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# U.S.-CHINA TRADE RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS

## HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

JUNE 17, 1998

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# U.S.-CHINA TRADE RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS

**WEDNESDAY, JUNE 17, 1998**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 1:03 p.m., in room 1100, Longworth House Office Building, Hon. Phil Crane (Chairman of the Subcommittee) presiding.

[The advisories announcing the hearing follow:]

# *ADVISORY*

## FROM THE COMMITTEE ON WAYS AND MEANS

### SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 3, 1998
No. TR-26

CONTACT: (202) 225-1721

## Crane Announces Hearing on U.S.-China Trade Relations and Renewal of China's Most-Favored-Nation Status

Congressman Philip M. Crane (R-IL), Chairman, Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on U.S.-China trade relations, including the issue of renewing China's most-favored-nation (MFN) status. **The hearing will take place on Wednesday, June 17, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 12:00 noon.**

Oral testimony at this hearing will be from both invited and public witnesses. Also, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

**BACKGROUND:**

Non-discriminatory MFN trade status was first granted to the People's Republic of China on February 1, 1980, and has been extended annually since that time. Annual extensions are granted based upon a Presidential determination and report to Congress that such an extension will substantially promote the freedom of emigration objectives in Title IV of the Trade Act of 1974, the so-called Jackson-Vanik amendment. Subsections 402 (a) and (b) of the Trade Act set forth criteria which must be met, or waived by the President, in order for the President to grant MFN status to non-market economies such as China.

The annual Presidential waiver authority under the Trade Act expires on July 3 of each year. The renewal procedure requires the President to submit to Congress a recommendation for a 12-month extension by no later than 30 days prior to the waiver's expiration (i.e., by not later than June 3). The waiver authority continues in effect unless disapproved by Congress within 60 calendar days after the expiration of the existing waiver. Disapproval, should it occur, would take the form of a joint resolution disapproving the President's determination to waive the Jackson-Vanik freedom of emigration requirements for China. On June 3, 1998, the President issued his determination to waive the requirements for China for the period of July 3, 1998, to July 2, 1999.

**FOCUS OF THE HEARING:**

The focus of the hearing will be to evaluate overall U.S. trade relations with the People's Republic of China and to consider the extension of MFN status for China for an additional year on the basis of that country's emigration performance. The Subcommittee will be interested in hearing testimony on China's emigration policies and practices, on the nature and extent of U.S. trade and investment ties with China and related issues, and on the potential impact on China, Hong Kong, Taiwan, and the United States of a termination of China's MFN status. Finally, witnesses may also address U.S. objectives in ongoing negotiations over conditions upon which China will enter the World Trade Organization (WTO), as well as the anticipated impact of WTO membership on U.S. workers, industries, and other affected parties.

**DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:**

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, June 10, 1998. The telephone request should be followed by a formal written request to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee on Trade staff at (202) 225-6649.

(MORE)

**In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard.** Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether or not they are scheduled for oral testimony, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies, along with an *IBM compatible 3.5-inch diskette in WordPerfect 5.1 format,* of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than close of business on Monday, June 15, 1998.** Failure to do so may result in the witness being denied the opportunity to testify in person.

**WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:**

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label*, by the close of business, Tuesday, June 23, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.
4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****

*****NOTICE — CHANGE IN TIME*****

# *ADVISORY*

## FROM THE COMMITTEE ON WAYS AND MEANS

### SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
June 12, 1998
No. TR-26-Revised

CONTACT: (202) 225-6649

## Time Change for Subcommittee Hearing on Wednesday, June 17, 1998, on U.S.-China Trade Relations and Renewal of China's Most-Favored-Nation Status

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade, Committee on Ways and Means, today announced that the Subcommittee hearing on U.S.-China Trade Relations and Renewal of China's Most-Favored-Nation Status, previously scheduled for Wednesday, June 17, 1998, at 12:00 noon, in the main Committee hearing room, 1100 Longworth House Office Building, **will be held instead at 1:00 p.m.**

All other details for the hearing remain the same. (See Subcommittee press release No. TR-26, dated June 3, 1998.)

****

Chairman CRANE. Will everyone please take seats and hold the conversation down to a minimum inside this room. And I want to welcome everyone to this meeting of the Ways and Means Trade Subcommittee to review the critical issue of U.S.-China trade relations.

On an annual basis, as required by the 1974 Jackson-Vanik statute, Congress considers the question of renewing China's MFN, or normal, trade status. After many years of isolation, China conditionally regained its status in 1980. As my colleagues know, every President since that time has recommended a renewal of this treatment. Even President Clinton, who experimented during his first year in office with linking China's MFN, most-favored-nation trade status to human rights conditions, ultimately conceded that such policies do not promote our national interests and do nothing to improve the human rights situation in this turbulent region of the world.

All legislative attempts at revoking MFN since 1980 or subjecting it to additional conditions have been resoundingly unsuccessful. This year, despite the investigation surrounding allegations of export control violations, we cannot afford to let the outcome be any different.

The Speaker recently joined Chairman Archer and me in a letter that affirmed our commitment to the importance of separating the MFN trade issue from the ongoing investigations.

The truth is that all Presidents since 1980 have realized that slapping China through the revocation of MFN will not bring about the changes that we all seek in China. Cutting off avenues of communication and trade between the United States and China will not help the Chinese people create the future that we want for them. In addition, revoking MFN could encourage additional financial instability in the region.

We must continue to emphasize that MFN is nothing more than normal trade treatment, uniform among 150 U.S. trading partners. I believe it's misleading to characterize MFN as somehow exceptional or especially favorable tariff treatment. Because the terminology in the statute causes endless confusion to those who don't focus on these topics everyday, I intend for the Trade Subcommittee to markup H.R. 2316, bipartisan legislation which would change the MFN label to normal trade relations, or NTR. I am sure we will all enjoy getting used to a new acronym.

I would now like to yield to my distinguished colleague from California, Mr. Matsui, for an opening statement.

Mr. MATSUI. Thank you very much, Chairman.

I would like to just submit my written statement for the record in view of the fact that you have a long hearing, and I think this issue, for the last 7 or 8 years, has been debated time and time again. And we probably know all of the issues that have to be discussed and all the issues that go into making a decision on whether to renew or not renew most-favored-nation status.

I might just point out, and followup on what Chairman Crane has said: that China is 22 percent of the world population. One out of every five individuals living on this planet is a citizen of China.

The U.S.-China relationship may be the most important bilateral relationship the United States has for the next decade, the next 25

years, perhaps the next generation. And it would be my hope that Members of Congress—House Members, Senators, people from the outside—would not politicize this issue. This issue is too critical for the future of not only this country, but for the free world. And it's my hope that, as time goes on, that we begin to recognize that the President's policies of engagement of the Chinese is really the appropriate policy to take. None of us want to see a renewal of the cold war, and it's certainly my hope that all of us understand that the decisions, comments, and statements we make now could have that kind of an effect over the next generation, the next decade.

Thanks, Mr. Chairman.

[The opening statement of Hon. Jim Ramstad follows:]

**Statement of Rep. Jim Ramstad -- Ways and Means Subcommittee on Trade**
**June 17, 1998**
**Hearing on Most Favored Nation (MFN) status for China**

Mr. Chairman, thank you for calling today's hearing to discuss US-China trade relations and renewal of Most Favored Nation (MFN) trade status for China.

While the issue of MFN for China is similar to last year, the atmosphere in which we consider this issue this year is clearly much different. Despite the strong concerns my colleagues and I have about the sale of U.S. goods that could contribute to China's nuclear proliferation, we must consider these export control and security issues separately from legitimate trade issues.

That's why Congress will establish a select committee to review national security implications of the recent technology transfers to China. Regardless of the committee's findings, the Administration's export waivers should not affect this issue.

Over the last 18 years, we have witnessed noticeable advances in economic and personal freedoms in China. Increased trade with Western countries has exposed the people of China to democratic values and practices. Continuing normal trade relations with China through MFN acknowledges the progress that has been made, but does not disregard the need for further improvements in human rights conditions for Chinese citizens. Through MFN, we can continue to influence the Chinese government to improve human rights, adhere to international trade and nuclear proliferation agreements, liberalize the Chinese economy and knock down barriers to trade for U.S. businesses.

The U.S.-Sino trade relationship is good for U.S. businesses and jobs. China is one of the fastest-growing markets in the world and is home to over 1.2 billion people -- 20% of the world's population. US-China bilateral trade has grown from $2 billion in 1978 to nearly $60 billion in 1996. Merchandise exports to China alone in 1995 totaled nearly $12 billion, which supported over 170,000 American jobs -- jobs that pay 13-16% more than non-trade related jobs.

