy. I do not accept this.

As far as I'm concerned, any of the four possible scenarios under which this incident took place still communicate the same message. Number one, the PLA Navy was directed to do it by the Chinese central leadership. Number two, the PLA Navy directed the submarine to do it without the knowledge of the civilian leadership. Number three, the submarine commander didn't know where he was or number four, the submarine shadowed the Kitty Hawk on the commander's own initiative. Either way, it doesn't matter. All four scenarios are disturbing.

Certainly the other message is that we, the PLA, are developing technologies to strike at your military strengths and exploit your perceived weaknesses. Plain and simple.

In terms of inferiority, this is a very complex question because it speaks to Chinese strategy and Chinese strategic thought, and the fact that even from a position of weakness; they are going to communicate the illusion of certain military strengths. At a minimum, they're going to maintain a sense of strategic ambiguity in terms of not allowing us to define what their military strengths and weaknesses are.

So I don't think necessarily they have an inferiority complex. An inferiority complex implies that they are resigned to the permanent existence of U.S. military dominance, and I do not believe that they accept this as inevitable or sustainable. I think that they are certainly cognizant of our superior military capabilities, but as I said in my statement, they're working hard--my counterpart is keeping the lights on at night in the PLA General Staff Department trying to figure out how to defeat U.S. military strengths and exploit perceived weaknesses. So I don't think they have an inferiority complex, and I'll leave it at that. They are clearly sending the message that we can challenge you.

VICE CHAIRMAN BLUMENTHAL: Anyone else?

DR. EHRHARD: Yes. And I already, as to the first question, I already communicated what I think about the message they're sending, which is that they can challenge these global commons. The U.S. thinks they dominate these global commons, but they do not. That's the simple message.

On the military, that's a very interesting question about military inferiority, and I would just say this. If you would contrast their behavior with other militarily inferior countries, then you see a different type of behavior. The difference is they feel--there is no question that they feel militarily inferior, but they see themselves as

rising.

So it's this vision of the future where they see themselves as the inheritors of hegemony, if you will, or dominance in that area or even parity. That's what causes them to fight above their weight-class. And these sorts of impulsive, destabilizing, acts are symptomatic of that progressive view.

COMMISSIONER FIEDLER: Let me just follow up on one thing, which seems to me leads to greater likelihood of miscalculation.

DR. EHRHARD: Yes, yes.

COLONEL HOOPER: Yes.

COMMISSIONER FIEDLER: Which is a more dangerous situation, and so I begin to wonder whether or not miscalculation or the acceptance on the Chinese part of the risk of miscalculation is, in fact, acceptable to them and part of their strategic thinking?

DR. EHRHARD: I would just answer quickly in saying, first of all, to some degree, they don't know how much risk they're assuming when they do that. Some of the things they've done, I think, indicate that. On the other hand, it has always been the case, what makes the wheel go round and round in military affairs is that the weaker power is always willing to assume more risk and the stronger power is always going to assume less risk and take less bold action.

So this is just a natural outcome of the configuration of power and the relative movement over time of that power and the way they see themselves rising.

VICE CHAIRMAN BLUMENTHAL: Thank you. Commissioner Brookes.

COMMISSIONER BROOKES: Thank you very much. Good to see some of you again, all of you, some of you for the first time. Good to see Charlie Hooper and Ken Allen here before us.

I was just wondering if you could quickly, all three of you quickly tick off what you think the Chinese objectives are in the exchanges? What the Chinese want out of these exchanges? I didn't notice it in your testimony, and I think it's pretty key because we're looking at it from our perspective, but what are the two or three things or more do you think the Chinese are after? I'll have a follow-up question if we still have time.

Ken, please.

MR. ALLEN: I'll take a stab at that. Thank you. I had this discussion with some people leading up to my testimony, and sort of look at we learn from and we learn about. I think the PLA wants to learn from us so that they can take some of these concepts and perhaps make their forces better regardless of whether it's education, training, systems across the board, so that's learning from us.

The second part is to learn about us. What are our capabilities? What do we do? How would we fight? They have just analyzed the Gulf War and Kosovo and Afghanistan to death to learn about us.

The other side of the coin is you ask us what does the U.S. want when we engage China? I would say from and about. We're not there to learn from them because we feel we're the superior force. And what could we possibly learn from them so that we could use this?

What we wanted to learn is about the PLA. So I think if you sort of use that as a context, I would say it's 50/50, and the PLA--one of the things is that when we say that we should not engage the PLA because they can learn X, Y or Z from us to make them better, learn from us, I would submit that their foreign exchange program around the world, many with our allies, they have pilots who are in France for two years of training. They're in Australia in the National Defense University. They're in countries around the world who are our allies. They are learning about us from our allies.

So I fully submit, going back to my first statement a little while ago, is that I think every time we say we are not learning things about the PLA when we go there, we need to look in the mirror, say we did not prepare ourselves for this visit. We did not prepare ourselves to learn from them, from them, not about them, but from them, and so I think the PLA has to look at both sides.

And I've talked to PLA folks. And they say that a lot of their delegations that come here are as ill-prepared to discuss things with us as we are ill-prepared to discuss things with them.

Thank you.

VICE CHAIRMAN BLUMENTHAL: Did you want to ask a follow-up?

COMMISSIONER BROOKES: I would like all three to please answer.

COLONEL HOOPER: It's good to see Commissioner Brookes again. I speak to this in part in my statement where I talk about process and results orientation. My personal opinion is that China’s civilian leadership has told the PLA to have this military relationship with the U.S., so they do.

I believe that they would certainly like to gain from this relationship and they do try their best to exploit whatever is offered to them to gain information on U.S. capabilities and intent, but not at the expense of exposing anything of their military capabilities and intent. I was once asked if I thought that the PLA’s relationship priorities were focused more on gathering information on U.S. military capabilities and intent or on restricting our access to information on their capabilities, and I've said that the PLA would cut off or severely

restrict the relationship to protect their own capabilities at the expense of gaining more information about ours.

In short, that's my answer. They do it, somewhat reluctantly, because they're told to do it by their civilian leadership, and their desire to conceal their own evolving military capabilities and strategic intent that inherently keeps the boundaries of the relationship restricted.

DR. EHRHARD: I would agree with those wholeheartedly. I would just say their two objectives are, number one, do no harm to themselves personally because they're at risk or to their country and their military forces; number two, they want to learn as much as possible, and let me just break that down a little bit. They want to learn as much as possible because we're at the same time a model for them to follow.

We are a model for the PLA in the same way that our Navy modeled itself on the Royal Navy, for instance, but we're also an adversary. We're both of those things at the same time. So they're interested in how our air forces conduct complex campaigns, for instance, and they really want to know about those things, and their air force is beginning to look a lot like ours as a consequence.

So we're both a model and an adversary, and the last thing I'd like to say is the difference between the two parties stems--and the way the Americans approach it and the Chinese--is that--and I outlined this in more detail in my remarks, but there's a hedgehog versus fox problem--the strategic asymmetry--where the Americans are like the fox: they want to know many things. China is just one of our strategic problems, and it's on the radar screen and it's off and various other things occupy your attention.

The PRC is like the hedgehog. They know one thing very, very well, and so they're very focused on us, both as, again, a model and an adversary, and I believe that the focus itself is a strategic advantage to them that they exploit when they do these exchanges.

VICE CHAIRMAN BLUMENTHAL: Thank you. Commissioner Reinsch.

COMMISSIONER REINSCH: That last comment was very interesting. My reaction to it is I'm not sure there is anything we can do about that given our different situations globally. We are what we are. And there would be other consequences if we tried to remedy that problem.

In any event, I just had a comment or two growing out of several of your statements, and I wondered maybe you can react to my comment. I take Colonel Hooper's points about no military dialogue. I have to say, nevertheless, I think I'm kind of surprised about them. I

don't think I've ever had an encounter with the Chinese where I didn't learn something.

Even when they're not telling me the truth, I learned something. If you try to measure are they learning more than we are in a given relationship, I suppose you can rather frequently come to the conclusion that they're learning more than we are. I'm not sure that's the appropriate metric to use in looking at cooperation. If we are learning something and getting something out of it, it seems to me that it's a useful thing to continue to look at and try to tweak to address the very real problems that you've identified.

I was also struck by Dr. Ehrhard's comment about essentially talking to people on the periphery, third countries, about this. It reminded me that the single-most useful conference I ever had with the Japanese was when the topic was the Russians. They were a lot more excited about talking about somebody else than they were about talking about themselves, as were we, although in the process, we learned a lot about them as well as their perspective on Russia, which at that particular point in time was important.

It seemed to me, and maybe you can react to this, that suggests two things. One, that you're right: that it's important to talk to third parties who inevitably have a different perspective, and they'll probably be more forthcoming about their view of somebody else than they will about what's going on internally.

It also suggests that perhaps it might be interesting for us to propose that we talk to the Chinese about the Indians or about the Russians or about somebody else and see if we can get a dialogue going that way, and in the process learn something about them.

Does anybody want to comment on that? Either of you?

DR. EHRHARD: I think that's brilliant. I never thought about that in that way, but the logic obviously follows, and I think it's at least something that should be tested to see what sort of reactions you get. I know that they have definite views about the militaries in the region. I know for sure they have definite views about our military.

But that might be an interesting way to divine their process of thinking about militaries. So I think that's a great idea.

COLONEL HOOPER: In terms of your comments on the value of the exchanges and whether or not you learned something, I do say in my statement, and I didn't have an opportunity to articulate it as well as I would have liked to, that there is something to be gained from continuing the military relationship, and that is my reason for believing that the exchanges should continue. We all go to the theater because there are glimpses of, and insights on, real life even in a staged performance, so, however flawed these exchanges are, I think

there are things we can learn about the PLA from them, provided that we protect those things that are important to us.

So, yes, they should continue. I would just urge everyone to consider and understand the realistic limitations of this relationship and consider the parameters and types of exchanges so that there is no risk of exposure to us and a realistic understanding how far the Chinese are going to be willing to go.

COMMISSIONER REINSCH: I agree with that, and I'm glad that we had a chance to allow you to sort of elaborate on that part of your testimony that you didn't have time to give because I think it's an important point.

I would just say in closing that I was there last month to play a simulation game, which was kind of an unusual exercise, and the scenario was an incident that happened somewhere else so it wasn't a direct thing, and I thought it very enlightening. I was surprised they did it, but I found it very enlightening and very educational and I think probably in both directions.

You can make these things useful if you design them properly and focus them, and I think doing something where the event that in that case started the game was an external event, not one that necessarily involved either of us, was a good exercise to really kind of tease out their thinking about a global crisis as well as ours.

I have to say I'm not sure we did very well, but that's another story. Thank you, Mr. Chairman.

VICE CHAIRMAN BLUMENTHAL: Thank you. We have time for one follow-up, and Chairman Bartholomew had the first hand up.

CHAIRMAN BARTHOLOMEW: One of the things I think Colonel Hooper, in particular, though, that I take out of what you said is that some of what we need to do is to stop pretending that we're getting things that we aren't getting, to be realistic about what it is we're getting, and I think that that's a very important step.

Out of deference to all of your time, I would ask if you could submit a response in writing, if you're willing to do this. I want to go back to this issue of how do we develop and maintain a cadre of independent thinkers on these issues? Again, Colonel Hooper, you mentioned that Middle East specialists will be surprised about what's happening in East Asia. There is no surprise that that's the case, but the problem seems to be that our Chinese specialists are surprised by what's going on.

When you look at the state of outside research, in particular think tanks are getting more and more funding from Chinese government or friends of the Chinese government; academics can't get visas to do research in China if the Chinese government does not like

the topics that they're doing or the conclusions that they're coming to.

So if we are going to talk about, and we all believe that there is need for more people with understanding, how do we make sure that that's a balanced understanding and/or an understanding that reflects our interests as well as the Chinese government's interests?

No need to answer that right now. I'd love to get your thoughts in writing on any of that from any of you who are willing to provide it. Thank you.

VICE CHAIRMAN BLUMENTHAL: Thank you all very, very much. It was a fascinating and very enlightening presentation on all your parts.

We're going to take a five minute break and reconvene the next session. Thank you all very much.

[Whereupon, a short break was taken.]

PANEL VI: PROSPECTS FOR U.S.-CHINA POLITICAL COOPERATION AND DIPLOMACY

VICE CHAIRMAN BLUMENTHAL: Our second panel today will examine the diplomatic relationship between the United States and China and the prospect of future cooperation.

Our first speaker is Dr. Edward Friedman, the Hawkins Chair, Professor of Political Science at the University of Wisconsin. He's published many works including the provocative, What If China Doesn't Democratize? Implications for War and Peace.

Second, Dr. Shiping Hua is an Associate Professor of Political Science and Associate Director of the Institute for Democracy and Development at the University of Louisville. His research focuses on Chinese political modernization, political culture and the three-way relationship between Beijing, Taipei and Washington.

Our third speaker is Dr. Alan Wachman, Associate Professor of International Politics at the Fletcher School. Formerly, he served in New York as the President of the China Institute in America and as a Co-Director of the Johns Hopkins University-Nanjing University Center for Chinese and American Studies.

Thank you all very much for joining us. We'll begin our testimony with Dr. Friedman.

STATEMENT OF DR. EDWARD FRIEDMAN HAWKINS CHAIR PROFESSOR OF POLITICAL SCIENCE UNIVERSITY OF WISCONSIN, MADISON, WISCONSIN

DR. FRIEDMAN: Thank you, Mr. Vice Chairman. It's an honor

to be back with the Commission. I think the work of this Commission is about among the most important things happening for those who care about peace, pluralism and prosperity in the world. The question is why?

The answer is that China is a superpower and we have a hard time figuring out what that means and China doesn't want us to figure out what it means. It loves to describe itself as fragile; it's merely emerging. Many analysts that tomorrow the whole thing might fall apart. I think this is silly.

