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I would like to thank the Prague Security Studies Institute for inviting me and the U.S. China Economic and Security Review Commission to participate in this symposium on Asian Pacific Security Challenge, with an emphasis on China. America's relations with China are extensive, complicated, changing rapidly and present a variety of opportunities for cooperation as well as challenges, -- and frankly, “risks” to U.S. interests. From that perspective, the conference is very timely, as we should be sorting out our approaches to China together with our European allies and friends, since those challenges are mutual

Let me explain the nature, creation and activities of the US China Commission, created in October of 2000 and now approaching its 8th birthday – and the only permanent Congressional Commission tasked with reviewing and recommending upon an international bilateral relationship.

U.S.-China Congressional Economic and Security Review Commission formation

Prior to 2000, there was an annual debate on China's Annual Most Favored Nation Treatment, which usually emphasized human rights, linking human rights to trade preferences.

But with China's accession to the WTO, with agreement from the U.S., we gave China permanent most favored nation treatment, meaning an end to the annual debate and annual leverage, modest as it might be.

Two commissions were created to sustain annual attention to US-China relations, with a new emphasis on the nexus between national security and economic flows, as well as a separate commission on human rights.

An independent, yet wholly congressional commission, whose mission was given to 12 commissioners, 6 Democratic and 6 Republicans, was established to make detailed annual determinations to the congress on the national security implications of the economic, trade, investment and other aspects of the bilateral relationship between the U.S. and China.

Basic elements of the U.S.-China Economic and Security Review Commission include:

- It is unique as a Congressional tool – there are no other existing bilateral Commissions;
- it is permanent
- it has worked successfully as a bipartisan organization;
- it produces a classified report to the Congress;
- it produces an annual extensive unclassified report to Congress;
- it is wholly congressional with no Executive branch nominees; and
- the internal rules of the Commission include: independent commissioners, rotating chairmanship, bipartisan co-chairs of hearings.

A second commission focusing on China was created by the U.S. House of Representative which continued the traditional role of examining human rights; however, this commission includes Executive branch and elected Members of Congress.

Both commissions remain in power, receive annual funding, report annually to the Congress, and testify regularly before congressional committees.

The U.S. China Economic and Security Review Commission was created as a reflection of growth of Chinese power, confidence, organizational and operational activities vis-à-vis the rest of the world.

Recent international attention focused on China during the 2008 summer Olympics. China is working to produce an image of a confident and benevolent power; however, the growth in its economy, military power and international diplomacy and operations results in challenges. The hoped-for political reforms the U.S. has supported for many years have not yet fully materialized. This has been a major disappointment, at variance with the expectation of the Clinton administration when it supported entry into the WTO and permanent access to our market.

The Chinese leadership is hesitant to adopt further market based reforms. In addition, the country has avoided political reform and strengthened its authoritarian powers internally. This was exposed at various times in connection with China's behavior at the Olympics. And the surge of free media coverage of the recent earthquakes has now been replaced by a backsliding on more open media coverage.

Conclusions of 2007 report of the U.S.-China Economic and Security Review Commission:

The Commission produces an extensive annual report to the Congress. The conclusions in the 2007 report are a mixture of good news and less than favorable -- let me summarize the salient conclusions of our latest report:

China has taken a constructive role in the attempt to bring a new agreement with North Korea on its nuclear program and has strengthened its export control system to limit the proliferation of nuclear technologies and weapons materials and equipment. Most notably, China's economic policies have lifted 200 million people substantially out of poverty, leading to the creation of a real Chinese middle class. China's leaders acknowledge the extensive environmental devastation caused throughout China and increasingly the world. The leadership wants to take steps to address economic and energy challenges. These are substantial and positive achievements which we acknowledge and further encourage.

On the less favorable side, the Commission reports on seven concerns with the Chinese government's policies. First, a continued suffocation of civic action by any organization except the Communist party still exists, with extensive media controls, including over the internet. Second, China's performance in complying with its obligations in the World Trade Organization has been disappointing in a number of very important respects. For instance, it is not enforcing its own laws against intellectual property theft – a problem which the U.S. shares with all of our allies in addressing China's performance.

Chinese violations of intellectual property protections and rights reflect the inadequacies of a Chinese system lacking the enforcement of an adequate rule of law. Even more important is an open question as to whether disregard for intellectual property rights in a broad sense is important to sustain China's rapid growth and technological progress.

It remains unclear whether the Chinese government is committed to engaging the IPR infringement issue or whether Chinese development is dependent on such infringement. The rampant piracy of everything from movies, to auto brakes to machine tools to the full range of imported industrial and commercial products should logically limit the level of foreign investment in China, but it has not. While it is often reported that foreign companies attempt to protect their most valued IP from Chinese pirates, they continue to invest and expose their IP. At the same time, it is clear the Chinese government seeks foreign investment as a means of technology transfer for its own development. Can we realistically expect advancement in the protection of intellectual property rights in China? In the 8 years since China joined the WTO there has been little improvement in the protection of IP. The U.S. Trade Representative is bringing cases in the WTO to start curtailing various aspects of China's IP violations. The U.S. Congress strongly supports this route as preferable to trade retaliation measures, and it is a test of the WTO as to whether such cases will succeed in changing this practice.

Is WTO action sufficient to change persistent and fundamental Chinese behavior?

Third, the Commission continues to report on the disappointment in China's efforts to continue moving in the direction of a market economy. These efforts are slackening in that the government has decided to retain state ownership or control of a large block of the economy, designating a dozen key industries (such as

telecommunications, aviation, and steel) as pillar industries to retain state ownership and control. Subsidies of many kinds to these key industries violate the WTO obligations China engaged in and pose a challenge to our policies, as they are unfair in the global competitive field.