We in Minnesota understand what this means. In 1996, we exported over $60 million worth of goods to the growing Chinese market, and we are currently working on improving that figure through the Minnesota Trade Office's Minnesota China Initiative.

Knowing how crucial a normal, engaged relationship between the US and China is for improving the lives of people in both countries, I want to thank you again, Mr. Chairman, for calling this hearing. I look forward to hearing from today's witnesses about the importance of US-China Trade relations and China MFN renewal.

Chairman CRANE. Thank you. And I want to thank the witnesses in advance for their prepared testimony and ask that you please try and keep your presentations to 5 minutes or less so that we can conclude the hearing by mid-afternoon. And please feel free to elaborate for the printed record. Any printed statements will be made a part of the permanent record.

The first witness today is our distinguished colleague on the Committee, Mr. Stark from California, followed by my good friend and Chairman of the Rules Committee, Jerry Solomon, who has a long record in Congress on this issue. We will then proceed with Mr. Smith from New Jersey, followed by Mr. Weldon of Pennsylvania. She's not here yet, but Ms. Pelosi will be next, assuming she arrives, and I feel confident she will. And we'll conclude with Mr. Dooley of California. Again, please try and keep it to 5 minutes or less. Thank you.

**STATEMENT OF HON. PETE STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. STARK. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here.

As you well know, I oppose renewing the most-favored-nation trading status to the People's Republic of China. Their record of forced abortions and sterilizations, human rights abuse, slave labor, proliferation of mass weapons of destruction provide more than enough reason to deny the status to China.

We talk about a meeting of the minds; I just think it's important to start the hearing off understanding that the Chinese have no interest or intent to meet our minds. The Chinese do not understand what human rights are, as we understand them. By our terms, the Chinese Government is barbaric. They do not believe in the value of human life. They do not believe in the right of self-determination; they oppose it, and they have no intention or desire to change. They will outmaneuver us and outflank us at the negotiating table and say, Oh, yes, we'll change. But they haven't; they've gotten worse. They release a few dissidents, and they put 10 more in. And they mock us and laugh at us.

Now, nobody in their right mind suggests we would not trade with China at all, but why we should give them an advantage that we allow only to our friends and allies escapes me.

You should recognize that there has been no record of China's aggregate improvement and, indeed, no indication that China intends to live by what we would say is the Christian-Judean ethic in this country, by the right of people to enjoy liberty and to protect human life. They don't believe in that. They believe the State owns the lives of their citizens, and they can force sterilization and abortions as they decide. And they want to do that. They believe that's their right. They believe it's all right to kill young girls; they don't need them, they don't want them. They don't add to their—whatever their mind set is that says government is intent to do. They are barbarians. Women who attempt to have more than one child either get abortions or get sterilized. China's work force produces goods and ships them to America, and they are produced with slave labor. There's forced overtime. It's typical for workers to work 6

and 7 days a week for 13 cents an hour. Migrant workers are housed in inhumane quarters.

Our President contends that continued engagement with these barbarians is essential to forming a common strategy. How do you form a common strategy with heathens? We wouldn't need to remedy a nuclear arms race between Pakistan and India if China hadn't supplied Pakistan with the nuclear weapons in the first place.

China must be condemned for their violations of proliferating weapons of mass destruction. The CIA has reported that China has 13 intercontinental ballistic missiles. They've sold Pakistan 34 nuclear-capable M–11 missiles. The Clinton administration did not want to oppose sanctions then, and they dismissed the CIA counterproliferation evidence.

In February 1996, the PRC sold 5,000 ring magnets to Pakistan to use in their uranium enrichment facility. In May 1997, the State Department cited seven Chinese entities for exporting chemical weapons technology to Iran. In 1997, the CIA identified China as being the most significant supplier of weapons-of-mass-destruction related goods and technology to foreign countries. In September 1997, the Navy reported that China is the most active supplier of Iran's nuclear, chemical, and biological weapons program. In 1998, China was found to be transfering chemical weapons to Iran, and just June 16, 1998 initial CIA findings show that China is helping Libya develop its own ballistic program.

What is there that makes us want to deal with these people? There may be millions of them, as my colleague from California suggests, but trading with them—dealing with them as we would deal with intelligent, loving, caring human beings—is idiocy. They don't hear us. They want our weapons of mass destruction. They want us to buy their cheap sneakers and T-shirts, and they are laughing all the way to the bank while they continue to perpetuate slavery, to denigrate the value of human life, and to peddle weapons of mass destruction around the world.

We must find another way to deal with this nation, and the sooner we face up to the fact that appeasing them, mollycoddling them, and subsidizing them will only give them the strength to someday turn and bite us. When we recognize that, we will begin to change our policy toward China and not try to contain them through trade. It's a gift to the enemies of humanity, and we should not be part of it.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Congressman Pete Stark
before the Committee on Ways and Means
Subcommittee on Trade
in opposition to Renewal of China's MFN Status
on June 17, 1998

I am here today to oppose renewing Most Favored Nation (MFN) trading status to the People's Republic of China (PRC). China's record of forced abortions and sterilizations, human rights abuses, slave labor and proliferation of weapons of mass destruction provide more than enough reason to deny MFN status to China.

There is no "meeting of the minds" when we discuss human rights issues with the Chinese government. Freedoms that we treasure--the right to practice religion, to assemble, even to procreate-- simply do not exist under this regime. Since all workers labor for the state, there is no such thing as slave labor. Women have no rights and no value under this regime.

The US cannot wait for Chinese government to change, especially when they have no economic incentive to change. Just think of what happens each year at this time--a few more

promises made and a few dissidents released but NO evidence of a commitment to honor basic rights for their own people or to stop the arms race.

The Chinese leaders have abused the rights of their people in large part because it has been to their economic advantage to do so. The US must not continue to abet China in abusing their people for the sake of economic growth.

Denying MFN does not cut-off all economic ties with the PRC. It merely means that they will face higher tariffs for their flawed policies.

China forces sterilization and abortions as a means of controlling the population in order to achieve economic growth. They fear that an overcrowded country will strip it of its natural resources and hinder economic growth and stability. Yet proponents of MFN for China insist that human rights should not be discussed within this context.

We cannot ignore what the Chinese government condones:

- Women in China are only permitted to have one child if they are married--unmarried women are forced to have abortions.

- Women who do attempt to have more than one child face severe abortion persuasion tactics. These tactics include heavy fines, dismissal or demotions of state employees, detention and psychological intimidation.

China's workforce labors to produce goods, such as apparel and toys, to export to the United States. One-third of China's trade is exported to the U.S. By denying MFN status to China, Congress will disapprove of China's labor practices that contribute to their growing economy.

The National Labor Committee's "Behind the Label: Made in China" found the following--

- There is forced overtime with workers forced to work 60-90 hour work weeks.

- It is typical for a worker to endure 6-7 day work weeks for wages of 13 to 28 cents an hour without benefits.

- Migrant workers are housed in cramped dorms and fed a thin rice gruel.

- The majority of the 4 million apparel workers in China are young women from rural areas who are completely unaware of their legal rights and have never heard of corporate codes of conduct.

- Workers can be fined for discussion of factory conditions and there are no independent human rights, labor or religious organizations to provide protections.

We have tried to get a commitment in regard to prison labor in 1994 when China signed an Memorandum Of Understanding (MOU) that prison labor products are not to be exported to the U.S. The Chinese government failed to make noticeable changes. A June 1997 State Dept. report on the MOU indicated that "Chinese cooperation has not been satisfactory, but may be improving."

Our President contends that continued engagement with the PRC is essential to forging a common strategy to roll back nuclear proliferation between Pakistan and India. However, we wouldn't need to remedy a nuclear arms race between Pakistan and India if China hadn't supplied Pakistan--and posed a threat to India--with nuclear arsenals in the first place. China must be condemned for their violations of

proliferating weapons of mass destruction, not rewarded with MFN status.

Let's review the facts that we know to date:

- The CIA reported that China has 13 Inter-Continental Ballistic Missiles (ICBMs) that can reach cities in the Western U.S.

- U. S. Intelligence reported that China sold Pakistan 34 nuclear capable M-11 missiles in November 1992, but the Clinton Administration did not want to impose sanctions and dismissed CIA counter-proliferation evidence.