China's is a robust economy. China is a stable polity; it is a rising superpower. It's also a revisionist nation. That project is inherent in the nature of Chinese nationalism. China's leaders see the world in terms of three periods. There was a period when China was glorious; then there was the period when China lost its glory; and now we're in a period when China is restoring its glory.

Restoring its glory changing the world in a way that China can once again be glorious. By the way, it does not mean it has to go to war tomorrow. Its revisionist nationalism assumes two things about what it will take to make China glorious again.

One is China will be at least equal to the United States. The second is that China will be the predominant nation in its region.

In the prepared testimony, I offer three or four pages of quotations from two recent volumes, both of which are written by authors who are very, very friendly to the Chinese government and very, very unfriendly to the American government. I cite them because what they have to say about China's revisionist aims are admissions against interest. You can see in their writings the Chinese notion of what it would take to make China glorious again. One, Taiwan is incorporated into the PRC; two, the East China Sea and the Senkaku Islands are China's and the South China Sea and the Spratly Islands are also China's; all the energy resources of the region are Chinese; and China has a blue water navy which projects out from Taiwan and has a large role in the world.

These are the findings of authors who are writing from a pro-Chinese, anti-American point of view.

There is one arena in which they find a basis for cooperation; that's energy. China feels very vulnerable on energy. Its leaders worry about the vulnerability of oil supplies if there were any crisis. They are anxious about the ability of the American Navy to cut off China's access to oil from the Middle East and Africa.

If you wanted to build trust and confidence between China and America, if you're serious about it, you've got to touch matters that really matter to China's leaders. Energy access is an issue which

really, really would matter to the Chinese. It's worth a lot more thinking hard about than we're now doing.

There's a problem, however, with the quest for energy cooperation. China's leaders are worried about it because if they were to act militarily against Taiwan, the oil might be cut off by the American Navy. In other words, China's energy vulnerability precludes some of the military actions China's leaders might otherwise feel capable of taking. Therefore, there are tensions in dealing with China because cooperation to build trust can undermine vulnerability which helps keep the peace. China is a rising superpower. China and America have real conflicts of interest. They're hard to wish away in an easy and simply kind of way.

Most of my colleagues do not like to talk about these kinds of things because they're worried--just what Jim Mann said yesterday--they're worried that they're going to give ammunition to dangerous hawks in the United States.

I think that an analyst's job is merely to tell the truth. Somebody else decides on policy.

Why is it so difficult to get an American-China cooperative relationship going in a direction Americans would like to go? Consider an arena where I'd like to see more cooperation, the human rights realm.

The truth of the matter is that China has totally defeated the international human rights regime. There really isn't a double standard favoring China versus the Soviet Union. It's that China defeated attempts to apply human rights standards to China. Why has it been able to do this?

Because it's not the old Soviet Union. It is a global economic power. It is the nation benefiting the most from open globalization. It has played that game quite brilliantly and no one is willing to risk losing the benefit of being part of China's rising globalization.

Each nation understands that if you were to do something alone, then you would yourself. It's Nokia v. Motorola; it's Airbus v. Boeing; it's Toyota v. VW v. GMC. The Chinese government plays Europe, Japan and America against each other to stymie human rights efforts.

To succeed on human rights, Europe, America and Japan would have to cooperate. That's not going to happen. An alternative approach would build an Asian human rights regime. That also is not going to happen. Japan gets discredited by China for its WWII behavior. India experiences international action on human rights as imperialism. Taiwan, which would love to see an Asian human rights regime, has no clout.

The only way human rights cooperation on China is imaginable

as someone said yesterday, is if China did something atrocious, something which was really appalling to the rest of the world. The June 4, 1989 Beijing massacre was not enough.

So there is not going to be human rights pressure to get China to change its behavior. The other approaches to changing China are all wishful thinking-- it will change because it's fragile, it will change because otherwise it will fall apart or, because the economy succeeds. China is simply going to democratize. Or because it's now playing a winning game, it's not going to do any of the bad things required to establish its regional hegemony and risk losing the benefits of world market access.

These aren't policies. These are matters of just wishful thinking, efforts to escape from facing up to the difficult problems of the real world. To have peace, pluralism, and prosperity perpetuated, given China's hegemonic ambition, China has to change policy on three matters:

It has to act fairly towards the South China Sea and the nations of Southeast Asia; it has to act fairly in the East China Sea and towards Japan; and it has to act fairly in terms of the people in Taiwan.

Were those matters to become a reality, then other elements of serious cooperation become possible, including energy. Were China to change on these important matters in very serious ways, America could act to remove China's fears and concerns. I would be very happy to see us go in a much more cooperative kind of a direction because I do believe that is what we should be looking for.

America should be taking the extra step and the risk to preserve peace and to maintain that pluralism and prosperity. So should China. [The statement follows:][6]

VICE CHAIRMAN BLUMENTHAL: Thank you. I cede over to the chairwoman.

CHAIRMAN BARTHOLOMEW: Dr. Shiping Hua, please.

[6] **Click here to read the prepared statement of Dr. Edward Friedman, Hawkins Chair Professor of Political Science, University of Wisconsin, Madison, Wisconsin**

STATEMENT OF DR. SHIPING HUA
ASSOCIATE PROFESSOR OF POLITICAL SCIENCE
DIRECTOR, CENTER FOR ASIAN DEMOCRACY, THE
UNIVERSITY OF LOUISVILLE, LOUISVILLE, KENTUCKY

DR. HUA: Chairman Carolyn Bartholomew and Vice Chairman Daniel Blumenthal, I am very honored to be invited by the U.S.-China Economic and Security Review Commission to talk about U.S.-China relations in the next five years. I have done about a dozen books and most of them are edited books. Only two of them are monographs and those two monographs are about comparative Chinese political thought and comparative political culture. So I consider that my main area.

So I will look at the issue largely from this perspective. This testimony was drafted in response to the four questions raised by the Commission. Each of the four questions is broad, and I can only focus on certain aspects of those four questions in this testimony.

First, the state of U.S.-China relations. The state of U.S.-China relations has entered into a more established stage. The two countries need to address bilateral issues on a constant basis and occasionally a crisis may occur.

Nevertheless, barring unusual circumstances, the conflicts between the United States and China in the next five years will be manageable. Three decades of engagement have enabled the two countries to know each other a lot better now and most leaders of the two countries realize it is in the interest of both to engage with each other.

Many key issues in the bilateral relations are not unique between the two countries. For instance, the trade frictions between the United States and China today are very similar to that between the United States and Japan in the past.

To effectively handle the bilateral relationship, soft issues such as cultural and historical factors may deserve more attention since much attention has already been given to hard issues such as economics and security.

Some economic and security crises in the bilateral relations have often been exaggerated because of cultural, psychological and historical factors.

Traditionally, the Chinese have a monistic understanding of the universe. Truth has one source; so does power. This monistic way of thinking is connected with China's traditional authoritarian political structure. With this kind of thinking, it is very difficult for the Chinese to understand the checks and balances and the separation of

power built into the U.S. political system.

On bilateral relations, many Chinese believe that there is a conscious division of labor between the two branches of the U.S. government in the sense that the executive branch wears a friendly mask towards China, while the legislative branch wears an angry mask towards China.

Similarly, many Chinese believe that the U.S. media demonize China, a situation that is believed to be orchestrated by the U.S. government. All these have contributed to the complexity of bilateral relationships.

Cultural miscommunication can go the other way around. The Taiwan issue is an example. Many Americans don't understand China's firm position on the Taiwan issue. Americans feel comfortable that Canada can be separate from the United States, although the two countries share similar cultural traditions. Many Americans wonder if the United States and Canada can be similar but separate, why not Beijing and Taipei?

With a more pluralistic way of thinking and the earlier building of the nation states in modern times, Westerners feel comfortable about many nation states existing under one civilization. Traditionally, for the Chinese, China equals the universe. The concept of nation states is alien to the Chinese.

Question number two: China as a responsible stakeholder. China's involvement in the global system is in the interest of the United States. Since China joined the World Trade Organization in 2001, U.S. exports to China have risen more than 20 percent a year. An average American household saves about $500 a year because of U.S. trade with China. Therefore, it is more constructive to treat China as a normal country, not a communist one, not one with ambition to dominate the world any time soon.

It may be more effective for the two countries to address those bilateral issues such as trade imbalance and intellectual property violations on an issue-by-issue basis and case-by-case basis, without drawing upon the references of ideological differences or global power competition.

China has the incentive to be a responsible stakeholder because in recent decades, countries like China, Japan and South Korea have been the beneficiaries of the global system maintained largely by the West, especially by the United States. The Chinese government at least for now has little incentive to change the current global system. Chinese leaders realize the crucial role that the United States plays in maintaining the global system under which China benefits.

China is at the opposite end of the so-called "failing states,"

which the United States is struggling with. For instance, some Middle East countries don't perceive the current global system as beneficial to them. Many people believe, right or wrong, that without oil, some Middle East countries would be like many African countries which are largely left out of the world's prosperity.

It takes a long time for a country like China to meet the international standards in every way. In a sense, China's opening up to the outside world in the last three decades parallels that of Japan after World War II. In the 1950s and '60s, Japan benefited from the global system, but did not worry about its own contribution to the maintenance of the system. During that time period, the United States market was wide open to Japan but Japan's market was not as open to the United States. Japan did not take a more active role in the maintenance of the global system until the 1980s.

I will move to the next question: U.S.-China collaborations. I will say that the most important common ground for bilateral cooperation between the two countries in such areas as proliferation of weapons of mass destruction, energy, security, and counterterrorism is the September 11 terrorist attack in New York in 2001.

Both countries have struggled with so-called "failing states." That is those who are outside of globalization and that do not benefit from the current global system.

The last question: China's political reform. Although major political changes in China are usually prompted by internal factors, external factors do have a huge impact on China's political process. The exchanges of students between the two countries have contributed positively to political changes in China, and it might be more constructive for the two countries to collaborate with each other in those areas where China has already made progress in terms of political reform, such as village level elections, NGOs, rule of law, and professionalization of legislation.

Thank you.

[The statement follows:][7]

CHAIRMAN BARTHOLOMEW: Thank you. Dr. Wachman.

[7] **Click here to read the prepared statement of Dr. Shiping Hua, Associate Professor of Political Science, Director, Center for Asian Democracy, The University of Louisville, Louisville, Kentucky**

STATEMENT OF DR. ALAN M. WACHMAN
ASSOCIATE PROFESSOR OF INTERNATIONAL POLITICS
THE FLETCHER SCHOOL OF LAW AND DIPLOMACY
TUFTS UNIVERSITY, MEDFORD, MASSACHUSETTS

DR. WACHMAN: Madam Chair, members of the Commission, good morning. It seems to me over the last several years that the Chinese strategist Sun Zi has appeared before this Commission by proxy a number of times. I'd like to read from his testimony, in which he says "If you know the enemy and know yourself, you need not fear the result of a hundred battles. If you know yourself but not the enemy, for every victory gained, you will also suffer a defeat. If you know neither the enemy nor yourself, you will succumb in every battle."

There is one formulation he left out: What happens if you know your enemy and not yourself? Now, perhaps he left it out because it's so self-evidently clear that one ought to know oneself, and yet I do wonder after all these years of considering the competition between China and the United States, how well we know ourselves.

In particular, as you will see from my written statement, I'm concerned about our expectations: How well do we understand our own expectations, both of the United States and of China?

That level of self-awareness, I think, is a very critical missing ingredient in a more balanced relationship between these two states, and, therefore, I have urged in the written statement that we:

- consider ways to recalibrate the expectations that we have, both of Washington and of Beijing,
- that we reconsider the efficacy of publicly scolding the PRC, and
- that we reassert the power of American leadership by example.

I very much appreciated the testimony yesterday of Mr. Aldonas who said, basically, "don't sell the United States short."

This Commission has invited comment about how the United States can obtain its diplomatic objectives while encouraging international behavior and domestic transformations by Beijing that are compatible with American visions and values, and I ask: Are those compatible expectations? Can we improve the quality of our diplomatic dialogue and induce the PRC to do what we want?

Here in the United States, it seems we have the unhappy practice of viewing China as an abstraction, and often exoticize it or objectify it. Americans, many of us, willfully surrender to an intoxicating mystique of the PRC's "Chineseness," as though China is somehow exempt from being a state like any other growing power.

And this is unwittingly perpetuated, I think, by the way in which we think about China and, therefore, I also was very heartened by the comments of the last panel, which urged greater education-- greater education to members of the military officer class, and as you saw from my suggestion in the written testimony, greater education of members of Congress and their staffs.

Now, the chair asked the last panel about broadening the dialogue, and here I'd have to say that China has been a terribly polarizing subject, not just over the last several years since the granting of PNTR, but probably since the late 1940s. Often, one's regard for the welfare and security of the United States, indeed one's loyalty as a citizen of this Republic, has been presumed to flow from the position one adopts towards the People's Republic of China.

It's been seen, in essence, as an acid test of one's patriotic bona fides, rather than being seen as a reflection of one's intellectual temperament, and by that I mean that the different positions we take on China may very well reflect nothing at all to do with China, but our tolerance or aversion to uncertainty, our propensity for optimism as individuals or pessimism, our inclination to equanimity or alarmism, our predisposition to thinking with complexity or with simplifications, and our urge to accepting moral ambiguity or our wish to cling to moral certainty.

Look, we all invest differently in the stock markets when we're faced with exactly the same evidence. Why would we invest differently in China when confronted with the same evidence? Because we think differently. It has nothing to do with our patriotism.

Our different interpretations lead to contrasting assertions about the PRC and about what constitutes a coherent policy toward it.

This Commission was born in the welter of sentiment about whether to grant Permanent Normal Trading Relations to China and whether to encourage its admission to the WTO. Advocates at that time suggested that these two steps would push China in the direction that we would like it to go in, and yet here we sit, seven years later, vexed by the very consequences of engagement that were once proclaimed to be the path toward greater cooperation and comity.

And I have to ask: What did we expect? There was discussion yesterday about China's compliance with WTO obligations in the five-year period. Why did we expect that to happen in five years? Because they said so? Was that a reasonable expectation? Was five years a reasonable expectation during which time the PRC should meet the standards of compliance?