Fourth, on energy, China appears to show a growing reliance on acquiring oil at the wellhead rather than relying on international market practices. In doing so, it has chosen to develop close relationships with countries such as Iran, Sudan and Burma, and this makes it more difficult for China to cooperate in multilateral efforts to address human rights issues in those nations.

Fifth we have become increasingly concerned over the rapid pace of China's militarization, and particularly its emphasis on cyber warfare and anti-space technologies. China is keying on defeating the capabilities of US Carrier battle groups, for instance, a key element of American power in the Pacific.

Sixth, in a related concern, we are concerned about China's growing reliance on industrial espionage, and an overlarge spy program.

Seventh, we are concerned over the growing trade surplus China is sustaining with the US, resulting in the acquisition of very large dollar holdings, and the apparent planned investment of such dollars in acquisitions of key American companies. This is the result, in part, of China's emphasis on export-led growth, which relies on large trade surpluses, and the importation of U.S. and other big manufacturers, and relies on WTO-illegal subsidies and government control of over 150 of the largest Chinese enterprises in so-called "pillar" industries.

Congress has supported the close review of such acquisitions of American companies, through an institution created for this purpose known as CFIUS (Committee for Foreign Investment in the US), and this resulted in the denial of a Chinese acquisition of an American oil company, Unocal, several years ago - an event extensively debated and publicized and which greatly angered the Chinese government.

In this regard, China's unwillingness to move its currency valuation to a realistic level, we believe, gives it an unfair advantage in the trade relations area, making its goods artificially cheap, and ours expensive, effecting the balance of trade.

Reciting this litany of complaints risks our being branded as just that - complainers. We believe we are obliged to bring problems to the attention of the Congress, and try to balance these issues with what progress we can discern in the relationship. It is clear that China listens to us, even if it is slow to reform many practices we feel are unfair or need reform for a healthy international system. So in the areas of trade, environment and security there are clusters of issues which we as a nation have created a network of initiatives and joint committees with the Chinese, in order to have a dialogue and try to fashion joint understandings and solutions. We think a robust series of such diplomatic initiatives are required, and a true understanding of the Chinese in the face of these problems has been apparent. It is another matter for the Chinese government to change its economy and environmental, energy and other practices throughout its society. A mixture of carrots and sticks, with the sticks focusing on international multilateral action - particularly through the WTO - and in cooperation with our allies is the preferable long term solution. In general we need to avoid vituperation; retaliation and actions which tend to close down the global economic system since that in the long run will have the impact of cutting off our noses to spite our face.

Perhaps the most dangerous issue which we face, and which demands more aggressive solutions, certainly from the American and Chinese governments alike, is in the area of environmental degradation and climate. If the developing science of climate change is correct we have little time left to curtail our greenhouse gas emissions. China's energy policies, focusing on increased coal use, are not helping our ability to address energy and climate change challenges. There is increasing restlessness in the congress on this issue, and will be an important subject for the new Administration to address. The rapid development of new technologies and new regimes of emissions controls is needed in the near term, and is particularly important because of the delaying affects of emissions now going into the atmosphere which linger there for many years, steadily accumulating for future effects.

Since that 2007 report, a consensus has developed among seasoned analysts with an objective viewpoint, such as Fred Bergsten in the U.S., that "inducing China to become a responsible pillar of the global economic system will be one of the great challenges of coming decades - particularly since at the moment china seems uninterested in

playing such a role.” Bergsten says in the current issue of Foreign Affairs that “Chinese recalcitrance seems to be increasing rather than decreasing over time”, is responsible in important part for the failure of the latest round of international trade talks, the Doha round. It looks like China may be preparing an effort to create an Asian free trade area to compete with the US and excluding the US.

Let me conclude with the following points:

-- U.S. criticisms of China policies have not translated into any serious retaliatory pressure because too many Americans receive too many benefits from their dealings with China for policymakers to jeopardize the Relationship and because other key countries are also unwilling to confront China.

--the U.S. has no mechanism to monitor trade and investment flows with china (and other parts of the world) from national security perspectives;

-- CFIUS (the Committee on Foreign Investment the US) as an institution and a concept needs to be made workable and broadened to function as a key Congressional-Executive mechanism to control and watch acquisition flows, particularly given the huge Sovereign Wealth Funds being used by China and other countries to buy up blocks of the American economy, including key infrastructures;

-- our engagement policy cannot be a permanent activity, without identifying the goals of such engagement;

-- what aspects of our continuing trade deficits affect our national security, including the effect on the strength of the dollar and the purchasing of large amounts of US bonds by the Chinese?

-- can common strategic architectures affected by economic flows be developed between the US and our European allies?

While China’s expansion is having a dramatic effect on the rest of the world, the divide between its behavior as a mercantilist power and its responsibilities as an international citizen required by the international organization it has joined – such as the WTO – is growing.

In sum, China behaves in many ways as a mercantilist power economically, and will comply with its international obligations only reluctantly if those obligations have an undesirable impact on its growth practices and goals. For the U.S. and our allies, the time for our reluctance is coming to an end. Chinas’ impact on our economies is too strong to tolerate permanent and fundamental noncooperation that has become a signature of China’s behavior in many fundamental respects. It is therefore necessary for the international community, through the institutions that are available to us, and if necessary bilaterally, to exert pressure to reform those practices – and the U.S. for its own health and economic strength needs to build strong and unambiguous bright lines around those aspects of its economy that constitute our own “pillars” of our national security. We in many ways are asking China to reform practices that we ourselves engaged in for many decades while we developed. Nevertheless the present understanding of the impacts of such practices are more clearly understood by everyone, and obligations have been entered into which underpin the modern international system and its viability. We certainly encourage European institutions to work with us in advancing the positive aspects of that system, and we look forward to working with you on specific issues in the future.

Thank you.