- In February 1996, the PRC sold 5,000 ring magnets to Pakistan for use in Pakistan's secret uranium enrichment facility.

- In May 1997, the State Department cited seven Chinese entities for exporting chemical weapons technology to Iran.

- In June 1997, the CIA identified China as being "the most significant supplier of Weapons of Mass Destruction-related goods and technology to foreign countries.

- In September 1997, the U.S. Navy reported that China is the most active supplier of Iran's nuclear, chemical and biological weapons programs.

- In February 1998, China was found transferring chemical weapons to Iran.

- And just yesterday, June 16, 1998, initial CIA findings show us that China is helping Libya develop its own ballistic missile program.

Just how many examples of bad conduct and bad faith by the Chinese government do we need?

Just how driven can the US government and business interest be in the desire to capitalize on the Chinese market?

The failed Loral launch and export licenses issued by the Commerce Dept. show us what happens when we try value economic priorities and constructive engagement with China theories above human rights and U.S. national security.

Constructive engagement has not done anything for the people of China when the only thing they understand is more work because more goods are being exported to the U.S.

This Congress must send a message to Beijing and the rest of the world that these behaviors will not be tolerated without repercussion. China must learn that a policy of engagement must be a two-way street and the release of two imprisoned dissidents does not constitute human rights reform.

This Congress must deny MFN trading status to China.

Chairman CRANE. Mr. Solomon.

**STATEMENT OF HON. GERALD B. SOLOMON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK**

Mr. SOLOMON. Mr. Chairman, I have great respect for you and your ranking member, Mr. Matsui, and I apologize for being late. I was at a meeting which is about to establish the Select Committee on China, looking into the transfer of satellite technology to the People's Republic of China, which, without question, now has resulted in the development and deployment, as Mr. Stark has just said, of at least 13 out of a known 18, deadly intercontinental ballistic missiles aimed at the United States of America. And that's really what is the crux of this debate here today.

In a week or so, the President of the United States will be received by the dictators who run China, in the very place where those dictators killed over 1,000 innocent people. This is morally revolting, but it is the logical result of our policy of appeasement of Communist China over the years, unfortunately under other administrations as well.

Of course, the continuous unlinked granting of MFN is the cornerstone of that appeasement policy. That is why I've introduced H.J. Res. 121, which is pending before you right now, which would temporarily—and I emphasize temporarily—suspend MFN for China.

Mr. Chairman, as has been the norm for over a decade, the trade picture with China continues to worsen. China's refusal to grant fair and open access to American goods has resulted in our trade deficit with that country skyrocketing to over $50 billion. And I've sat at this table year after year after year, when it was only $5 billion, $10 billion, $15 billion, and $30 billion. Now it's more than $50 billion and skyrocketing.

Mr. Chairman, this costs thousands of American jobs. Supporters of the current policy keep telling us that U.S. exporters will get access to this vast Chinese market in return for this, but that remains just an elusive myth. It just is not happening. American exports to China totaled only $13 billion in 1997, less than one-fifth of one percent of the total U.S. economy. Mr. Chairman, that is a very slim return when you consider that we give China favorable tariffs on over one-third of all of their exports.

On human rights, Mr. Chairman, I truly hope that no one is fooled by the recent release of a couple of dissidents from Chinese jails. The fundamental situation remains the same. China continues to be a vicious violator of basic human rights, consistently ranked at the bottom by all human rights observers from all across this world. According to our very own State Department, in its 1997 human rights report noted that the Chinese Government, "continued tight restrictions on freedom of speech, freedom of press, assembly, association, religion, privacy, and worker rights." Everything, Mr. Chairman; "serious rights abuses persisted in minority areas, including Tibet." And what a terrible, terrible thing that is there, where tight controls on religion and other fundamental freedom continue, and are even intensifying, as we sit here this minute. All these years of trade, yet we still wait for the improve-

ment in human rights that the engagement theorists keep promising.

In the field of national security—and this probably is, without question; the most important issue here today—our appeasement of China's reckless proliferation activities has finally borne its bitter fruit in the form of a nuclear arms race in south Asia. There should be no mistaking China's guilt in this matter.

Just days before the first Indian nuclear test last month, their defense minister stated unambiguously that China represents the No. 1 threat to Indian security. Subsequent statements and analysis by Indian officials and observers leave little doubt that China's longstanding support for Pakistan's nuclear and missile programs, coupled with American appeasement of China's actions, prompted the Indian tests.

Mr. Chairman, MFN has led directly the bankruptcy of our so-called nonproliferation policies, which, quite bluntly, Mr. Chairman, have been discarded by this administration in its quest for trade dollars with this Communist country. Last year, a new element was interjected in this debate: The revelations that the Chinese embassy here in Washington sought to buy influence with the U.S. Government through campaign contributions. This year, we have had confirmation of this from Democratic fundraiser Johnny Chung, who has admitted to receiving $300,000 from a Chinese military officer, who also happens to be connected to Chinese firms involved in the business of launching satellites and proliferated missiles.

The dots are beginning to connect themselves here, Mr. Chairman, and the odor of money and influence peddling that hangs over this entire debate smells. It smells badly.

Tomorrow, my committee will create a Select Committee to get to the bottom of all this. But frankly, Mr. Chairman, we don't need a Select Committee to know that it is our policy of business as usual, at any cost, that has set the stage for this whole sorry scenario.

MFN is the crux of that policy, and until we link it to the behavior of the Chinese Government, as Mr. Stark has said, we will continue to invite the kind of abuses we see now. These are the very bitter fruits of engagement, Mr. Chairman.

And in closing, let me just say cutting off MFN does not mean that we cease all trade and contact with China—and you should all listen to this. It simply means we raise tariffs on Chinese goods to the point where we get their attention. That's the only way that will get their attention. This, and only this, will encourage better behavior by the Chinese dictators. When we see that happening, this Congress can turn around within days, weeks, or months and restore MFN for China. You're not cutting it off permanently. You don't have to wait 1 or 2 years; you can do it at the whim of this Congress; the next day if you want to. I guarantee you, having worked with the Chinese for all of these 50 years, that this would hit them like a rock. Then they would wake up and, pay at least some consideration to human rights, to human decency, to human life itself.

And, Mr. Chairman, I plead with you, and I know your position, I know you're sincere and well meaning, you ought to come out and

we all should, once and for all, temporarily stop MFN for China. And you will see the direct results, resulting in the saving of human life.

Thank you, Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Smith.

**STATEMENT OF HON. CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY**

Mr. SMITH of New Jersey. Thank you very much, Chairman Crane and Members of the Subcommittee, and thank you for the invitation to be here.

Whatever decision the Congress makes about MFN for China this summer, the American people will see it as a decision about the role of morality in U.S. foreign policy, and they will be right.

Mr. Chairman, I think you would agree with me that legislatures should judge their actions against two basic laws of economics: What you subsidize you get more of; what you penalize you get less of. So in judging whether we should continue to confer billions of dollars in economic benefits on the Government of the People's Republic of China, we need to decide whether we want more of what this government has been doing for the last several years. In other words, the China MFN is about whether a government that routinely practices forced abortion and forced sterilization should be rewarded or punished.

Last week, I convened a hearing of my Subcommittee on International Operations and Human Rights. We heard from Harry Wu and other witnesses, but also from a woman from Fujian Province who gave stark and compelling testimony of how she ran the program and how she and the other family-planning cadres routinely compelled woman to have abortions in the ninth month of pregnancy. She talked about certificates—birth approval certificates—without which the child is illegal in the eyes of the Government and is, therefore, killed by abortion. She talked about the tears shed by women whose babies were first stolen by the State and then killed with a shot of formaldehyde or some other substance into the head.

This vote is about how we treat a government that imprisons Catholic bishops and priests, Protestant ministers, and Tibetan monks and nuns.

This is vote about a government that routinely uses slave labor, and has dying rooms in its orphanages where so-called unwanted children—mostly girls and handicapped—are left to die of starvation and disease.

This is the country of which Chi Haotian, the PRC Defense Minister, when he came to our country said, No one died at Tiananmen Square. My Subcommittee, Mr. Chairman, very quickly put together a hearing and had several eye witnesses come forward, including an editor from the People's Daily who told us how he saw people die right in front of his eyes. And yet this high-ranking Chinese Government official, who received a 19-gun salute and the red carpet treatment at the White House, said that no one died at Tiananmen Square. No doubt he and his comrades will be there at

Tiananmen Square to welcome our President when he visits. Chi was the one who ordered the killings.