Why do we expect that the opening of China to a more integrated role in the rest of the world will necessarily bring with it the

transformation of civic society and attitudes toward human rights? Why did we expect that? Perhaps, as some have said, it will come, in which case we have to ask: Why did we expect it to happen fast? Why are we frustrated now? All I'm suggesting is that we question our expectations.

They may be correct. They may be valid. They may be worth endorsing. Or, they may be flawed, but we need to be prepared to question our expectations and look at them afresh.

Now, one of this Commission's questions pertains to the issue of how to hold China up to the standard of being a "responsible stakeholder," and, as you will know from my written testimony, I'm not much a fan of that term. I prefer to think in terms of a statement written by George Kennan in 1961 that "if we are to regard ourselves as a grown-up nation, we must, as the biblical phrase goes, put away childish things, and among these childish things, the first to go should be self-idealization and the search for absolutes in world affairs: for absolute security, absolute amity, absolute harmony."

Because if we expect those things, we will be absolutely disappointed. Now, as to "responsible stakeholder," it's a very nice-sounding phrase. It seems to mean a lot, but as Professor Saunders suggested in his testimony yesterday, it was ambiguous from the start. The Chinese could not define it and I would defy the United States to come to consensus about what precisely is meant by the term "responsible stakeholder."

And even if we could agree to what is a "responsible stakeholder," who died and left us in charge as a nation to determine whether China deserves that label or not? So while I have more I would like to share with the Commission, I will end by saying that holding Beijing up to the standard of a "responsible stakeholder" yardstick was a rhetorical lapse that should not be compounded by repetition.

Thank you.

[The statement follows:][8]

Panel VI: Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Thank you very much for the

[8] **Click here to read the prepared statement of Dr. Alan M. Wachman, Associate Professor of International Politics, The Fletcher School of Law And Diplomacy, Tufts University, Medford, Massachusetts**

interesting and lively testimony from all of our witnesses. I think we'll have an interesting debate during our questions and answers. We'll start with Commissioner Blumenthal.

VICE CHAIRMAN BLUMENTHAL: Yes. Thank you all. Professor Wachman, I appreciate the cautionary notes that you struck, but there are some real world problems that we face today, that this Commission is tasked with advising the Congress. Some of them have to do with unfair trade practices that affect workers in America. Some of them have to do with the launching of ASATs, the growth in military capabilities.

These are real world problems. We have real world allies. The Taiwan question, of course, which trends on the cross-Strait are not necessarily favorable to peace and prosperity.

So you did a good job in throwing away a framework to think about how to deal with China. I can't tell from your testimony whether your temperament is optimistic or pessimistic, but we heard testimony from Dr. Friedman, and he pointed out that China has managed to defeat the global human rights community, which was a deliberate strategy. I think we could probably also agree, as a broad swath of Americans would agree, is important to us as a value.

So, again, I ask you on how to deal with these real world--you might be absolutely right that the expectations are too high, but we have to face some real world issues and challenges that China poses today. What is then the framework you would submit to us?

DR. WACHMAN: I'll back up. I'm not going to suggest there's a single framework to deal with all of those individual problems. There isn't a single posture one can adopt towards the PRC that's going to solve trade practices, that's going to solve anti-satellite missile technology, that's going to solve the Taiwan problem.

I think we would be well advised as a nation to spend less time carping and more time working hard. I liked very much what Mr. Allen said--that we need to do our homework. We need to get back to work and stop complaining because competition is tough, but it can promote industry, industriousness. It can promote ingenuity, it can promote a variety of differentiation, and there is no question that the PRC is working hard. They have “fire in the belly,” to use a phrase that they're now all going to go run to try to translate.

They have “fire in the belly.” They want to succeed. Well, what about us? Do we have “fire in the belly”? Or, are we just carping because things aren't the way they used to be?

Let me take the issue of unfair trade practices. I don't doubt that there are some and some of your panelists yesterday suggested that we take those complaints to the World Trade Organization, because

frankly, our interpretation of what may be unfair and China's interpretation of what may be unfair may both be wrong and we may need arbitration.

But, the landlord here--Congress--represents every district in the nation, and our policy is not made in response to the cries of those who are pained most by China's practices or those who have the greatest wallets to buy policy. Our policy is a national policy and that's why everybody comes together to make a national policy.

The truth of the matter is that our growth as a nation will cause pain. It isn't as though the pain is all going to be elsewhere. So, yes, our industrialists are benefiting from trade with China and people are losing jobs. That's unfortunately a reality. And congressmen from districts that are losing jobs are going to be upset about it, but we're not devising policy to suit the needs of a *particular* district. We're devising policy that suits a *national* objective.

VICE CHAIRMAN BLUMENTHAL: On the military questions, is it that we need more fire in the belly on that, too, now that the Chinese are wanting to, as we heard testimony before, show us that we will not be able to control the global commons, that they will have the capability to coerce Taiwan at the very least and possibly other countries? Do you suggest having more "fire in the belly" on the military competition as well, spending more, getting into the kind of military competition we had with the Soviets?

DR. WACHMAN: Sometimes having "fire in the belly" means thinking harder, not spending more. Spending is not always the solution and I'm not sure that we spend too little. I don't know that what we spend it on is necessarily what ought to be spent on.

VICE CHAIRMAN BLUMENTHAL: Let me rephrase my question. Should we have fire in the belly on thinking harder and being better but knowing that we're engaged in a military competition with China?

DR. WACHMAN: Yes, sir, we are engaged in a military competition with China. And I think this was reflected several times in the testimony so far. Everyone has asked, well, what about the submarine that came up near the Kitty Hawk; well, what about the ASAT; well, what about the EP-3 incident?

My response to that is, let's look at our expectations. We expected to be able to fly our EP-3 close to the Chinese coast without a response. Now, who should be faulted for that expectation? That was our expectation" that we could fly close to the Chinese coast and there would be no response. We expected that could have the Kitty Hawk cruising around in the Pacific without a response. Well, the Chinese are here to tell us that our expectations cannot prevail without a

response.

Now, what should we do? In each instance, something different to be sure, but the first thing we should do is put aside our expectations that we can cruise around without a response. We are in competition.

VICE CHAIRMAN BLUMENTHAL: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Wortzel.

COMMISSIONER WORTZEL: I have to make a comment to Alan, but I have a question for Shiping. First of all, I want to thank all of you for being here. We do expect responses to our military activities, and we got them from the Soviets for years and we get them from other countries, but we expect safe, sound and careful responses, and that's part of our objection to the Chinese or their behavior.

Shiping, you didn't spend a lot of time on it in your oral testimony, but in your written testimony, you have the comments that Westerners feel comfortable about many nation states under one civilization, but for the Chinese, China equals the universe and that the concept of the nation state is alien to the Chinese.

Now, if that's the case imbedded in political culture, then why is it that Beijing's entire approach to sovereignty is imbedded in the international system, in the Westphalian system, and it's very firm, and why doesn't that affect Taiwan? Why was Beijing able to give up its claims to Mongolia, but cannot revise the way it relates to Tibet and Taiwan?

DR. HUA: Thank you, Larry. I think basically these are two related questions. The first one is the concept of nation states and we know the concept of nation states is a modern concept, and the Chinese didn't go through this process as early as Westerners. So I think this is one difference. The concept of nation states originated from Western Europe. China is a latecomer. You know it needs some time to adapt to this conceptualization.

This is the reason number one. Reason number two is probably more important. That's the way of thinking. In my paper, I did a paragraph on this. I think it has to do with the geography. In a sense that China's geographic location is a closed system in the sense that to the north, there are highlands, to the east and southeast there was the Pacific, and to the southwest, there's Himalayas, and to the west there was the great desert.

China geographically was also large enough to be self-sufficient. So China geographically is a closed system in the sense that China I think until about several hundred years ago, in the official map of the world, Europe didn't exist. So anything beyond the border of China is barbarian to the Chinese. So this way of thinking is very different

from the Western way of thinking. Western civilization originated from the Mediterranean, and the Mediterranean is basically sort of inland lake, and we know the story of the Odyssey. Odysseus was able to travel to different parts of Europe. He encountered people of different linguistic backgrounds, ethnicities, so the Westerners' way of thinking is more pluralistic.

So these two questions are sort of interrelated to each other. Most of the Americans that I talk to feel very comfortable that Canada is separate from the United States. The two countries share very similar civilizations, the Western civilization.

But, for the Chinese, for thousands of years, China is more like a civilization by itself. So that's a cultural difference there.

Second question, Larry, is probably harder to answer. How about the fact that China is willing to give up parts of Mongolia, and also I think some scholars have done some studies recently about China's territorial disputes with neighboring countries. China is willing to give up some of the territories, not only in negotiations with Mongolia, but also Russia, and Burma and some other countries, but not an inch on Taiwan and not an inch on Macau.

I think this is probably different. It's very important fact. I myself thought about this issue. I still haven't quite figured out what it means. I think it's probably a matter of pride, you know. You give up some territories to Burma. It's not loss of face because Burma is a small country; right. But if you give up Taiwan, you give up Macau, which is a colony of Portugal, for instance, you look weak. So probably this has something to do with the China's nationalism.

Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: I have two questions, one for you, Dr. Hua. Your comment in your written and your oral testimony, about the Chinese leadership seeing the Congress as one view and the executive branch as another, and the press is demonizing this, and this one big conspiracy, would seem to me to go to the question that the Chinese Embassy--I mean after the last decade of very complicated politics in the United States, that they would see that this is an oversimplified view and if they articulate that view, is it just the political position they're taking, one? That's the question to you.

Dr. Wachman, your commentary on the formulation of national policy and your apparent lament that congressional districts where people are injured by unfair trading practices, that is simply a reality, seems to me to be in contradiction to your general testimony about expectations.

In other words, perhaps your expectations about the democratic

process here are not completely in sync with the political reality of how decisions get made. So, I'd like you to comment on that.

DR. HUA: Should I go first?

DR. WACHMAN: Please.

DR. HUA: I think what I was trying to say is that the Chinese way of thinking is monistic, and this is connected to the authoritarian political structure of China for thousands of years. And I think your position is well-taken in a sense that if this were the case for the Chinese leadership three decades ago, that's probably the case.

But after three decades, the top leadership probably has already realized this. Checks and balances, separation of power. But I was talking about common people. When I was in Beijing, I talk to common people; they really don't understand. They honestly believe that the U.S. president can simply shut down CBS, tell CBS what to do.

So I'm not talking about top leadership. Top leadership probably with exposure, with exchange of relations of the two countries in the last three decades, they probably realize this. I don't know to what extent they realize this. At least in theory they probably realize this, but if you talk to the common people, they honestly don't understand the separation of power and the checks and balances that is built into the U.S. political system. Media, too. Lots of people that I talk to think how can the government of the most powerful nation in the world not have the power to shut down CBS? This really unthinkable for lots of Chinese.

Thank you.

DR. WACHMAN: Well, even in the ivory tower, we are aware that there is a world around us. I was invited to discuss ways of, I thought, improving the political dialogue. If we're content with the way things are, there was no reason for me to come.

COMMISSIONER FIEDLER: Oh, no, no, no.

DR. WACHMAN: What I'm suggesting is that we will have districts that will be hurt by our trade with China. We will have districts that will benefit. How should we make a national policy? On the basis of those who cry loudest? On the basis of those who pay more? I would like to think, in line with the idea that there is a *national* leadership, that these various experiences will be reviewed from the vantage of a national interest with the expectation that for our growth as a nation, there will be pain. I'm occasionally disturbed by comments made by statesmen in this nation that suggest somehow that China is responsible for the pain we feel, and that's not true in all cases.

In some cases, it's choices we have made in the national interest that is the cause of the pain, and it hurts. I understand. Now, you can

say: “You're a professor, your industry isn't hurt.” Well, that's actually not true. I live in a school where my dean is very concerned about competition from China and we are trying to adjust.

So, what I'm suggesting is that rather than complain that China has caused the pain, that we accept that national policy grows out of a national interest, and that where there is pain, we have to devise means of adjusting, recreating, regenerating, and not simply think that the answer is to blame somebody else. That to me is a very defensive and not very productive response.

COMMISSIONER FIEDLER: Just to follow up quickly, first of all, I took your expectations argument to heart. I actually agree with more of it than you might think.

But I viewed the comments you made as a slight oversimplification for the policy because I could argue that despite all the cries of pain that have been expressed in the Congress in the last ten years that the policy has been determined on some other basis.

DR. WACHMAN: All I'm suggesting is that if that's the case, that we stop blaming somebody else. That was really the core point. Can I just add a word to Commissioner Wortzel, which is the PRC certainly has diplomatic relations with Mongolia and officially has an amicable relationship, but I think we'll find as late as the 1980s, Deng Xiaoping was telling the former President Bush that actually Mongolia is really part of China. I had the pleasure of meeting the Mongolian ambassador to the United States just yesterday, and I can tell you that some of his comments suggest that he has compatriots who are very concerned about Mongolia's place in the periphery of China even today, and that is the subject of my next book.

CHAIRMAN BARTHOLOMEW: Which is due out when?

DR. WACHMAN: Well, I haven't actually begun, but I’m gathering evidence and so forth.

CHAIRMAN BARTHOLOMEW: Commissioner Houston.

COMMISSIONER HOUSTON: I have a question that I would like all of you to answer. Dr. Wachman, I want you to know that my feelings aren't even remotely hurt that you don't like responsible stakeholder. We've struggled with the definition of the word a little bit, too.

We are indeed Americans and this is indeed America. If you put on rose-colored glasses, you see pink. If you put on blue glasses, you see blue. We look at everything or we certainly should look at everything from our own national interests' point of view, and there are some voices in this country that say we're too nationalistic, but if you're going to protect yourself or maintain your economy or your security, obviously you have to a great extent be nationalistic.

The problem comes with China or any other country where the two ideas of nationalism sort of bang. But we still need to come back to what I would argue would be a nationalistic policy that benefits the U.S. and that's pretty much what you've said all along.

You made the comment that we need to do more thinking and spending less money. A shot in the heart when you said that to me was, yes, we did that with Osama bin-Laden. We thought a lot, didn't put any money toward it, and that didn't work out very well. So I think that there has to be a balance.

My question that I would really like to hear all of you answer is, not necessarily arguing about the word "responsible stakeholder," but we need something, every policy needs something to rally around. It needs an ideal or a principle to rally around. The founding of this country is a perfect example: the individual liberty, rule of law, property rights.

So when it comes to national policy regarding a nation like China that does pose some both economic and military threats to us, twofold. What position do we come from? What sort of overarching principle do we embrace and come up with that leads us down to a policy that lets China have its own sphere of influence but doesn't harm us, and what benchmarks do we use to calibrate whether we've been successful either in the short term or even in the long term?

DR. FRIEDMAN: I'll make a distinction between what I'd like it to be and what I think it could be. I really would love it to be that we could do something to see democracy spread in the world. I think that's not in the cards. We're living in an age, similar to the age after World War I, in which democracy is in trouble, an era in which authoritarian solutions are increasingly going to become palatable, a time during which China is seen as a success story all over the world. This China takes as a goal, especially in Asia, but not only in Asia, doing whatever it can to stop the spread of democracy and human rights.

I think that the CCP leaders are winning and supporters of democracy are losing. There’s surely no point in an American to decide which nation should be the hegemon in the world. That would be ugly. America could lose as the international community as soon as it phrased its purpose that way. Instead, America should be always against hegemony, anybody's.

In addition, authoritarian China's rise is most likely going to continue. So what can Americans basically hope for? I think the answer is pluralism. I think America should be on the side of seeing that all the nations and regions (ASEAN is a region), have the capacity to maintain their autonomy and fulfill their own goals including, of

course, maximizing their benefits from dealing with China. America should be seen by all those governments and regions as a friend of those purposes which are theirs rather than imposing America's purpose on them.

In terms of a competition with a rising China, whose leaders do have hegemonic aims, America is much more appealing acting as an anti-hegemonic nation on defending pluralism in the region.

DR. HUA: I think the United States worries about two things that sometimes go together, sometimes don't. One is that the United States has its own national interests, and the United States has to protect its national interests. But on the other hand, the United States is also a global leader.

Many countries, most countries, except a few so-called "failing states," look up to America for global leadership, and as a global leader, the United States needs to stand for some principles: democracy; free market principles, for instance. So if the United States regards itself as a global leader, then the United States itself has to stick to those principles.

And then if in other countries--there are human rights violations, we handle this on a case-by-case basis, for instance. But do these two things go together? For instance, if we do not practice protectionism, are we going to get hurt even more economically? That would be a very hard question to answer.

Actually, this is an old question first raised by President Richard Nixon in the 1970s. In my testimony I said that there is a parallel situation between the trade relations and U.S.-Japan trade relations in the 1950s and 1960s. The U.S. market was wide open to Japan, but Japan's market was not open to the United States, and the United States tolerated it for several decades until the 1970s when President Richard Nixon decided to do something.

There currently is a similar situation in the sense that the United States is a global leader. Most of the countries look to America for global leadership, but the United States also has to take care of its own national interests. But without practicing protectionism, are we going to get hurt even more?

So those are the questions. I don't think there is an easy answer for those questions because there are two goals. Sometimes they go together; sometimes they don't. I don't think there is a clear-cut answer to this.

Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Reinsch.

COMMISSIONER REINSCH: Thank you for your testimony.

This has been a really interesting panel. Dr. Wachman, I particularly was intrigued by your testimony, some of which I've preemptively borrowed in the past. I've tried to convince my colleagues that you're right. I haven't had much luck. I hope you've had better luck.

My questions, however, are for Dr. Hua, and they're two points that I'd like you to comment. I was very interested in your description of the Chinese monistic understanding of the universe, which is something that I've thought about in the very distant past when I was in school.

It seems to me that one of the consequences of the world view that you described is an inability to view relationships as a matter of equality, or as a matter of parity, but rather to view relationships both personal and between countries hierarchically. One seeks one's place and one's place is superior or inferior, and you can change that, but you see the world that way.

One question is do you agree with that, and if so, what are the implications for the bilateral relationship?

DR. HUA: I was talking about the monistic understanding of the universe by the Chinese. They habitually view China equals the universe. Anything beyond the border of China is barbarian, not worth understanding. For thousands of years, that was the case because China geographically located in a closed system, unlike the Mediterranean.

In terms of U.S.-China relations, I just give two examples. One is that it's very difficult for the Chinese to understand checks and balances, separation of power. Civil society as well. Even in pre-modern times, the Chinese government intervened in the country's economic activities more than its counterparts in the West. The United States did not have income tax until about a hundred years ago. The role played by the U.S. government was traditionally viewed as some kind of a judge. Traditionally, if you don't have jobs, you don't turn to the government for help. That is your own responsibility. The government's responsibility is kind of a judge.

But for the Chinese, because of this monistic understanding, because of this traditional authoritarian structure, the Chinese people traditionally expect the government to help them in their welfare things. In terms of U.S.-China relations, the Chinese monistic way of understanding sometimes serves the interests of the United States.

For instance, one example that I use in my written testimony is China's voting behavior at the United Nations as a Permanent Member of the United Nations. China is one of the five Permanent Members of the Security Council of United Nations. It has veto power. Practically, China can stop the Security Council from doing anything if

it wants to, but during the period from 1978 to 1997, 20 years, China exercised veto power only once because that issue involved Taiwan. Pretty much on all the other issues, China let the United States do whatever it wants.

The United States during the same period of time exercised veto power 60 times, and all the other countries, the even close allies of the United States, like Great Britain, for instance, they exercised veto power a lot more. If they disagree with the United States; they will say it and they will do it because of this pluralistic understanding of the universe. Countries like Great Britain and France realize that they can work with the United States in spite of some differences.

Chinese think differently. On many matters, China exercised abstention, which means I disagree with you, but I let you do what you want to do. I think many people interpret this kind of behavior politically. They thought that China wanted to focus on domestic development so it let the United States run the show on the international arena, but I think culturally it has this monistic understanding of the universe because they thought, well, now this world is dominated the United States. We let it that way.

So this is another example of “truth has one source”; “so does power.” Thank you.

COMMISSIONER REINSCH: Thank you. Rather than ask the other question, because there's no time, I'll just commend to the other commissioners' attention some parts of Dr. Hua's testimony that he didn't deliver orally that relate to political changes going on in China that nobody has paid any attention to. I think it's very insightful and ought to be something that we t look at closely.

Thank you.

CHAIRMAN BARTHOLOMEW: Thank you. This has been a very interesting panel. I find myself with a number of comments. I know we're supposed to do questions, but Commissioner Reinsch, who always reminds me that questions are supposed to be questions, earlier today did mostly comments. So I have a few comments that I want to make.

Dr. Friedman, you also talked about expectations--that the situation has been unfolding exactly as some of us expected and that's the concern. Over the course of the debate, the policy debates of the past ten or 15 years, there were a number of people who I think put expectations out there that weren't real in the first place, but they did it in order to get votes, and the votes happened in order to implement the policies.

Like Commissioner Fiedler, I would agree that the policy that we have, because it seems that some of what we're all trying to struggle

with is how do we balance national interests with a U.S. role in the world? How do we define our national interests, which this Commission has said in the past we don't have a policy architecture in place to balance the national interests?

I suppose I'm now, reflecting my own cynicism and my experience in the U.S.-China debate that the policy indeed for the most part has been driven by the monied interests of a handful of companies and a handful of congressional districts. There are some districts that have benefited enormously at the expense of other districts, so I think I disagree with some of your analysis of how people are responding to events as they're unfolding. I would have loved, as we went through the years of the MFN debate to not have things unfold the way that we predicted that they were, that they are actually unfolding.

It also seems to me that there is an elephant in the living room that nobody has mentioned today or yesterday, and it frequently goes unmentioned in our hearings, and that is one of the reasons that the rise of China is of such concern is the nature of the Chinese government, that it is not concerns about the future that we can have with the people of China, but it is the nature of the Chinese government itself, the authoritarian nature of the Chinese nature, that has created this framework that raises all of these questions.

Often we end up being put in a position of treating the Chinese government in negotiations or whatever as though they are some sort of fragile egg and we can't make demands because they'll break, which is just not true.

The question I would pull out of all of this, though, is the entire world system is based on this concept of a rules-based system, that there are international rules, international norms, international obligations, and the complaints that many of us have is that the Chinese government has not abided--you might call it whining--but has not abided by the commitments it has made.

Many of the concerns on human rights issues are it's not that we're talking about Jeffersonian democracy; we are talking about rights that the Chinese people have provided within China's own constitution that China is not abiding by. So there are starting points. It seems to me that if we say that there is no--we shouldn't be expecting the Chinese government to live by these commitments that it makes to its own people through the WTO, on nonproliferation, the Universal Declaration of Human Rights, what is the point of having those agreements in the first place?

So to pull a question out of it with not much time left is, is there a role for international rules, norms and obligations in this world, and what are we supposed to do when there is clearly a major and

important player who seems to be often more interested in changing those rules and obligations than abiding by them?

DR. WACHMAN: May I try an answer to that? First, my word was "carping." I think "whining" was in Professor Friedman's testimony.

CHAIRMAN BARTHOLOMEW: Complaining came out too.

DR. WACHMAN: Look at the rules and norms. Who establishes these? These, internationally, are established by who's in power. Let's not be naive. The rules and norms are established by who's in power. China has not been in power. Now it has more power. It is going to try to pull the tablecloth closer to its side of the table. It's going to try to adjust the rules. That's not because China is evil. It's because China has more power, and it has not, prior to this time, had the privilege. Now it will. So the rules may change, first of all.

Second of all, the expectations that we all said -- or some of us said -- would eventuate have eventuated. Well, yes, maybe. Maybe Jim Mann is correct. On the other hand, maybe we expected all of the good things to happen too quickly. Maybe we have not given it enough time. Maybe we have approached this with our time table instead of a realistic time table.

I mean, look at where we are. We're in 2007. Is China better or worse at protecting civil liberties, human rights, than ten years ago, 20 years ago, 30 years ago, 40 years ago? It takes time.

We may not have the patience. That's our problem. It doesn't *mean* that the approach *is* wrong. Maybe the approach is wrong. Maybe Jim Mann *is* right, but I think we need to have that discussion before we throw the baby out with the bath water.

On money, I wasn't suggesting that we don't spend, only that if we spend, we spend wisely.

CHAIRMAN BARTHOLOMEW: Dr. Friedman.

DR. FRIEDMAN: Hard questions. Important questions. If the Chinese Communist Party had its way, it would evolve into an authoritarian state such as Singapore. I think that's their goal. They're very well aware that lots of bad things happen inside of China that they too wish would go away. There is no will in the Chinese Communist Party leadership, however, to democratize.

On human rights, that leadership is very well aware that brutality and torture happen all over the country. They really would like those evils to end. The political system that keeps them in power, however, hasn't found a way to make those evils end.

So you're really right about the political system. The CCP leaders experience the very existence of so many democracies in the region--Japan, Taiwan, South Korea, Thailand, the Philippines, India,

Mongolia--as an inherent threat to their power and China's rise. They find the spread of democracy as a threat to their kind of system.

This authoritarian commitment does very much influence the CCP's foreign policy. The political system has an impact of a very serious kind on who their friends and who their enemies are. Their view of the world is that the United States is the leading subverter of authoritarian regimes. Therefore they look at the United States as the CCP's worst adversary because the number one goal of the group in powering China is to hold on to power. I think this is true of politicians everywhere by the way.

Their point of view, their most basic interests create both an anti-American and an anti-democratic perspective. This commitment gets complicated because China is the great winner in the global game which depends on ties with America. The CCP leaders have no desire to mess that up. They want to benefit from globalization. Indeed, they are winning in the economic game.

Why do we expect they're going to change a winning game? If they change it, it's going to come not because Americans scream and yell or complain. It's going to come for Chinese reasons. And there is a discussion in China of Chinese reasons. There are people in China who don't like Chinese dependency on foreign investment. They don't like dependency on foreign markets. They don't like foreign brand names all over China. The alternative to the dominant discourse is not a happier discourse for a peaceful and open world. But there are debates which go on in China about alternative futures.

Can I make one last comment?

CHAIRMAN BARTHOLOMEW: Yes.

DR. FRIEDMAN: There is one point where I disagree with my colleague, Dr. Hua. I do not see China as a closed monistic place. I think that all cultures have all the possibilities. Opposite possibilities are all real. "Look before you leap," versus "He who hesitates is lost." "Out of sight, out of mind," versus "Absence makes the heart grow fonder."

CHAIRMAN BARTHOLOMEW: Cognitive dissonance.

DR. FRIEDMAN: Chinese have a broad spectrum of possibilities. It was the greatest trading power in the world in pre-modern times. It was the most open society in the world in pre-modern times. At the Imperial Academy in Changan, half the students were international students. Today's CCP rulers are modern nationalists. They do understand how America works. They are not quaint people. They are modern nationalists. They understand modern power.

For pre-modern Chinese, Taiwan was a barbarian place full of cannibals which was never civilized for most of the history of the

Asian continent. It was not a civilized Chinese region.

China's CCP has rethought China's great power ambitions very pragmatically in terms of national interests. We should treat China as a great modern power and not give the CCP a free pass by explaining away bad behavior saying that's their culture.

CHAIRMAN BARTHOLOMEW: Dr. Hua, any brief comment?

DR. HUA: Yes. I have picked three points from Chairman Bartholomew's remarks. One is that this world is based on rule-based system. China has signed a whole bunch of documents, international documents, and I think as a nation China has signed the international document, it has to go by it. But, on the other hand, it takes some time for China to be able to do so. For instance, this is just one example of my own example. I published my first book in 1987. It was a translation of my professor's book; Professor Edwin Emery is a Professor of Communications, University of Minnesota. He taught me for two years in China, in Beijing. I translated his book into Chinese. Nobody knew there was such a thing as a copyright at that time.