Those who believe that "comprehensive engagement," will eventually bring about respect for human rights in China must ask themselves several questions.

First, how long do we need to keep trying this strategy before it begins to produce results? It has not succeeded yet in the 25 years that we've been trying it—25 years of a tragic, unrequited love affair with the Communist regime in Beijing. There is no question that increased contact with the West has changed China's economic system, but there is little or no evidence that it has increased the regime's respect for fundamental rights. As a matter of fact, Amnesty International and other organizations say things have actually gotten worse.

Mr. Chairman, this is because China's economic system is not changing from a Communist system into a free economy. Rather, it is making a much simpler transformation: from communism to fascism. Foreign businesses are permitted to make money and lots of it, but only if they take the Government as their partner. I repeat, this is not freedom; it is fascism. American businessmen made money in Nazi Germany in the 1930's, but at least they did not have the temerity to predict that because they were making money, human rights were somehow just around the corner.

What more does Beijing have to do before we admit that our engagement has not been constructive, that it has, instead, been destructive of human rights?

Second, when big business and the Clinton administration really want to change the conduct of the Government, they talk about sanctions. Let's not forget: When intellectual property rights were at risk, we very quickly said sanctions would be in the offing. And a 301 action was initiated, and we were all set to impose sanctions in order to preserve intellectual property rights and combat piracy and infringement of those copyrights..

Let me also say that Wei Jingsheng testified recently before my Subcommittee, and he made the point—and this is counter intuitive to what some of you may thing—that when we are in a mode of appeasement and working with the dictators, that's when the bullyboys in the Laogai—the Gulag system—are afraid to beat, punish, and mete out torture. He said, You may think that's not the case, but we know from experience, that things go from bad to worse as soon as you are in a concession mode.

I happen to believe very strongly, Mr. Chairman, that, as Mr. Solomon said, we should suspend MFN and say, Look, our markets are open, but you've got to make some fundamental changes in the way you treat your own citizenry and stop these abuses of human rights.

You know, the underground church—the Roman Catholic and the Protestant Evangelical Church, is under incredible siege. I met with Bishop Su, of Boading Province, an underground bishop who celebrated Mass for our delegation. He got arrested—rearrested. He had already spent 19 years in the Gulag because of his faith, and he went right back to the Gulag as a result of our meeting. Some other people have testified that, just as with other Communist countries over the years, as soon as MFN is locked in for another

year—in the book, as they say in baseball—right away they go to massive amounts of torture, executions, and the like because they know they're scot-free, nobody's looking.

We need to say that MFN and its linkage to human rights is something we care about. This Sub-committee and Members individually, when they vote on this on legislation, can advance the ball significantly. Where is China going to find a market for its $60-plus billion worth of goods? They're not going to find it in Europe, Asia, or anywhere else. We have real clout; let's use it on behalf of the suffering people in the People's Republic of China.

Thank you, Mr. Chairman.

[The prepared statement follows:]

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# Congress of the United States
## House of Representatives
Washington, DC 20515-3004

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COMMISSION ON SECURITY AND COOPERATION IN EUROPE
CO-CHAIRMAN

**Statement of Representative Christopher H. Smith**
**Chairman, Subcommittee on International Operations and Human Rights**

June 17, 1998

Whatever decision the Congress makes about MFN for China this summer, the American people will see as a decision about the role of morality in United States foreign policy. And they will be right.

Mr. Chairman, I think you would agree with me that legislatures should judge their actions against the two basic laws of economics: What you subsidize, you get more of. What you penalize, you get less of. So in judging whether we should continue to confer billions of dollars in economic benefits on the government of the People's Republic of China, we need to decide whether we want more of what this government has been doing for the last few years.

In other words, the China MFN vote is about whether a government that practices forced abortion and forced sterilization should be rewarded or punished. It is a vote about how to treat a government that imprisons Catholic bishops and priests and Protestant ministers and Tibetan monks and nuns. This is a vote about a government that uses slave labor, that has "dying rooms" in its orphanages where unwanted children are left to die of starvation and disease, that massacres its own young people at Tiananmen Square and then denies that there was ever a massacre.

Those who believe that "comprehensive engagement," as they call it, will eventually bring about respect for human rights in China must ask themselves several questions:

First, how long do we need to keep trying this strategy before it begins to produce results? It has not yet succeeded in the twenty-five years we have been trying it --- twenty-five years of a tragic unrequited love affair with the Communist regime in Beijing. There is no question that increased contact with the West has changed China's economic system -- but there is little or no evidence that it has increased the regime's respect for fundamental human rights.



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This is because China's economic system is **not** emerging from a communist system into a free economy. Rather, it is making a much simpler transformation --- from communism to fascism. Foreign businesses are permitted to make money, and lots of it, but only if they take the government as their partner. **I repeat, this is not freedom, it is fascism.** American businessmen made money in Nazi Germany in the 1930s, but they did not have the temerity to predict that because they were making money, human rights were just around the corner. What more does Beijing have to do before we admit that our engagement has not been constructive, that it has instead been destructive of human rights?

Second, when big business and the Clinton Administration really want to change Beijing's conduct --- for instance, in the effort to get China to respect international copyrights -- what do they do? Do they decide that we should be patient, that we should constructively engage for a few years, and sooner or later Beijing will come around? No. They use economic sanctions --- the very same sanctions they say would be counterproductive as a means of promoting political and religious freedom in China. But if economic sanctions are an effective tool in the war against software piracy, then why not in the war against torture? Why not in the war against religious and political persecution, against forced abortion, against the use of slave labor? Maybe there's an explanation, but the burden of offering it is on those who would use sanctions to protect software but not to protect torture victims.

Finally, I want to respond to the argument that taking away MFN would hurt some of the people we most want to help, such as those who are persecuted for practicing their religion. But this argument proves too much. In essence, it is an argument for the appeasement of **every** brutal regime in virtually **every** set of circumstances, because such regimes typically keep an ample supply of hostages. And yet history has shown that in the long run, appeasement of tyrants is counterproductive.

Contrary to what some have suggested, Christian missionaries in China --- at least those who minister to members of "unofficial" religions such as the Roman Catholic Church and the independent Protestant "house churches" rather than to religious institutions sanctioned by the Communist authorities --- are **already** subject to mistreatment. In the case of the missionary, this mistreatment most often amounts to expulsion from the country. But the Chinese believers with whom they meet are often subjected to far more severe penalties. For instance, Pastor Philip Xu is serving a three-year sentence in a labor camp, a sentence imposed under an administrative procedure that requires no trial, for having an "unauthorized meeting with a foreigner" --- that is, with a missionary. Roman Catholic Bishop Su Zhimin has spent over 20 years in jail and has been beaten and tortured. And the nine-year-old Panchen Lama has been in detention for over three years. When the Chinese Communists first arrested him, he was only six years old.

At a recent hearing of the Subcommittee on International Operations and Human Rights, I asked Wei Jingsheng what practical effects MFN and other concessions to the Chinese government have had for prisoners of conscience in China. He said that the torturers are usually more cautious in their treatment of prisoners at times when the United States is withholding some benefit. But then, as soon as there is "a turn for the better in the Sino-American . . . relationship . . . , last year specifically when the United States declared its intention to establish this strategic collaborative partnership with China, immediately the prisoners had been beaten and received other abuses."

At a hearing last October on whether constructive engagement is working, a young Muslim Uighur woman from the Xinjiang Uighur Autonomous Region told our subcommittee of an even more chilling cause-and-effect relationship between MFN and human rights. In February of 1997 a number of young Muslim men had been arrested for participating in a religious demonstration. According to the witness, "[w]e were little surprised about the patience of the Chinese government in making open executions. Everything was clear, they were waiting for the U.S. to offer Most Favored Nation Status to China. Right after MFN was approved by the Congress, the Chinese government made the first open execution of 7 Uighurs . . . . In order to 'kill the chicken to scare the monkeys," Chinese military forces load them on the open truck [and] drove slowly through the busy Uighur bazaar and neighborhoods. . . [through a] crying crowd including relatives, family members and friends." When the mourners got too close to the trucks, the Chinese soldiers opened fire and killed nine more people.

Mr. Chairman, the people of China know that the effect MFN has on their lives is consistent with the first law of economics. What we subsidize, we get more of. For victims of religious persecution, forced abortion, forced labor, and other ongoing human rights violations, the policy of "constructive engagement" has been tried and tried and tried. It has failed and failed and failed. We need to try something else. "Comprehensive appeasement" is too expensive, both for American interests and American values.

Chairman CRANE. Thank you.
Mr. Weldon.

**STATEMENT OF HON. CURT WELDON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA**

Mr. WELDON of Pennsylvania. Thank you, Mr. Chairman. It's a pleasure to be here today. I have a deep respect for both you and this Subcommittee, as well as my colleagues at the table with me.

My testimony today—you've put my statement in the record, so I will talk basically ad hoc. I will differ from my other colleagues at the table. As someone who is on the Human Rights Caucus and takes great pride in focusing on human rights issues around the world, I am pro-life and take great pride in my votes to stop abortion in this country and around the world. But I am pro-MFN.

I also come as the Chairman of the Military Research and Development Subcommittee, which oversees $37 billion of our dollars each year to focus on defense systems to protect our country, our people, and our troops from the growing proliferation posed by weapons of mass destruction and by missile technologies.

I am here to say that while I am pro-MFN, I am pro-constructive and enforced engagement with China. I am the first to admit that there are very serious problems, but, Mr. Chairman, I think we have to look at what's happening here. You have a country of 1.3 billion people with a Government about 50 years old. I would ask my colleagues to look back when America was 50 years old: Were women considered citizens? Were blacks considered human beings? They were pieces of property that we bought and sold. This country was not perfect. Now, I'm not trying to say that we should forgive China the atrocities that they do in forcing abortions and in other human rights violations. But to totally isolate them—and politically make the case that all is not going to be well unless we totally remove them from the world—I think will not have the desired result.

Let me say, Mr. Chairman, that nobody works harder on the issue of proliferation in this Congress than I do. I work this issue on a daily basis; but, unlike my colleagues, I'm willing to confront the Chinese. In my two trips to China last year, I sat across the table from General Gong at lunch, in front of all of his subordinates. Now, you remember General Gong is the one—No. 2 in the Chinese military—who issued the veiled threat against Los Angeles. And he was commenting to me about how unhappy they were with the United States. And I said, Let me tell you something, General: We in the United States do not take high Chinese officials making veiled threats against our cities lightly. He put his head down in embarrassment and didn't know what to say. That's the kind of approach we should be using: We should be confronting them across the table. We should be debating them and engaging them.

Now, on the issue of proliferation, Mr. Chairman, let me ask to put in the record a CRS, Congressional Research Service analysis that I've had prepared of 21 Chinese violations of arms controls agreements since 1992.

Chairman CRANE. Without objection, so ordered.

Mr. WELDON of Pennsylvania. This listing, which I had CRS prepare, basically shows potential violations of every major arms control agreement that this country is a signatory to and which China has also pledged to abide by, from the MTCR to other major arms control agreements. This administration only imposed sanctions in 3 of those 21 cases, and they were eventually waived. Now we can, of course, blame China. We can blame China for the most recent Loral case, which I'm in the middle of investigating, but, Mr. Chairman, let me say that if we have arms control agreements we don't enforce, maybe we ought to blame ourselves. Maybe we ought to look at the White House and ask this administration why there could be 21 consecutive violations of transfers of M–11 missiles to Pakistan, ring magnets to Pakistan for their nuclear weapons program, and no sanctions?

If you have an arms control agreement and you're not going to enforce it when it's violated, of course you can blame the country that's doing the violation. But I also blame our administration because the same practice is happening with Russia.

I would also be happy to enter into the record Mr. Chairman, the CRS report on Russia where there were 17 violations of arms control agreements in the past 6 years and, again, no sanctions were imposed.

[The information follows:]

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***Memorandum*** May 6, 1998

TO : Honorable Curt Weldon
U.S. House of Representatives

FROM : Shirley Kan, Analyst in Foreign Affairs, (ext. 7-7606) and
Robert Shuey, Specialist in U.S. Foreign Policy and National Defense
Foreign Affairs and National Defense Division

SUBJECT : **Chronology of Suspect Russian Weapon-Related Transfers**

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At your request, we have prepared the attached table listing controversial or illicit Russian transfers of weapons and weapon-related technology since the early 1990s. The table also lists any treaty or multilateral regime that may have been violated by such transfers, any provision of U.S. law that may require sanctions for such transfers, and any punitive action taken by the U.S. government in response to the transfers. We gathered the information for the table from media accounts and publicly available government reports that may not correspond to classified accounts of these incidents. Specific sources can be provided upon request. The Director of Central Intelligence (DCI)'s June 1997 report to Congress, as required in section 721 of the Intelligence Authorization Act for FY 1997, was also used. It is entitled, "The Acquisition of Technology Relating to Weapons of Mass Destruction and Advanced Conventional Munitions: July-December 1996."

Also attached are copies of CRS Report for Congress 97-474F, *Iran: Arms and Technology Acquisitions,* updated March 27, 1998, by Kenneth Katzman; CRS memorandum, *Implications for U.S. Russian Space Cooperation of Russian Sales of Rocket Engines to India and Related MTCR Issues,* September 13, 1994, by Robert Shuey and Marcia Smith; CRS Report for Congress 98-299F, *Russian Missile Technology and Nuclear Reactor Transfers,* March 27, 1998, by Stuart Goldman, Kenneth Katzman, Robert Shuey, and Carl Behrens; and CRS Report 98-103F, *Nuclear, Biological, and Chemical Weapons and Ballistic Missiles: The State of Proliferation*, February 10, 1998, coordinated by Robert Shuey.

In some cases of Russian missile technology transfer, we have indicated the Missile Technology Control Regime (MTCR), the Arms Export Control Act (AECA), and the Export Administration Act of 1979 (EAA) may apply. However, because Russia is a partner in the MTCR, the sanctions required by section 73 of the AECA and by section 11B of the EAA frequently do not apply.

Section 73(b) AECA and section 11B(b)(2) EAA, both titled *Inapplicability with Respect to MTCR Adherents,* state that sanctions do "not apply with respect to (1) any export,

transfer, or trading activity that is authorized by the laws of an MTCR adherent, if such authorization is not obtained by misrepresentation or fraud; or (2) any export, transfer, or trade of an item to an end user in a country that is an MTCR adherent."

Section 73(c) AECA and section 11B(b)(3) EAA, both titled *Effect of Enforcement Actions by MTCR Adherents,* state "sanctions set forth in [the preceding] paragraph ... may not be imposed under this subsection on a person with respect to acts described in such paragraph or, if such sanctions are in effect against a person on account of such acts, such sanctions shall be terminated, if an MTCR adherent is taking judicial or other enforcement action against such person with respect to such acts, or that person has been found by the government of an MTCR adherent to be innocent of wrongdoing with respect to such acts."

Section 74(3) AECA and section 11B(c)(3) EAA state "the term `MTCR adherent' means a country that participates in the MTCR or that, pursuant to an international understanding to which the United States is a party, controls MTCR equipment or technology in accordance with the criteria and standards set forth in the MTCR...."

Language to cover development of chemical, biological, and nuclear weapons in the Iran-Iraq Arms Non-Proliferation Act of 1992 (section 1604 and 1605) was not enacted until February 10, 1996.

In some of the cases listed in the table, the Administration may have secretly sanctioned Russia or Russian persons or entities, and such actions are not publicly known. There have been a number of determinations to impose sanctions that withheld names and nationalities of the sanctioned entities, on grounds that disclosure would harm U.S. national security.

Reported sales related to chemical weapons do not violate the Chemical Weapons Convention unless they occur after April 29, 1997, when the accord entered into force.

Please see pages 3 and 17 of CRS report 98-299F for further discussion of the statutory sanctions.