He actually didn't make any money out of that, and he wrote the introduction for my book, and my book sold thousands of copies. So what I was trying to say is that things like copyright in China are a relatively new thing. On the one hand, I think if China has signed international document, China has to go by it. But on the other hand, it will probably take some time.

The second point is: What is the nature of the Chinese government? Certainly it's not a democracy. I basically agree with lots of China watchers by saying that the Chinese government currently is dominated by technocrats and they are not revolutionary ideologues. They are technocrats.

They themselves may not be democrats, but I don't think they are fundamentally opposed to the idea of democracy. That's my personal opinion, and that's why in China, most of the villages have multi-candidate elections nowadays. Why village level, why not at the top level? Because if there were top level elections, they themselves, their jobs are on the line. So at the base level, they can do it. So that's the second point.

The third one: Is the Chinese government fragile nowadays? And I think you are right in a sense that the Chinese government nowadays is different from the Chinese government in the 1980s and early 1990s. In the 1980s and early 1990s, it was more divided.

But now among the top leadership, I think there is a greater amount of consensus as to the general direction that China is moving.

Thank you.

CHAIRMAN BARTHOLOMEW: Thank you.

DR. WACHMAN: Is there time for one brief comment?

CHAIRMAN BARTHOLOMEW: We're about eight minutes over. I'll do one brief comment, and then Dr. Wachman, if you want to respond to Commissioner Houston's, I think there was a question that was still outstanding.

DR. WACHMAN: It was in response, yes.

CHAIRMAN BARTHOLOMEW: I do just want to point out another cognitive dissonance, as you were mentioning, and that is several of you have mentioned we need to expect things to go slowly, and yet over the course of the past two days, we have heard people talk about China's rapid militarization, China's rapid economic growth.

There are things moving very quickly in China. I think it's one of the challenges to our trade system and to everything else that it's moving much faster than anybody expected, and yet there is this inconsistency of saying we need to expect other things to go slowly. That's it.

Dr. Wachman.

DR. WACHMAN: Thank you. I don't recall precisely your words, Commissioner Houston, but if I understood, you were looking for some way of embodying our national interests toward China, and I want to build on something that Professor Hua Shiping said.

There was a time, not so long ago, that this nation was a land of both economic opportunity and hope for the individual. China is now competing with us as a land of opportunity. Even Americans, American enterprises, find opportunity in China.

China is *not* competing with us as a land of hope, but we, we the Americans, have allowed our role as a land of hope to be tarnished, and I say this understanding that this goes well beyond the purview of this Commission, but frankly, our relationship to China can't be completely separated from our relationship to the rest of world politics, and I think if we are to compete with China, the best avenue for the United States is to restore ourselves as a beacon for hope, and that means adopting many of the suggestions that Professor Hua Shiping was alluding to, having to do with those values that we still see as animating our national character.

We don't do that as well as we could, and I think that is an area where China will not compete with us, and that has feedback in terms of our relations not just with China but with other states in Asia and elsewhere.

CHAIRMAN BARTHOLOMEW: I think that this is a debate that could go on significantly. Our next panelist is here. Thank you all very much for a very thoughtful discussion. We look forward to further contact with you.

[Whereupon, a short break was taken.]

PANEL VII: ADMINISTRATION PERSPECTIVES

CHAIRMAN BARTHOLOMEW: We are pleased to welcome Acting Deputy Assistant Secretary of State for East Asian and Pacific Affairs. He is also the Director of the Office of Chinese and Mongolian Affairs. We need to get his business card to see how they managed to fit all of those words. John J. Norris.

Mr. Norris is a Senior Foreign Service Officer. Prior to assuming this position, he served on the Pentagon as Foreign Policy Advisor to the Commandant of the Marine Corps.

Thank you for coming on such short notice. As we mentioned earlier, Mr. Christensen is still out in the region tending to pressing issues. I do want to mention again, you were originally supposed to be on a panel with someone from the Department of Treasury. They called us late yesterday afternoon and withdrew from the hearing.

We're not sure whether we will or not be getting any written testimony from them. While we're pleased to see you, we're nonetheless disappointed that Treasury isn't participating, but thank you for joining us today. We very much look forward to your remarks.

STATEMENT OF JOHN NORRIS
ACTING DEPUTY ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, D.C.
REPRESENTING THOMAS J. CHRISTENSEN, DEPUTY ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS

MR. NORRIS: Thank you very much, Chairman Bartholomew and Commissioners. It's a privilege for me to be here before you and thank you for this opportunity to discuss the U.S.-China relationship. We appreciate the work of the Commission and the importance that you attach to this key relationship that we have in the world.

As you mentioned, Tom Christensen is unable to be here. He sends his regards and also his regrets that he can't testify. He was in Mongolia celebrating the 20th anniversary of establishment of our diplomatic relations with that country and having our annual consultations with them on key issues, and with the start of the Six Party Talks next week; it was decided for him to stay on in the region.

But he has prepared a written statement and we're submitting that for the record, and I would just like to briefly summarize some of the

key points in the statement.

The Commission is well aware of the overall approach taken by this administration in its interactions with China. In fact, the notion of China as a responsible stakeholder in the global system was the central focus of Dr. Christensen's August testimony.

Our vision continues to be of a China that is more open, transparent and democratic, a China that will join us in actions that strengthen a global system that has provided peace, security and prosperity to America, China and the rest of the world.

I'd like to reiterate, as Dr. Christensen did in August, that the U.S. does not maintain that China is currently the responsible stakeholder that we envisioned, but rather that U.S. policy should focus on urging China in that direction.

We don't simply assume that China will choose a benign path. Rather, our policy aims to help shape China's choices. We are prepared to work with China in positive ways to advance our common interests. We are also prepared to respond appropriately should China choose another direction.

We are committed to maintaining a strong presence in Asia and view our regional alliances as essential to peace, security and prosperity of the region.

The written testimony goes into some detail about the various institutional mechanisms, both bilateral and multilateral, that we use to engage China. You'll let me highlight the statement that Ambassador Negroponte made during his Tuesday confirmation hearings, in which he noted his intention to continue the Senior Dialogue at the deputy secretary level, should he be confirmed.

As you know, the Senior Dialogue together with the Strategic Economic Dialogue led by Secretary Paulson is one of our government's most important opportunities for broad policy engagement with China.

After former Deputy Secretary Zoellick chaired the U.S. two meetings of the Dialogue in 2005, Under Secretary Burns continued the Dialogue with the Chinese in November of last year, showing the administration's commitment to remain engaged with China frequently and at high levels on the broad range of issues that confront us.

Let me now touch on a few of those issues. China continues to play a constructive role on North Korea hosting the Six Party Talks, helping broker the September 2005 Joint Statement, supporting strong measures in the United Nations, and urging Pyongyang to return to the negotiating table. We look forward to the Six Party Talks resuming next week.

In the case of Iran, China joined the U.S. in condemning Tehran's

nuclear activities by voting for U.N. Security Council Resolution 1696 and 1737. We will look to Beijing to support our efforts to significantly increase pressure on the Iranian regime should it remain intransigent. And there remain significant areas of concern such as reports that Chinese companies continue to negotiate on deals to help develop Iran's gas fields.

We have told Beijing that these types of investments along with continued arms sales would send the wrong signal to the Iranian regime and could raise serious concerns under U.S. law.

China's approach to the Darfur crisis has long been a difficult area in U.S.-China relations, but we have seen some positive movement in China's policy as evidenced in Special Envoy to Sudan Andrew Natsios' recent trip to Beijing.

China, for example, has given public support to a strong U.N. force in Darfur. President Hu Jintao is currently in Sudan and is having important meetings there. The world will be watching what comes out of those discussions.

Overall, we believe we've had some success in encouraging China to play a positive role in a number of key international and regional security issues, but the record remains mixed as the Chinese veto of the January 12th U.N. Security Council Resolution on Burma suggests.

On the economic side as well, we see progress as well as many challenges. For example, since China's 2001 WTO entry, U.S. exports to China have grown nearly five times faster than our exports to the rest of the world.

However, as this Commission well knows, there remain substantial imbalances in our economic relations. It is a top priority of the Administration to address these including our growing trade deficit. We have a number of concerns with China's trade, investment and currency policies that contribute to bilateral and global economic imbalances.

China's record in implementing its WTO commitments is mixed and American firms are disadvantaged in various ways including by China's terribly insufficient protection of intellectual property rights. To manage the U.S. economic relationship on a long-term basis, President Hu and President Bush agreed to raise our economic dialogue by establishing the Strategic Economic Dialogue.

Secretary Paulson is leading an interagency effort to engage China broadly to discuss the entire range of our economic relations and how our respective policies impact the global economy as a whole. We will continue to seek resolutions to our concerns through bilateral dialogue with China, but we will not hesitate to use tools such as WTO

dispute settlement when dialogue fails.

Before I conclude, I would like to mention a few important areas in which China and the U.S. continue to have real differences. We continue to be concerned with China's program of military modernization and its lack of transparency, particularly when it comes to the build up of forces across the Taiwan Strait.

China's recent tests of an anti-satellite weapon is a disturbing development and we have stressed that China should respond to international calls for a full explanation of this test and China's intentions including how China's development of this weapon squares with its claims to be opposed to the militarization of space?

Nonproliferation is an area in which the Chinese profess to share common objectives with us. Yet, we continue to have a mixed record with China in cooperating to stem the proliferation of weapons, especially those related to missile technology and weapons of mass destruction. And we continue to have substantial differences when it comes to human rights and religious freedom as our more detailed written testimony makes clear.

In conclusion, let me again state that the administration remains committed to engaging in China on an enormously wide range of issues and a variety of high level dialogues, both bilaterally and multilaterally, to advance U.S. interests and encourage China to join us in taking responsibility to build and strengthen the global system.

Throughout our engagement, our message is consistent: it's in the interests of China, the U.S., the East Asia region and the world for China to succeed and play a constructive role in the global system. We must continue to build on the foundations of cooperation that we have established, broadening and deepening them while engaging China in a frank and direct manner about those areas in which we believe China's policy or behavior is undercutting our common objectives for peace, security and prosperity in the region and the world.

I remain both realistic and optimistic about U.S.-China relations and look forward to continuing our work to encourage China down the path of becoming a truly responsible global stakeholder. Now I'd be pleased to take your questions.

[The statement follows:]

Prepared Statement of Thomas J. Christensen
Deputy Assistant Secretary of State for East Asian and Pacific Affairs, Department of State, Washington, D.C.

Chairman Bartholomew, Vice Chairman Blumenthal, Commissioners, thank you for inviting me again to

discuss with you the extremely important topic of U.S.-China relations.

When I was before this Commission last August, I discussed the notion of China as a responsible stakeholder in the global system. Importantly, as I emphasized last August, our view is not that China currently *is* the responsible stakeholder we envision, but rather that U.S. policy should focus on urging China in that direction. Our vision is a China that is more open, transparent, and democratic, and a China that will join us in actions that strengthen and support a global system that has provided peace, security, and prosperity to America, China, and the rest of the world. Encouraging China to move in that direction continues to be the foundation of our policy; the question, as this Commission has correctly pointed out, is how we can most effectively do that.

Today I will address that question and provide an update on our diplomatic efforts to that end. We have made real progress in some areas, but much work remains to be done. We continue to work closely with China, engaging on an extremely broad range of issues, cooperating on issues in which we can find common ground, but also discussing in a frank and candid manner the issues on which we do not see eye-to-eye. In those areas in which we differ, we encourage China to understand our concerns and change its behavior in ways that will advance not only our interests, but also its own. The tone of our discussions with China is consistent and firm and based on what we know to be true: that the changes we encourage China to undertake—internationally and domestically—will benefit China as a nation and a member of the global community. U.S.-China relations are far from a zero-sum game. A strong U.S. regional presence combined with constructive and candid diplomatic engagement should serve to deepen areas of cooperation and reduce the likelihood of backsliding in the relationship.

It is important to point out at the outset what may seem obvious: China is an incredibly dynamic society, undergoing change at a breakneck pace. We are not faced with a choice between engaging with China or excluding it from the international system; China is already an integral part of the system, and China's rise is now influencing that system in myriad ways. We encourage China to use its growing influence proactively to help solve international problems that challenge the international community. As President Bush said when he welcomed Chinese President Hu to Washington in April 2006 last year, the U.S. welcomes the emergence of a China that is peaceful and prosperous and that actively participates in and contributes to international institutions.

We see many ways in which China's success can make important positive contributions to the global system. At the same time, China must decide whether or not it will use its rising influence to help bolster the global system and promote peace and security. U.S. policy does not simply assume that China will choose a benign path, but aims to help shape China's choices. We are prepared to work with China in positive ways to advance our common interests, but we are also prepared to respond appropriately, should China choose another path. Our continuing strong presence in Asia and our strong regional alliances make clear that the U.S. maintains critical interests in the peace, security, and prosperity of the region. Our policy on China is designed to encourage China to join us in support of those objectives, both in the region and around the globe. In this regard, our positive diplomatic agenda with China and our strong regional presence are not in contradiction with each other, as they are often portrayed. Both provide strong incentives for China to adopt cooperative strategies that will benefit China, the region, and the world.

Allow me to offer some examples of our engagement with China and evidence of concrete progress in recent months.

Along with the Strategic Economic Dialogue, led by Secretary Paulson, one of our government's most important opportunities for broader policy engagement with China is the Senior Dialogue. The Senior Dialogue was established on the basis of a commitment made in 2004 between President Bush and President Hu to develop a regular forum to discuss "big picture" strategic issues. It is not primarily

intended to address bilateral issues, but rather to provide a forum in which the U.S. and China can discuss how our respective policies, particularly on political and security issues, can help shape the global system on which we and many other countries depend. We have held three rounds of the Senior Dialogue, with Under Secretary Burns co-chairing the most recent meeting last November in Beijing. The State Department is committed to continuing this useful forum, which allows both sides not only to discuss the pressing issues of the day, but also to take a longer look at where our relations are headed five to 20 years down the road and what that could mean for the global system and our respective interests. In the meeting in November, Under Secretary Burns and his counterpart, Vice Foreign Minister Yang Jiechi, had fruitful talks that covered a range of key global issues, including North Korea, Iran, Darfur, Burma, APEC, and UN reform. Allow me to touch on a few of these issues in more detail.