**Abbreviations Used**

Regimes:

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|---|---|
| BWC | Biological Weapons Convention |
| MTCR | Missile Technology Control Regime |

U.S. Laws:

| | |
|---|---|
| AECA | Arms Export Control Act |
| EAA | Export Administration Act |
| FAA | Foreign Assistance Act |
| FOAA | Foreign Operations Appropriations Act |
| IIANPA | Iran-Iraq Arms Non-Proliferation Act |
| NPPA | Nuclear Proliferation Prevention Act |

| Date of Transfer or Report | Reported Russian Transfers That May Have Violated a Regime or Law | Possibly Applicable Treaties, Regimes, and/or U.S. Laws | Administration's Response |
|---|---|---|---|
| early 1990s | Russians sold drawings of a sarin plant, manufacturing procedures, and toxic agents to a Japanese terrorist group. | AECA sec. 81<br>EAA sec. 11C | No publicly known sanction. |
| 1991 | Transferred to China three RD-120 rocket engines and electronic equipment to improve accuracy of ballistic missiles. | MTCR<br>AECA sec. 73<br>EAA sec. 11B | No publicly known sanction. |
| 1991-1995 | Transferred Cryogenic liquid oxygen/hydrogen rocket engines and technology to India. | MTCR<br>AECA sec. 73<br>EAA sec. 11B | Sanctions against Russia and India under AECA and EAA imposed on May 6, 1992; expired after 2 years. |
| 1992-1995 | Russian transfers to Brazil of carbon-fiber technology for rocket motor cases for space launch program. | MTCR<br>AECA sec. 73<br>EAA sec. 11B | Sanctions reportedly secretly imposed and waived. |
| 1992-1996 | Russian armed forces delivered 24 Scud-B missiles and 8 launchers to Armenia. | MTCR<br>AECA sec. 73<br>EAA sec. 11B | No publicly known sanction. |
| June 1993 | Additional Russian enterprises involved in missile technology transfers to India. | MTCR<br>AECA sec. 73<br>EAA sec. 11B | Sanctions imposed on June 16, 1993 and waived until July 15, 1993; no publicly known follow-up sanction. |
| 1995-present | Construction of 1,000 megawatt nuclear reactor at Bushehr in Iran. | IIANPA sec. 1604 and 1605<br>FOAA<br>NPPA sec. 821<br>FAA sec. 620G | Refused to renew some civilian nuclear cooperation agreements; waived sanctions on aid. |

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|---|---|---|---|
| Aug. 1995 | Russian assistance to Iran to develop biological weapons. | BWC<br>AECA sec. 81<br>EAA sec. 11C<br>IIANPA sec. 1604 and 1605<br>FAA sec. 620G and 620H | No publicly known sanction. |
| Nov. 1995 | Russian citizen transferred to unnamed country technology for making chemical weapons. | AECA sec. 81<br>EAA sec. 11C | Sanctions imposed on Nov. 17, 1995. |
| Dec. 1995 | Russian gyroscopes from submarine launched ballistic missiles smuggled to Iraq through middlemen. | United Nations Sanctions<br>MTCR<br>AECA sec. 73<br>EAA sec. 11B<br>IIANPA sec. 1604 and 1605<br>FAA sec. 620G and 620H | No publicly known sanction. |
| July-Dec. 1996 | DCI reported Russia transferred to Iran "a variety" of items related to ballistic missiles. | MTCR<br>AECA sec. 73<br>EAA sec. 11B<br>FAA sec. 620G and 620H<br>IIANPA sec. 1604 and 1605<br>FOAA | No publicly known sanction. |
| Nov. 1996 | Israel reported Russian assistance to Syria to build a chemical weapon plant. | AECA sec. 81<br>EAA sec. 11C<br>FAA sec. 620G and 620H | No publicly known sanction. |
| 1996-1997 | Delivered 3 Kilo diesel-electric submarines to Iran. | IIANPA sec. 1604 and 1605<br>FAA sec. 620G and 620H | No publicly known sanction. |
| Jan.-Feb. 1997 | Russia transferred detailed instructions to Iran on production of the SS-4 medium-range missile and related parts. | MTCR<br>AECA sec. 73<br>EAA sec. 11B<br>FAA sec. 620G and 620H<br>IIANPA sec. 1604 and 1605<br>FOAA | No publicly known sanction. |

| | | | |
|---|---|---|---|
| April 1997 | Sale of S-300 anti-aircraft/anti-missile missile system to Iran to protect nuclear reactors at Bushehr and other strategic sites. | IIANPA sec. 1604 and 1605<br>FAA sec. 620G and 620H | No publicly known sanction. |
| Oct. 1997 | Israeli intelligence reported Russian technology transfers for Iranian missiles developed with ranges between 1,300 and 10,000 km. Transfers include engines and guidance systems. | MTCR<br>AECA sec. 73<br>EAA sec. 11B<br>IIANPA sec. 1604 and 1605<br>FAA sec. 620G and 620H<br>FOAA | No publicly known sanction. |

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***Memorandum*** May 6, 1998

TO : Rep. Curt Weldon
Attention: Debbie Hughes

FROM : Shirley Kan (ext. 7-7606)
Analyst in Foreign Affairs
Foreign Affairs and National Defense Division

SUBJECT : Chronology of Chinese Weapon-related Transfers

This memorandum was prepared in response to your request for an update of a chronology in tabular form of sensitive weapon-related transfers by China and the Administration's response (since the beginning of the Clinton Administration in 1993) — originally prepared in September 1997 for the House National Security Committee. The following transfers were reported by news media and the Director of Central Intelligence. Specific sources can be produced on request. Some transfers were confirmed by the Administration. For details, see attached CRS Issue Brief 92056, *Chinese Proliferation of Weapons of Mass Destruction: Current Policy Issues* and CRS Report 97-850F, *China's Compliance with International Arms Control Agreements*, updated January 16, 1998. If you have further questions, please call at 7-7606.

**Abbreviations Used for International Regimes to Which China Committed**

BWC Biological Weapons Convention
MTCR Missile Technology Control Regime
NPT Nuclear Nonproliferation Treaty

| Date of Transfer or Report | Reported Transfer by China | Possible Violation | Administration's Response |
|---|---|---|---|
| Nov. 1992 | M-11 missiles or related equipment to Pakistan (The Administration did not officially confirm reports that M-11 missiles are in Pakistan.) | MTCR<br>Arms Export Control Act<br>Export Administration Act | sanctions imposed on Aug. 24, 1993, for transfers of M-11 related equipment (not missiles); waived on Nov. 1, 1994 |
| Mid-1994 to mid-1995 | dozens or hundreds of missile guidance systems and computerized machine tools to Iran | MTCR<br>Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| 2nd quarter of 1995 | parts for the M-11 missile to Pakistan | MTCR<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Dec. 1994 to mid-1995 | 5,000 ring magnets for an unsafeguarded nuclear enrichment program in Pakistan | NPT<br>Export-Import Bank Act<br>Nuclear Proliferation Prevention Act<br>Arms Export Control Act | considered sanctions under the Export-Import Bank Act; but announced on May 10, 1996, that no sanctions would be imposed |
| July 1995 | more than 30 M-11 missiles stored in crates at Sargodha Air Force Base in Pakistan | MTCR<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Sept. 1995 | calutron (electromagnetic isotope separation system) for uranium enrichment to Iran | NPT<br>Nuclear Proliferation Prevention Act<br>Export-Import Bank Act<br>Arms Export Control Act | no sanctions |

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| 1995-1997 | C-802 anti-ship cruise missiles and C-801 air-launched cruise missiles to Iran | Iran-Iraq Arms Nonproliferation Act | no sanctions |
| before Feb. 1996 | dual-use chemical precursors and equipment to Iran's chemical weapon program | Arms Export Control Act<br>Export Administration Act | sanctions imposed on May 21, 1997 |
| summer 1996 | 400 tons of chemicals to Iran | Iran-Iraq Arms Nonproliferation Act[1]<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Aug. 1996 | plant to manufacture M-11 missiles or missile components in Pakistan | MTCR<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Aug. 1996 | gyroscopes, accelerometers, and test equipment for missile guidance to Iran | MTCR<br>Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Sept. 1996 | special industrial furnace and high-tech diagnostic equipment to unsafeguarded nuclear facilities in Pakistan | NPT<br>Nuclear Proliferation Prevention Act<br>Export-Import Bank Act<br>Arms Export Control Act | no sanctions |
| July-Dec. 1996 | Director of Central Intelligence (DCI) reported "tremendous variety" of technology and assistance for Pakistan's ballistic missile program | MTCR<br>Arms Export Control Act<br>Export Administration Act | no sanctions |

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|---|---|---|---|
| July-Dec. 1996 | DCI reported "tremendous variety" of assistance for Iran's ballistic missile program | MTCR<br>Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| July-Dec. 1996 | DCI reported principal supplies of nuclear equipment, material, and technology for Pakistan's nuclear weapon program | NPT<br>Nuclear Proliferation Prevention Act<br>Export-Import Bank Act<br>Arms Export Administration Act | no sanctions |
| July-Dec. 1996 | DCI reported key supplies of technology for large nuclear projects in Iran | NPT<br>Iran-Iraq Arms Nonproliferation Act<br>Nuclear Proliferation Prevention Act<br>Export-Import Bank Act<br>Arms Export Administration Act | no sanctions |
| July-Dec. 1996 | DCI reported "considerable" chemical weapon-related transfers of production equipment and technology to Iran | Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Jan. 1997 | dual-use biological items to Iran | BWC<br>Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| 1997 | chemical precursors, production equipment, and production technology for Iran's chemical weapon program, including a plant for making glass-lined equipment | Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |

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| Sept. to Dec. 1997 | China Great Wall Industry Corp. provided telemetry equipment used in flight-tests to Iran for its development of the Shahab-3 and Shahab-4 medium range ballistic missiles | MTCR<br>Iran-Iraq Arms Nonproliferation Act<br>Arms Export Control Act<br>Export Administration Act | no sanctions |
| Nov. 1997/<br>April 1998 | may have transferred technology for Pakistan's Ghauri medium-range ballistic missile that was flight-tested on April 6, 1998 | MTCR<br>Arms Export Control Act<br>Export Administration Act | no sanctions |

And we wonder why India and Pakistan are saber-rattling now, or why Iran and Iraq have medium-range missile or nuclear capabilities. It's because they got that technology from China and Russia, and they got it in spite of arms control agreements that, if they were properly enforced, would have stopped that technology from being sold or transferred abroad.