North Korea. Last year saw a number of provocative actions by the DPRK that threaten international security, including missile tests in July and the test of a nuclear device in October. In an unprecedented fashion, China joined with the United States and the rest of the international community to condemn the nuclear test, voting in favor of UN Security Council Resolutions 1695 and 1718, which impose sanctions against North Korea. China's actions to express its concerns over North Korea's nuclear activities demonstrate that its patience with its erstwhile ally has worn thin. We expect that China will continue to implement the requirements under these Security Council resolutions until North Korea comes into full compliance with its obligations. Many Chinese elites increasingly say that they see North Korea as we do: a destabilizing actor that potentially threatens the region and the world. The resumption of Six-Party Talks in December was a positive step, and we look forward to the next round of talks this month. The Chinese have played a very positive role in the Six-Party process, hosting the talks, helping draft the September 19, 2005 Joint Statement, supporting strong measures in the United Nations, and urging Pyongyang to return to the negotiating table. It is imperative that China continue its efforts in this process. The Administration is committed to continuing to work closely with the Chinese to find ways to persuade North Korea to abandon completely, irreversibly, and verifiably its nuclear weapons program; adopt more responsible behavior; and implement the Joint Statement. Of course, we will not be satisfied until we achieve these goals.

Iran. As in the case of the DPRK, it is vital that the international community join together to send a clear and unequivocal message to Iran that it must comply with its nuclear obligations. China says that it shares our assessment that Iran must not obtain nuclear weapons capability. As one of the Permanent Five (P5) members of the UN Security Council (UNSC), China joined the United States in condemning Iran's nuclear activities by voting for UN Security Council Resolution 1696 in July 2006. In December 2006, China joined the UNSC's unanimous vote in favor of UNSCR 1737, which imposed sanctions under Article 41, Chapter VII on Iran's nuclear and missile programs. This support represents an important step for China and the international community. And in the face of continued Iranian noncompliance, we hope that Beijing will support our efforts to significantly increase pressure on the Iranian regime through financial measures, increasing efforts to block transit of proliferation sensitive materials between Iran and North Korea, and ceasing its unhelpful weapons sales to Tehran. We are particularly concerned over reports that China is moving forward with investments in Iran's gas fields. As we have clearly conveyed to Beijing, we believe these types of investments, along with continued arms sales, send the wrong signal to the Iranian regime and raise concerns under U.S. law.

Sudan. China's approach to the Darfur crisis has been a difficult area in U.S.-China relations. Recently, however, even here we have seen some positive movement in China's policy. While China abstained on UNSCR 1706, it has given public support to building a strong UN force in Darfur and has endorsed Kofi Annan's three-phase program. By all accounts, China's Ambassador to the UN played an important role in helping broker the accord signed in Addis Ababa. We now look to China to assist in persuading Khartoum to implement that accord promptly and effectively. Chinese leaders have shown an increasing willingness to engage with the international community to find a way to end the terrible violence in Darfur, a position that high-level officials reaffirmed to our Special Envoy to Sudan Andrew Natsios during his recent trip to

Beijing. There are recent precedents for constructive Chinese activism. For example, China currently has over 400 personnel in the United Nations Mission in Sudan, and they are doing important work in policing the North-South peace accords there. We would encourage Beijing to make a similar commitment to the UN force in Darfur.

Burma. We were naturally disappointed that China, along with Russia, vetoed the January 12 Security Council resolution on Burma; the resolution had the support of nine countries, and China was in the minority. It is worth noting, however, that in explaining its veto, China explicitly recognized the "quite serious" problems that exist in Burma and called on the regime to undertake an inclusive dialogue and reforms. This statement was considerably more direct than China's previous public statements on Burma, and we are hopeful that it signals a change in China's view on which we can build further cooperation to address the unacceptable behavior of the Burmese regime.

Lebanon. Last summer, we worked closely with China and other members of the Security Council to achieve a peace agreement in Lebanon. China did more than support such a peace agreement in diplomatic terms, it sent forces there as part of the United Nations Interim Force in Lebanon to help keep the peace. China announced recently that it will increase its peacekeeping troops to 335 this month, up from the previous level of 225. China also participated in the January 25 Paris international aid conference on Lebanon, announcing its donation of approximately $16.6 million in assistance to Lebanon. China could play a valuable role in the region, and we would welcome its positive engagement. At the same time, we have expressed our deep concerns about China's continuing arms sales to Syria and reports that a missile Hezbollah used to attack an Israeli navy ship last summer was a Chinese model. We continue to remind all states of their obligations to abide by the embargo on the sale of weapons to unauthorized groups in Lebanon, established by UNSCR 1701.

Military Developments. We continue to be concerned with China's program of military modernization and its lack of transparency, particularly when it comes to the buildup of forces across the Taiwan Strait. China has made large increases in defense spending in recent years and is developing increasingly sophisticated systems. The lack of transparency on the pace, scope, and direction of China's military modernization will continue to be of concern to us and to China's neighbors. China's successful test of an anti-satellite weapon in January is a disturbing development in China's military modernization. While China subsequently insisted that its test was not directed at nor a threat to any other country, China should respond to international calls for a full explanation of the test and China's intentions, including how China's development of anti-satellite weapons squares with its claims to be opposed to the militarization of space.

In keeping with President Bush's and President Hu's commitment to enhance bilateral military ties, we are encouraging China to be more forthcoming about its military budget, doctrine, and strategy in order to build confidence and improve the U.S.-China military relationship. We seek engagement with China's military to better understand China's doctrine and strategic goals. We have been attempting to schedule a meeting between the military commanders of the PLA's Second Artillery and the United States Strategic Command as agreed to by President Bush and President Hu during their April 2006 Summit in Washington. We urge China to agree to such a meeting at an early date.

We remain deeply concerned about the growing arsenal of missiles and other military systems arrayed against Taiwan, and note Beijing's refusal to renounce the use of force against Taiwan. We respond to those increases in accordance with our obligations under the Taiwan Relations Act and speak frankly to Beijing about our strong interests in a secure Taiwan and our insistence that cross-Strait differences be resolved peacefully in a manner that is acceptable to people on both sides of the Taiwan Strait. We continue to press Beijing to reduce those threats and to increase cross-Strait dialogue, including direct talks with Taiwan's duly elected leaders.

Non-Proliferation. This is an area in which the U.S. and China should have common objectives and strong cooperation. Yet, we have a mixed record with China in cooperating to stem the proliferation of weapons, especially those related to missile technology and weapons of mass destruction. I believe China's awareness and understanding of the importance of this issue at the strategic level is growing, but it needs to do much more to rein in the proliferation activities of its own companies. The United States will continue to make clear to China that failure to stem such proliferation activities threatens China's security, just as it threatens global security, and we expect China to do more to enforce international nonproliferation standards. We believe that China's experience in working in the UN Security Council on the issues of North Korean and Iranian missile and nuclear programs is doing much to raise China's awareness of the importance of working with us on these issues – and as I stated earlier, China's cooperation in the UN has been important as we attempt to resolve these crises.

Economic Relations. I'd like to shift focus now to talk a little bit about the economic aspects of our relationship. I will not go into great detail, since others will testify on these issues. I will say that we continue to have a number of concerns, not least of which is our growing trade deficit. We continue to raise economic imbalances with China in multiple venues. It is important to point out that since China's 2001 WTO entry, U.S. exports to China have grown nearly five times faster than have our exports to the rest of the world. The value of U.S. exports to China in 2006 was $50 billion as of November – almost triple what they were in 2001 – and we expect this growth in our exports to continue. Here is a clear example of the benefits of diplomatic engagement with China. It is also an example of what is good for the United States is also good for China. China's engagement with the global economy has raised tens of millions of its citizens out of abject poverty, has opened China's economy to quality U.S. products and services, has helped educate and inspire a generation of Chinese entrepreneurs, engineers, and officials, and has contributed to keeping inflation low in the U.S. by lowering prices on a wide range of consumer goods and inputs to U.S. production.

However, there remain substantial imbalances in our economic relations, and it is a top priority of the Administration to address these. We continue to have a number of concerns with China's trade, investment, and currency policies that contribute to bilateral and global economic imbalances. China's record in implementing its WTO commitments is mixed, and American firms, particularly in the services sector, are disadvantaged in various ways, including by China's terribly insufficient protection of intellectual property rights. We will continue to seek cooperative and pragmatic resolutions to our concerns through bilateral dialogue with China, but we will not hesitate to use WTO dispute settlement when dialogue fails. As Secretary Paulson pointed out in Beijing, we utilize trade dispute settlement mechanisms with our closest allies and trading partners. This is not a sign of hostility toward the country in question. In fact, it is often a sign of the deepening of the overall economic relationship between the United States and its trade partners. Moreover, resolving disputes by opening trade further is clearly in the long-term interests of not only the United States, but also its trade partners.

Strategic Economic Dialogue. Recognizing the growing relationship between the U.S. and Chinese economies, President Bush and President Hu agreed to raise our economic dialogue to an unprecedented level with the Strategic Economic Dialogue (SED). Treasury Secretary Paulson is leading an interagency effort to engage China broadly to discuss the entire range of our economic relations and how our respective policies impact the global economy as a whole. China faces enormous challenges as a result of its rapid economic growth, including a widening gap between its urban and rural areas, a lack of access to quality health care and education, and environmental degradation. The SED's essential goal is to ensure that our growing economic relationship with China results in strong growth and prosperity for both countries. We want greater opportunities for American business and to encourage China's continued integration in the global economy. We are working in the SED as well to address the needs of China's population and to ensure that economic growth does not continue to harm the environment. The first session of the SED was

held in December in Beijing, with seven Cabinet-level officials from Washington engaging their Chinese counterparts, led by Vice Premier Wu Yi, in discussing a broad array of economic issues. I had the privilege of joining Assistant Secretary of State Dan Sullivan at the first round of the dialogue, which included discussions on the importance of establishing open and competitive markets, cooperation on energy security, energy efficiency, and furthering our understanding of the environmental and health impacts of different energy practices.

NDRC-State Dialogue. Complementing the SED, as well as the USTR/Commerce-led Joint Commission on Commerce and Trade (JCCT) and Treasury-led Joint Economic Committee (JEC), the State Department continues to lead our ongoing dialogue with China's National Development and Reform Commission (NDRC). In December, I participated in the latest round of this dialogue, which was chaired on the U.S. side by Under Secretary for Economic Affairs Josette Sheeran. The NDRC, as the former central planning commission of the Chinese government, has a critical role to play in the ongoing reform of the Chinese domestic economy. Our annual dialogue with NDRC is a forum in which we can present our experience and understanding of the importance of open and competitive markets and suggest ways in which China can address some of the imbalances in its domestic economy. One of the most important issues we discussed in December, for example, was China's need to develop a sustainable social safety net, particularly in the rural economy. The lack of reliable health care or pensions encourages over-savings and under-consumption, contributing to China's reliance on export-led as opposed to demand-driven growth. Reform in this area thus will not only improve China's own economic stability and sustainability, but also will help address many of our broader systemic concerns with the trade deficit and other imbalances.

Global Issues Forum. We also engage China actively on a wide range of global issues outside the traditional security and economic framework. In our Global Issues Forum (GIF) with China, which meets once a year, most recently in August 2006 in Beijing, a U.S. delegation led by Under Secretary of State for Democracy and Global Affairs, Paula Dobriansky, discussed with China energy security and clean energy, public health, humanitarian assistance, trafficking-in-persons, environmental conservation and sustainable development, and international development cooperation.

Other Dialogues. In December, in an expression of China's increased willingness to engage with the U.S. and international community, the NDRC organized and hosted a Five-Party Ministerial on Energy in Beijing, coinciding with the SED. It brought together the five largest energy consumers in the region – China, India, Japan, South Korea, and the United States – and provided a template for future energy cooperation. In the ministerial, we discussed energy investment concerns, energy conservation and efficiency initiatives, the development of alternative energies and utilization of clean and efficient energy technologies, and the establishment of oil reserves. In the Asia Pacific Partnership on Clean Development (APP), we are engaging China on a variety of fronts, including energy-efficient buildings and appliances, clean processing of fossil fuels, and the reduction of barriers to renewable and energy-efficient technologies. The APP brings together government, industry, NGOs and businesses to promote clean development in the participating countries.

Human Rights and Religious Freedom. As I mentioned at the opening of my remarks, while we continue to make progress in the areas in which we can work with China, we acknowledge that there are areas where we will continue to have strong disagreements. We will not hesitate to protect our interests, promote humanitarian values, and urge China to bring its human rights practices into compliance with international standards. We are very concerned about recent negative developments in key human rights areas, including Chinese efforts to step up the monitoring, harassment, intimidation, and arrest of journalists, Internet writers, defense lawyers, religious and social activists, and human rights defenders seeking to exercise their rights under Chinese and international law. We will continue to use every opportunity not only to raise issues of concern and individual cases of political prisoners, but also to support through our rule of law and civil society programming China's efforts to engage in systemic reform. This is particularly true as the

2008 Olympics approaches. China cannot be considered a fully responsible stakeholder and leader in the international system until it develops a more open, transparent, and free society, unleashing the innovation and creativity of its own people. China's controls on press freedom and Internet traffic and its restrictions of fundamental human rights violate international human rights instruments and, to return to my main theme here, are detrimental to China's own progress. As long as China limits its people, it limits its rise to full potential. In addition to the clear domestic benefits of a more open domestic system based on the rule of law, there are clear international benefits for China. Much has been said and written about China's "peaceful rise." Without a more open, transparent, and, therefore, predictable political environment, it will be more difficult for China to gain and maintain the internal stability and the trust among its neighbors necessary to achieve a smooth transition toward great power status.