So I say the bulk of the problem lies right here in our city, right at the end of Pennsylvania Avenue. If we really want to put the heat on China, then start enforcing the laws on the books; start using the pressure we can apply. But should we hurt the Chinese people—the Chinese people who would be set aside—and portray them as some kind of radicals who should be ostracized from the world community? I think not.

I think, Mr. Chairman, that the time has come for us—and, sure, I understand the political vote. The easy political vote is the vote against MFN. But I say—as someone who was willing to hold China accountable every step of the way for its human rights violations, for its policy on forced abortions—on the issue of defense and security, on violations of arms control agreements, it is better to deal with them directly and confront them. On both of my trips to China last year, I spoke at the PLA's National Defense University. I went before mid- and senior-level officers in the Chinese military and I confronted them on the issues that I'm bringing up today: arms control violations, cooperation in nuclear technology with Pakistan, M–11 missile sales to Pakistan, and the other numerous violations that I cite here in this document. That is the way to deal with China, and eventually we will prevail.

Allowing the argument that's put forth by my colleagues here—all of whom are my good friends—I think it is the wrong signal, at the wrong time, and I think in the end will not help us. So I'm here to say, Mr. Chairman, that I support the renewal of MFN.

[The prepared statement follows:]

## Testimony of Congressman Curt Weldon

**House Ways and Means Subcommittee on Trade**
**Hearing on China-MFN**

June 17, 1998

Mr. Chairman, I am here today to address some concerns that have arisen regarding U.S. relations with China and the tools that we have to address them. While there are many contexts in which we can view U.S.-China relations, as Chairman of the House National Security Subcommittee on Research and Development, I would like to specifically focus on security issues and their relationship to China's MFN status.

I have visited China twice in the past year and found both trips to be eye-opening. Both sides benefitted from the opportunity to better understand one another's mysterious culture. I can readily understand U.S. Ambassador James Sasser's assessment that the most challenging aspect of his job is getting Americans to understand the Chinese and the Chinese to understand Americans. If one accepts the description of Russia as "a riddle wrapped in a mystery inside an enigma," then one would have to add two mystifying layers to accurately describe China and the age-old traditions upon which its culture is based. While fully understanding China remains a challenge, we cannot afford to ignore this rapidly emerging economic power and increasingly significant military power. It is in our security interest to engage China to work with us where we can, and to have a forum to effectively prod them on issues where we continue to disagree.

One thing I have learned about dealing with Chinese officials is that you must simply look them in the eye and be firm in order to garner their respect. As one who has consistently challenged this Administration to hold the Chinese accountable for proliferation and their human rights record, I absolutely believe we must pursue these matters at the highest levels and use every effective tool at our disposal to get them where we want them to be. But we must focus our efforts, and in the case of retaliatory measures, ensure that the punishment is targeted to the crime.

We have provisions for sanctions with respect to proliferation, and we should enforce them. We can seek restrictions on IMF and World Bank loans in response to human rights abuses. But denying MFN status to China - applying an "all-or-nothing" mechanism instead of selective sanctions targeted to the wrongdoing - is the wrong way to go. In my view, that is like using a sledge hammer to perform an intricate surgery. Not only do we isolate China and potentially invite aggressive behavior on their part, we lose any leverage we might have to prod China in the right direction on human rights and democracy. And in the process, we undermine our own economy by negating a $13 billion market for U.S. companies.

I sympathize with those who argue that sanctions are not sufficient, especially in light of the Administration's refusal to employ them. We should continue to hold the Administration's feet to the fire on this matter. I also feel compelled to add that I do not believe that even if sanctions were applied in all cases, that they are a wholly sufficient foundation on which we can base our national security. With or without China's cooperation, we must pursue a multi-pronged security strategy which includes preventive efforts, as well as effective defensive and offensive capabilities to hedge against threats around the globe. We should also hold the Administration accountable for what I believe are its failings in that regard. I am even more concerned that we may have willingly handed the Chinese the technologies to improve their offensive capabilities against us - but again, that should not be tied to this debate. We must hold those in this country accountable for any misdeeds in that regard. Despite our frustrations with our own shortcomings or those of the Chinese, we must understand that lashing out at China by denying MFN now, even if it makes us feel better, could well put us in the position of winning a psychological battle and losing the real war. The bottom line is that it will do nothing to advance our own national security goals.

If anything, MFN denial will isolate China, which will hamper any ability we have to get increased cooperation on critical security goals -- especially nonproliferation. While China may not have the capability to project power on a global scale outside of its rocket forces, its status as a formidable, continental superpower is undeniable. The more threatened China feels, the more likely it is to emphasize increased military power for itself and its allies. Denial of MFN could make a dicey Asian situation significantly worse by altering alliances and capabilities against the West. And the less civilian market it has to sustain its economy, the more likely it is that China will focus efforts on lucrative arms exports.

The greatest asset that the capabilities of our armed forces have given us is the respect of the world as a defender of democracy and justice. This deference has been instrumental in limiting the need for American military action. Were we to disengage from our strong global posture, diminishing world respect, our forces would certainly recognize an increase in the number of challenges they face. If we were to disengage from the Chinese, we would not only be unable to look them in the eye and face increased challenges from them, but we would lose the hard-won diplomatic foot in the door-- the benefits of which we have yet to fully recognize. That is precisely why three Presidents, six Secretaries of Defense, six Secretaries of State, and five National Security Advisors have signed an open letter to Congress urging it to approve MFN status for China.

I respect the heart-felt convictions expressed by my colleagues here today and I sincerely support their objective to have China recognize the tenets of human rights that we hold so dear. I simply feel that the indiscriminate and arbitrary tool of "China-MFN" will not only not be ineffective, but it will be counterproductive to our shared goals.

The economic prosperity of the United States provides us the luxury of concentrating on the relative minutia of maintaining a healthy society. If we are to, in effect, restrict China's economic development on a broad scale, which removing normal trade relations will undoubtedly do, we will only stunt the social development to which a healthy economy is so

inherently connected. As we all know, nations with healthy economies are far less likely to experience political instability, feel threatened by social insurrection, or, as a possible result, wage war. Cutting off the huge Chinese market to U.S. exporters likewise undercuts our own economy. Ironically, cutoff of MFN would also isolate the United States, because our key allies are likely to refuse to do the same.

We should continue to forcefully engage the Chinese on issues of disagreement, but at the same time recognize that full achievement of the ideals for which the United States now proudly stands for was a long, evolutionary process. We have come a long way in two centuries, but we continue to aspire for even better for our own people and others around the globe. We cannot expect the Chinese to change its mind set or ways overnight. I am not excusing or forgiving Chinese human rights transgressions, but I am advocating our continued diligence and patience in helping them to recognize their flaws, just as we do ours every day. Let's not undercut one of the most powerful engines of democracy and human rights in the world -- active trade and a blooming capital economy. Let's preserve our leverage to remain an agent of change by preserving normal trade relations with China.

Chairman CRANE. Thank you, Mr. Weldon.

Ms. Pelosi.

**STATEMENT OF HON. NANCY PELOSI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Ms. PELOSI. Thank you very much, Mr. Chairman. Here we are again: 10 years we've been doing this, 10 hearings—9 years; next year it will be 10. And to tell you the truth, Mr. Chairman, I have never expected this Subcommittee to ever vote out Mr. Solomon's amendments to reject the President's special request for a special waiver for China to have most-favored-nation status. But I would hope that, in having this discussion, we point out the need for a change in U.S.-China policy.