Conclusion. As should be clear, we are engaging with China on an enormously wide range of issues in a variety of high-level dialogues, both bilaterally and multilaterally, to advance U.S. interests and encourage China to join us in taking responsibility to build and strengthen the global system. Throughout our engagement, our message is consistent: it is in the interest of China, the United States, the East Asia region, and the world for China to succeed and play a constructive role in the global system. China is a major stakeholder in that system, from which it has and continues to enjoy enormous benefit.

We must continue to build on the foundations of cooperation that we have established, broadening and deepening them, while engaging China in a frank and direct manner about those areas in which we believe China's policy or behavior is undercutting our common objectives of peace, security, and prosperity in the region and the world. I remain both realistic and optimistic about U.S.-China relations and look forward to continuing our work to encourage China down the path of becoming a truly responsible global stakeholder.

I would be pleased to take your questions.

Panel VII: Discussion, Questions and Answers

CHAIRMAN BARTHOLOMEW: Thank you, Mr. Norris, and thank you very much for your service to the nation through your distinguished career. We'll start with Commissioner Videnieks.

COMMISSIONER VIDENIEKS: Good morning. Still is. I have a brief question. I looked at the prepared testimony and it doesn't say anything there about Central Asia. Could you please briefly describe the bilateral relationship and the drivers for each country in Central Asia? For example, separatism, Global War Against Terrorism, how do these—also extremism—affect the U.S.-PRC relationship?

MR. NORRIS: Sure. On the issue of Central Asia, maybe I could just start by noting that under the Senior Dialogue that I mentioned that has been led at the Deputy Secretary level on our side and which Under Secretary Burns conducted a third round, underneath that, we have detailed discussions with China on regional issues and South and Central Asia is one of those areas.

Our Assistant Secretary for South and Central Asia, Richard Boucher, went to Beijing last August and met with his counterpart and had detailed discussions on this matter, and so it's an area that is very much a bilateral focus for us.

Obviously, for us, Central Asia is a key region, particularly in the area developing our relations with those countries on their own merits, but also developing our energy and other relations with them, and in the Global War on Terrorism, they are key to supporting the effort, for example, in Afghanistan.

For China, China also attaches great importance to the region. For them, energy is a key focus, and they have joined together with countries in the region and Russia to form the Shanghai Cooperation Organization. So we maintain contact with them to understand the purposes of the SCO, and through our dialogue at the assistant secretary level, better understand what their policies are in that region.

COMMISSIONER VIDENIEKS: A quick follow-up. What are our interests, U.S. interests, in Central Asia? What is our footprint there? What kind of people do we have there? For example, military and commercial interests?

MR. NORRIS: We have, I think, very strong interests in those states both in terms of the Global War on Terrorism, the proximity to Afghanistan, as I mentioned. Several of those countries are energy producing states and so we have a strong commercial interest and good ties with them pursuing our interests there. We have representation, diplomatic representation, in all of those states.

They were part of the former Soviet Union and after the breakup of the Soviet Union, we established diplomatic ties and made a conscious decision to set up embassies in each of these newly independent states.

COMMISSIONER VIDENIEKS: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you for being here this morning. I appreciate your testimony. I would like to ask your thoughts on the question of how we approach many of what have become divisive issues, economics clearly being a major part of that, as we look at the Joint Dialogues?

You mentioned the willingness to file WTO cases if, in fact, that becomes necessary. It appears that both our administration as well as the Chinese viewed those kind of activities as hostile acts rather than part of the normal implementation process of trade agreements, et cetera, and almost as part of the normal rule of law process that we've been having trouble with China overall, intellectual property, et cetera, that the adjudication of disputes is better left to those kind of bodies rather than what we're facing now, which is sometimes political hysteria on both sides about the actions we're taking.

Can you speak for a moment about how we are viewing those acts rather than having them, again, be viewed as sort of an act to be

rejected or withheld until the last possible moment rather than really just part of an implementation process?

MR. NORRIS: Sure. I think obviously we would prefer to use dialogue to resolve issues. I think that's everyone's first choice in addressing problems when they occur and serious problems, some of the serious problems we have with China in the economic area. That's why we set up the Strategic Economic Dialogue in part because we want the SED by bringing together the top decision-makers and policymakers on each side to provide better understanding of the directions of both countries and that through this better understanding, generating momentum for the existing mechanisms that we have to deal with our bilateral trade relationships such as the Joint Commission on Commerce and Trade that's led by Commerce and USTR to work on issues like market access and IPR protection.

But so that's certainly our preferred course, and so we're hopeful that this SED will generate this kind of momentum, but we certainly don't rule out the use of WTO dispute settlement. In fact, we consider that part of the toolkit that we have available if we have to go that route, and actually the dispute settlement mechanism, filing WTO cases, is something that we do with other countries that we have very close economic relations with. So I don't think that we're making an exception for China.

As our economic relationship grows stronger, we'll probably see more of this where we may have to go that route.

COMMISSIONER WESSEL: I appreciate that, and clearly dialogue and consultation has to be the goal. The problem with the length of some of these talks is it raises expectations and also fuels the impatience that as we saw with the semiconductor case that was filed by the U.S. against China, that resolved in a very quick resolution, that we have to find a way of minimizing the hostile nature, if you will, of these WTO actions and view them as much more of again a rule of law approach if we're going to try and get some resolution.

I think it's something that needs to be looked at as an earlier tool rather than the last arrow in the quiver.

MR. NORRIS: Thank you very much.

COMMISSIONER WESSEL: Thank you.

CHAIRMAN BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: Yesterday, we heard testimony from Assistant Secretary Lawless at the Defense Department. This morning, although we've been occupied by the hearing, I heard on the radio, but only vaguely, that the United States announced--and I don't know who--that we would not have cooperation with China on manned satellite programs.

COMMISSIONER WESSEL: Space.

COMMISSIONER FIEDLER: Space programs. Could you as a matter of information walk us through the chronology of the diplomatic back and forth between the United States and China in the intermediate aftermath of the ASAT shot?

MR. NORRIS: Right.

COMMISSIONER FIEDLER: So that we have sort of a full deck to understand the diplomatic action or inaction that took place.

MR. NORRIS: Immediately after we detected the test, we went to the Chinese government in Beijing and actually in Washington also to tell them that we had detected the test and to ask for an explanation. We raised concerns on two levels. In the strategic sense, trying to understand what China was trying to accomplish by conducting a test of this nature? How that squared with their professed support for peaceful uses of space and opposition to weaponization of space?

And how that also squared with the desire expressed by our two presidents to cooperate in the area of civilian in space endeavors. And we also raised operational concerns, the creation of the debris field and its possible impact on satellites, the increased risk to satellites but also to human space flight.

So we raised those, as I mentioned, concerns directly in Beijing and Washington. The Chinese at a later time responded.

COMMISSIONER FIEDLER: How long after?

MR. NORRIS: Well, it was about ten days, I believe. The Chinese responded that, confirmed that a test had taken place, and they said that it was not aimed at any country and not a threat to any country, and that they reiterated their position for peaceful use of space and against weaponization of space.

But we don't, while they made these reassurances, they didn't answer our questions about their intentions. And so that we continue to pursue those through diplomatic channels with them.

As far as the actual cooperation with China in the area of civilian in space, my understanding is that it's extremely limited. I believe the Chinese administrator, space administrator, was here within the last year or so, and our NASA administrator went to China in September for just sort of discussions, similar to what we have with other countries. But it was just very much at the discussion level and certainly we're taking a look at evaluating what we should do in the civilian and space area as a result of the ASAT test.

COMMISSIONER FIEDLER: Just one quick follow-up. How do we view the ten-day lapse?

MR. NORRIS: Well, I think we would have thought that the Chinese should have gotten back to us sooner, and as I said, we remain

unsatisfied with the response that we've gotten to date, and we will continue to pursue it with the Chinese.

COMMISSIONER FIEDLER: Do we have an understanding or do we have any educated speculation about why it took ten days?

MR. NORRIS: I don't know. I think we're looking, still looking for the Chinese to explain and so I think that's the--I would emphasize that this is not a U.S.-China relation--not a U.S.-China issue. It's an issue that affects the international community and that many countries have raised this with China through diplomatic channels, and the countries have spoken out publicly to express their concerns.

So I think it's something that China needs to explain, not just to us, but to the international community.

CHAIRMAN BARTHOLOMEW: Commissioner Houston.

COMMISSIONER HOUSTON: Thank you so much, Mr. Norris. I have a question that really goes to your opinion on this more than anything else.

You mentioned that China was marginally improving on issues that concern us, like Iran, Sudan and North Korea. Of course, in Iran and Sudan, they're worried about oil, and in North Korea, they don't want the neighborhood to set his house on fire and his kids come live in China. So they're very concerned about that leaching over the border if anything bad happened in North Korea.

So my question is whenever you are searching for a greater understanding of someone that you have some fear or some adversarial position, you always want to understand their motivation. So when you look at these marginal improvements that you mentioned and you look at their motivation, in your opinion, how much of that is driven by purely their self-interests versus concern for their position in the rest of the world and/or concern for their position with the United States?

MR. NORRIS: I think certainly one of the points that we've been making to the Chinese is that they do have to look to the bigger picture and to the longer term and considering their own interests. So I think China acts in its own interests and they have a very evident interest in maintaining a good relationship with the United States because I think the U.S. is so important to China for a variety of reasons including their own economic development, which I think is their primary motivation.

So I think that factors into their considerations. I think they also, as an energy importing country, they also have to consider the impact of a nuclear-armed Iran in the Middle East. I certainly don't think that that's in China's interests. I think China has an interest in a stable Persian Gulf, and so I think that if they have an interest in

seeing Iran not go down that path, just as we do.

They do have obviously a need for energy and other resources so that's another important factor in explaining their foreign policy and I think explaining their interest in developing relations with countries in Africa. It's become a new area of emphasis for China and certainly Africa's source as a supplier of natural resources including energy, oil and gas, is certainly an important factor.

CHAIRMAN BARTHOLOMEW: Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Madam Chairman, and thank you for coming and testifying today, Mr. Norris. I'm sorry that the Treasury Department witness got ill this morning and you have to answer all the questions. So you're doing pretty well.

MR. NORRIS: Thank you.

COMMISSIONER D'AMATO: I have a question on the dialogue dealing with energy and particularly with regard to the question of climate change. We have here an Asia Pacific Partnership on Clean Development and in the layout of the variety of fronts that are being discussed in that partnership, a number of those issues are certainly alternative energy issues, also climate change issues, such as reduction of barriers to renewable and energy efficient technologies, efficient buildings and appliances.

The terrain is shifting very rapidly in terms of climate change. There's substantial movement in the business community, substantial movement politically in Washington, and even substantial movement scientifically with the new report today from the U.N., a periodic report.

The president, of course, mentioned it in his State of the Union address, and as I understand the administration's policy on climate change, it's not so much to have mandatory cap and trade systems and so on, but certainly have international partnerships and technology sharing.

Certainly, we would be interested in whatever you can get us for the record of what's going on in terms of a dialogue with China on developing partnerships and what technologies and what kinds of future planning there may be. The Kyoto Treaty I think lapses in 2012, so we're talking about a post-Kyoto agreement of some kind that's going to be discussed fairly shortly in terms of where we're going on this.

Can you tell us what you know about the dialogue with China on climate change and also get back to us for the record in terms of what the Department knows?

MR. NORRIS: Sure. I'd be happy to do that. Get something back to you for the record. In just general terms, we're pursuing the

question of energy in a variety of venues. Energy and environment, certainly that's one of the key topics in the Strategic Economic Dialogue that Secretary Paulson is leading. This issue cuts across many different areas. Obviously, it doesn't fit into one bureaucratic stove pipe very neatly. It cuts across many years including, for example, health.

So it's very important, a very key topic, and one that we think deserves a sort of approach of having many of the different decision-makers in the room to discuss the role of energy in the environment.

At the more working level, we have--I think you heard yesterday from an Energy Department representative--Energy Department has a dialogue with China on these issues. In the State Department, we have a couple of different mechanisms for engaging the Chinese. One is the Global Issues Forum, which is led on our side by Under Secretary Dobriansky and that looks at global issues including environment.

And this Asia Pacific partnership that you mentioned is one of the topics, one of the areas of focus for that particular dialogue and there's an office in the Bureau of Oceans Environment and Scientific Affairs that runs that particular program for us.

The State Department, one of the other dialogues we have with China that's run by the Under Secretary for Economic Affairs engages the Chinese National Development and Reform Commission, and they met in December and had a discussion about energy use, particularly in the rural setting.

Finally, we also engage with China in a more multilateral context. U.S., China, Japan, Korea and India have a five party grouping at the ministerial level. There was a meeting in Beijing right after the SED in December, and they looked at these issues of energy efficiency and strategic petroleum reserve and the use of market forces in energy. So we're addressing it in many areas, but I can follow up with some more specific information for you.

COMMISSIONER D'AMATO: Thank you. Just one quick follow-up. The S&T agreements include technology transfer and sharing with the Chinese. We'd be interested in knowing what advanced technologies such as carbon sequestration and so on are being worked with the Chinese in the coal area particularly because of the tremendous development of China's coal resources.

MR. NORRIS: Yes, I should have mentioned the Joint Commission on Science and Technology as being another arena that has a piece of the energy issue.

COMMISSIONER D'AMATO: Right.

MR. NORRIS: Yes, thank you.

COMMISSIONER D'AMATO: Thank you.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Reinsch.

COMMISSIONER REINSCH: What's our attitude these days toward the SCO? Have we sought any role there formal or informal?

MR. NORRIS: To my knowledge, we haven't sought a formal role, but we engage with the organization, try to find out, deal very closely with them and try to find out what they're doing, what their objectives are. We meet, our embassy in Beijing, I know meets periodically with the SCO Secretariat to see what the direction it's headed in.

COMMISSIONER REINSCH: What direction is it headed in?

MR. NORRIS: Obviously they're looking at energy cooperation as one of the main areas. We follow it closely. Two years ago, I believe, they made a statement about foreign basing in the region, that we objected to, and so we follow it from that perspective also.

COMMISSIONER REINSCH: On another matter then--thank you for that. One of the issues I've been following closely is the proposed export control regulation with respect to China--which is something that I understand from having met with Mr. Christensen that your department has some role in. One of the issues I know perhaps you would know about it and your department has been working on is the question of whether anybody else in the world is going to adopt the same approach? Is anybody else in the world going to adopt the same approach?

MR. NORRIS: I'm not sure about the answer to that. We'd have to get back to you with a follow-up reply. I know that you had a very extensive discussion about the export controls with Tom Christensen, but--

COMMISSIONER REINSCH: Yes. I don't think that's the reason he's not here today. If you could get back to us, that would be useful. We had a dialogue with someone else in the department in a different bureau on the same subject, and the specific question, which I'll repeat at this point, was to provide a list of other countries that have decided to implement a similar requirement with respect to China. We've been unable to get a very clear answer out of anybody on that question.

I believe the answer is zero, but it would be nice to have somebody from the government tell us whether that's right or not, and if it's wrong, who is participating.

MR. NORRIS: Okay.

COMMISSIONER REINSCH: You haven't been involved in this personally, I take it?

MR. NORRIS: I haven't been involved in that particular issue

personally, no, I have not.

COMMISSIONER REINSCH: Well, you're lucky. Thank you.

CHAIRMAN BARTHOLOMEW: Thank you. Commissioner Wortzel.

COMMISSIONER WORTZEL: Thanks very much for being here and for your testimony, I appreciate it a lot.

MR. NORRIS: Sure.

COMMISSIONER WORTZEL: In the past three years now, officers from the Second Artillery Corps Command Academy have opined in the PLA publication Military Science, China's Military Science, Junshi Kexue, that China must control outer space over China, not just airspace but outer space. In a 1999 internal volume on information warfare that was published based on papers at an All PLA Conference on Information Warfare, PLA officers offered that China must be prepared to prevent other nations from observing its missile force and must control outer space over China.

So if we've got all these dialogues with the Chinese, would it be useful for the Department of State and the Foreign Ministry to have a dialogue about the importance of space verification and warning as a means of providing strategic stability?

MR. NORRIS: Sir, I think that's a good idea. Of course, we are, on the defense side, I know that we've invited the head of the Second Artillery Corps to visit the U.S. and we think that that would be a very important discussion to have, and we hope that the Chinese will agree to that, and we continue to urge them to accept that invitation. I think that's very important for understanding their intentions and direction.

But we also on the Foreign Ministry side, I think there's certain a role for us to play on the State Department side with the Foreign Ministry in this particular area, especially as a result of this--

COMMISSIONER WORTZEL: Do you see this as a defense issue because I know when we negotiated agreements with the Soviet Union, it wasn't Defense that was the leader in these discussions. I think this is State Department matter; isn't it?

MR. NORRIS: Yes, and I think that we want to pursue our dialogue and various aspects of security issues.

CHAIRMAN BARTHOLOMEW: Thank you, Mr. Norris. You've been very generous with your time, and it's been a real privilege for us and a real opportunity for us to be able to monopolize your time and have you as our only witness this morning.

I'll take my opportunity to ask questions now. You are a diplomat--

MR. NORRIS: Right.

CHAIRMAN BARTHOLOMEW: --and dialogue is important, and

I suppose there are reasons why I am not a diplomat. But one of the issues that consistently comes up, of course, is dialogue for dialogue's sake versus dialogue getting results.

MR. NORRIS: Right.

CHAIRMAN BARTHOLOMEW: And there are consequences that happen on the ground while the dialogue is taking place and while the diplomacy is taking place. I think of that as American manufacturers are shutting down small and medium-sized enterprises on the economic front. Certainly on the diplomatic and political front, there is a genocide going on in Sudan. Every day that action isn't taken, people are dying.

How do we gauge our success beyond the fact that dialogues are taking place? At what point do we say dialogue perhaps is not sufficient? We need to move into something else? That's one of my questions. That's tough. It's a big broad issue, but where is the line at which we decide enough talk and we have to act on economics or diplomatic initiatives?

The second one, which is no easier, I'm afraid, is we hear often this argument that China is an old civilization, change moves slowly, we have to be patient, it's going to take time on things like improvement in human rights or intellectual property rights, IP protection.

At the same time, however, and we've been hearing this over the course of the past day and a half, there's been enormous examples of incredibly rapid development and success when the Chinese government is interested in having that rapid development taking place. Economic development, it's an amazing success story, and the implications, and the positive implications for the people of China are really wonderful.

So rapid economic growth but also rapid modernization that seems to come as some surprise to us. How do we reconcile the fact that when the Chinese government wants to make rapid progress on things, we see rapid progress, and when it doesn't, we are handed these explanations that things take time?

MR. NORRIS: On the first issue, I think, obviously we don't want dialogue for dialogue's sake or talk for talk. We want to achieve results also, and I think that's what we're aiming for in these different mechanisms that we have with China.

Sometimes we have breakthroughs that we can point to as being major developments. Other times the changes may be much more difficult to point to, changes that take place slowly over time. I think the dialogue is useful in addition to achieving specific results, achievements. Dialogue can also be helpful in forcing the two sides to

reflect on their positions and maybe make changes in them, and that's useful to have a regular schedule of meetings in all these different areas because it sort of forces the Chinese side to think about its policies and address them anew.

So I think it's useful in that area, but obviously in these areas we have other tools that we can use. We talked about the WTO dispute settlement mechanism in the economic area. In the case of nonproliferation, the Chinese have improved their export control regulations, but enforcement still obviously leaves very much to be desired, and in those cases I think there's not a week that doesn't go by where we aren't sending a message out to China with a concern about some particular possible transaction.

And where the Chinese companies have violated our laws, we impose sanctions on them. So we have different tools to use and not just through these diplomatic exchanges, but we also have some other things that we draw on when they're appropriate.

Let's see--

CHAIRMAN BARTHOLOMEW: The other question?

MR. NORRIS: As far as China's modernization, well, I think China is undergoing dramatic change. Anybody that goes there sees it. You go there and I remember, I left in '92, I had been working in Shanghai, left in '92, came back to Shanghai five years later, and could barely recognize the place because it had changed so much in five years. So it is a country that is undergoing very rapid economic change but also social change.

When I went to China for the first time in the early '80s, people were sort of dependent on their work unit for their livelihood, for their housing, and now people in China have a lot more choice about ways that they conduct their personal lives.

I think that eventually the changes that are taking place in China in the economic and social area are going to force changes in the political system, and that the changes inside China will generate I think interest among China's own citizens for political change. It's not something that's going to happen overnight, but I guess I think somewhat more optimistically that maybe these things will happen.

CHAIRMAN BARTHOLOMEW: Thank you. Thank you again for your time and your willingness to share your knowledge. I hope one thing, in closing, that the State Department will express concern to the Chinese government about President Hu Jintao's call for the purification of the Internet, which also seems to be driving things in the wrong direction in terms of both the promise of the Internet, the promise to access of information and freedom of expression.

We really appreciate your willingness to come before us today. I

want, before we close, to acknowledge the work of Marta McLellan, of our Commission staff, in putting this hearing together, and with that, we will close. Thank you very much.

MR. NORRIS: Thank you very much.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Statement of Senator Carl Levin
U.S.-China Economic and Security Review Commission Hearing on
The U.S. China Relationship
February 1, 2007

Thank you for the opportunity to testify on the subject of the U.S. –China relationship. I'd like to focus the majority of my statement on trade and then mention the strategic relationship. This hearing is timely as the one-sided nature of the U.S.-China relationship in trade is causing increased impatience in America's heartland as well as in the U.S. Congress.

We need a more balanced trading relationship with China. We need to take bold action and insist that trade with China be a two-way street for American manufacturers, farmers and service providers trying to do business there.

The one-sided nature of the U.S.-China trade relationship is evident when you look at the trade deficit figures. In 2005, China exported $243 billion worth of goods to the U.S. – six times the amount that the U.S. exported to China. This left us with a deficit of $202 billion in 2005 – our largest deficit with any country. In 2006, the U.S.-China trade deficit is expected to exceed $230 billion.

One reason for this glaring trade imbalance is China's continued non-compliance with its WTO obligations and our failure to challenge this non-compliance. When China jointed the WTO it committed to abide by international trade laws. But in case after case China has thumbed its nose at these laws and we've not objected. We should be bringing trade cases against China on currency manipulation and Intellectual Property Rights (IPR) violations and against its industrial policies that discriminate against imports.

As a result of the administration's lack of action in the face of China's WTO noncompliance, Congress will need to take greater legislative initiative to force action.

There are many facets to our failed trade relationship with China. This morning I'd like to run through the most glaring complaints that we should be taking up at the WTO.

Intellectual Property:
Counterfeiting has exploded in recent years across many industries to become a serious threat to the competitiveness of the U.S. economy. Intellectual property theft is rampant in China, and counterfeit products make their way back into the U.S. and third country markets, hurting the companies that are the victims of this theft.

I testified before this Committee last June on the topic of auto parts counterfeiting. We know that China is the primary source of counterfeit auto parts and components and counterfeiting is one of the U.S. auto parts industry's greatest concerns with China. The U.S. auto parts industry loses $12 billion annually to counterfeit auto parts, and China is responsible for about 75 percent of those counterfeit auto parts. A new U.S. Chamber of Commerce study reported that counterfeiting and piracy cost the Ford Motor Company about $1 billion annually, not including the health and safety costs associated with the fake items. The Justice Department and other federal agencies need to do more to fight auto parts piracy. Intellectual property theft is a serious crime with serious consequences and should be treated as such.

On April 29, 2005, the USTR placed China on the Special 301 Priority Watch List because of its failure to improve protections for U.S. intellectual property rights. Yet China has not changed its behavior. We need an enforcement office at USTR to pursue trade cases against countries that fail to meet commitments to

reduce IPR infringement levels, and to prosecute counterfeiting more aggressively.

Currency manipulation

The Bush administration has also failed to take action on China's currency manipulation. The continued undervaluation of the Yuan has made Chinese products artificially cheaper, harming U.S. workers and businesses, and has exacerbated the U.S.-China trade deficit. By rigging its currency at between 15 and 40 percent below its appropriate value, China is giving a subsidy to its imports to the United States and imposing a direct cost on U.S. exports to China.

China has pegged the value of its exchange rate to a basket of currencies heavily weighted to the dollar and intervenes massively to maintain that peg. So why has China not been cited by the Treasury Department in its semi annual report? We should challenge China's currency manipulation in the WTO by initiating either a Section 301 unfair trade case or filing a case with the World Trade Organization's Dispute Settlement Body against China's currency peg. U.S. manufacturers and many members of Congress are wondering: why has the U.S. Trade Representative not taken such actions?

We should also be honest about what currency manipulation really is.
Currency manipulation is a government subsidy, and it should be treated as such. That is why I will work with Senator Stabenow and others to develop legislation to make currency manipulation subject to U.S. countervailing duty laws and to direct the U.S. government to pursue countervailing duty cases in non-market economies such as China.

Import Surges

The administration has also failed to use China specific safeguards that were built into China's accession agreement precisely to defend American industries harmed by surging Chinese imports. Despite the International Trade Commission finding that U.S. manufacturers are being harmed by a flood of Chinese imports in various sectors, the administration has denied cases involving standard pipe, ductile ironworks, wire hangars, and pedestal actuators. We should be pursuing these cases and defending our manufacturers.

Industrial Policy

This administration has been dragging its feet for years on using international trade laws to fight for a two-way street on trade. The USTR has finally requested a WTO dispute settlement panel with China over its unfair tax regime on imported auto parts. This is a long overdue step which will hopefully end some of the discriminatory treatment of American auto parts by China. By vigorously pressing our case against these and other egregious violations of the very WTO rules that China has agreed to abide by, we can hopefully help force an end to the one-way street on trade with China.

We have a huge and growing trade imbalance with China. So far, our government has done nothing to stop China's unfair trade practices, and this is costing us jobs.

This Commission can help exert pressure on the administration by continuing to expose these egregious practices and by making strong recommendations for actions to address them.

Finally, as the Chairman of the Senate Armed Services Committee I want to say a few words about the U.S.-China strategic relationship. Over the last several years, the United States and China have pursued a constructive strategic relationship, addressing common concerns such as North Korea's nuclear programs, bilaterally and multilaterally. China has demonstrated a greater willingness to play a responsible role on the world stage, contributing police forces to the U.N. operation in Haiti, for example.

Yet, at the same time, China is still unwilling to join the international community and pressure the

Sudanese government to end the genocide in Darfur. The Chinese government speaks in favor of export controls, but still appears to have a way to go in establishing its own regime to prevent proliferation of nuclear, chemical and biological weapons. And most shockingly, a few weeks ago, the Chinese government, authorized the shooting down of their own weather satellite, raising questions about whether they are indeed – contrary to their protestations – pursuing the weaponization of space.

So, while the U.S.-China strategic relationship has been strengthened through the pursuit of common national security objectives, through diplomatic efforts and increased military contacts, it is a fragile accommodation for the United States, fraught with uncertainty about China's true intentions.

The Commission will hopefully offer recommendations to Congress regarding how the Untied States might more effectively further its interests vis-à-vis China, and how Congress can help the Administration to foster greater transparency and cooperation from China.

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Assistant U.S. Trade Representative Timothy P. Stratford - Statement on U.S.-China Trade Relationship.[9]

American Apparel & Footwear Association, Kevin M. Burke, President and CEO – Written comments for the record.[10]

[9] **Click here to read the Statement by Assistant U.S. Trade Representative Timothy P. Stratford**
[10] **Click here to read the statement by the American Apparel & Footwear Association**