Although my colleague, Mr. Weldon, and I disagree on MFN, I certainly agree with him that we have to enforce our own laws, and in making this point on MFN a privileged resolution that comes to the floor, it gives us that opportunity. So if people say they don't approve of President Clinton's policy, MFN is the cornerstone of it. And one way to get the President to change his policy is to remove the support for it.

I come as a member of the Appropriations Committee, as the ranking member of the Foreign Operations Committee; I also serve as a member of the Intelligence Committee. And I can say with great confidence that in the areas of concern to Congress—trade, proliferation, and human rights—that the case is even stronger than ever that we should not renew most-favored-nation status for China this year.

I know as I say that—I wish that I could say that progress has been made but, unfortunately, that is not the case. The President likes to describe his engagement policy as constructive engagement. I say it is neither constructive nor true engagement, because it is a policy that does whatever the Chinese want; it does not have the give-and-take to respond to our concerns about proliferation, human rights, and trade. I want to set the record very straight, because the President is fond of saying that those who oppose him on his China policy wish to isolate China. Nothing could be further from the truth.

We want engagement that is honest, that is effective, and that sustains our values, our own economy, and international security.

I've said already that I don't expect this Subcommittee to reject the President's request, but I do think that this Subcommittee should face the facts. As I've said, Mr. Chairman, we've been doing this for many years, and when we first set upon this issue about 10 years ago, the trade deficit was about $2 billion with China. For 1997, it was $50 billion and for 1998 it is projected to be $63 billion—the trade deficit is on President Clinton's watch alone.

Now, how effective is his policy on trade? On President Clinton's watch alone, by the end of this year, the trade deficit—for his watch alone—will be a quarter of a trillion dollars—not million, not billion—a quarter of a trillion dollars and growing. Something must be wrong with that.

Don't take my word for it. The administration's own book, the United States Trade Representative Estimate on Foreign Trade Barriers, says that China has used prohibitively high tariffs—

which in late 1997 still reached as high as 100 percent on some motor vehicles—in combination with other import restrictions and foreign exchange controls to protect its domestic industry and restrict imports. These high nominal tariff rates, to which China adds applicable value-added taxes and, on some goods, consumption taxes, contribute to inefficiencies in China's economy and pose a major barrier to U.S. commercial opportunity.

And regarding trade in services, the same report notes that China's market for services today remains essentially closed. Restrictive investment laws, lack of transparency in administrative procedures, and arbitrary application of regulations and law limit U.S. service exports and investment in China. It goes on further, but I want to talk about the proliferation issue, so I refer you to the USTR's own book on foreign trade barriers.

In the case of proliferation, those who support the status quo are saying we need the Chinese Government's help in solving the nuclear weapons crisis in south Asia. But Pakistan's nuclear program was developed with China's help, which the U.S. Government consistently ignored, as Mr. Weldon mentioned. Without China's help, Pakistan would not have been able to develop or carry out its missile capacity with which it could deliver nuclear warheads or carry out its nuclear tests. Without China's help, Pakistan would not be participating in a nuclear arms race in south Asia. And in addition to that, those who support the status quo tout the agreement that President Jiang Zemin signed last October, halting China's proliferation of weapons of mass destruction. Less than 4 months later, Mr. Chairman, China was caught trying to transfer dangerous chemical weapons to Iran, in violation of the very agreement President Clinton is claiming as progress. I submit more about that as well as more on proliferation, for the record.

In terms of human rights—so much to say, so little time. Those who support the status quo point to the forced exile of Wang Deng and Wei Xin Chang as progress. These people were not freed. They were forcefully exiled—forcibly exiled. They cannot speak freely in China; how could that be progress? I will submit a list of all of the atrocities and human rights violations for the record, Mr. Chairman. According to Human Rights Watch Asia, there has been no substantial improvement in China's human rights record in the past year. Isolated prisoner releases such as the release of Weng Deng and Wei Xin Chang, have little impact on the overall state of repression in China. In the 6 months since Wei's release, others have been detained and arrested. The overall pattern of government treatment of political dissidents has not changed.

Mr. Chairman, I wish I had more time. As we embark on our annual debate over granting MFN, most-favored nation status to China we must face up to the realities of the U.S.-China relationship. MFN is the centerpiece of the administration's China policy, a policy which is not working. Instead of an honest, effective, and sustainable engagement which would make trade fairer, the world safer, and people freer, we have in place a policy which actually makes matters worse. Trade with China is growing more lopsided. China's proliferation of weapons of mass destruction continues, and China's people are not free.

We have the opportunity to signal to this administration, and to the Chinese Government, that the status quo is not acceptable by opposing MFN for China. We must associate ourselves with the aspirations of the Chinese people.

And I remind my colleague, Mr. Weldon, that Taiwan is also 50 years old, and enjoys a thriving democracy—and their elections were even threatened by missiles from mainland China just recently. So 50 years, for some of us, is old. For some of us, it is young; for me, it's young. But I point to the fact that, because the people of China share our aspirations, they should not be penalized because they live under an authoritarian regime which promises the mirage of a market for some products made in America at the expense of our values—and hopefully not at the expense of our international security.

Thank you, Mr. Chairman, Mr. Matsui, members of the committee.

[The prepared statement follows:]

Representative Nancy Pelosi
Ways and Means Subcommittee on Trade
Hearing on Most Favored Nation (MFN) status for China

June 17, 1998

Mr. Chairman, Ranking Member Matsui and members of the Subcommittee, thank you for the opportunity to appear before you today at this important hearing on the President's request for a waiver of law to grant Most Favored Nation (MFN) trade status for China. As you know, I join my colleagues in appearing before you annually to discuss Congressional concerns about U.S. policy toward China, concerns which are focused in the three broad categories of trade, proliferation and human rights. Every year, I wish that we could come in and say that progress has been made, and every year, we must tell the truth that the reality is worse than the year before. This year is no exception. In terms of the U.S.-China trade relationship, China's proliferation of weapons of mass destruction technology, and the protection and promotion of democratic freedoms and basic human rights, it is clear that the Administration's policy of so-called "constructive engagement" is a failure. The situation is getting worse, not better, and we are in serious need of a new U.S.-China policy of honest, effective and sustainable engagement.

I am under no illusions that this Subcommittee will vote to revoke MFN for China. It never has, and I suspect it never will. Before we engage in our debate, however, I believe it is important to state for the record that neither I nor the people with whom I work in the coalition which opposes the Administration's China policy believe that we should be isolating China. I have come to the sad conclusion that those who mischaracterize our position as isolationist do so because they must cover for the failure of so-called "constructive engagement". When the facts are not there, people sometimes unfortunately resort to polarization. Such mischaracterization does our debate and the entire U.S.-China issue a disservice. Opponents of the Clinton policy advocate honest, effective and sustainable engagement.

**TRADE**

Now let us face the facts on trade. In preparation for today's hearing, Mr. Chairman, I reviewed my testimony before this very Subcommittee exactly one year ago. It is striking that the issues of concern from last year -- issues relating to lack of access to the Chinese market for the vast majority of U.S. goods and services, compulsory technology and production transfer by U.S. companies in order to do business with China, and intellectual property rights piracy -- are the same. There is no progress to report in making trade fairer. The statistics tell a bleak story.

The U.S. trade deficit with China was $49.7 billion in 1997 and is conservatively projected to be $63 billion for 1998. This deficit is up from $3 billion at the time of the Tiananmen Square massacre in 1989. During the years of the Clinton Administration alone, by the end of 1998, the U.S. trade deficit with China will reach $238 billion -- one-quarter of a trillion dollars in U.S. trade deficit with China in the past five years alone. Surely this magnitude

of deficit is not the hallmark of a sound policy.

Again this year, those who support the status quo policy are talking about the importance of China's market for U.S. goods and services. But only 1.9% of all U.S. exports are allowed into China, while 34.3 % of Chinese exports come into the United States. From 1985 to 1997, while U.S. exports to China grew 3 ½ times, imports from China grew 16 times.

Over the past three years, U.S. exports have grown 15% worldwide, but the percentage of overall U.S. exports going into China has actually decreased, not increased, down from 2% to 1.9%. Over that same three year period, China's economy has grown by 29%. U.S. exports have not even kept pace with the growth of the Chinese economy and Chinese consumers do not have access to U.S. goods and services despite the fact we continue to grant Chinese products preferential access to the U.S. market.

According to the United States Trade Representative's 1998 National Trade Estimate Report on Foreign Trade Barriers,

> China has used prohibitively high tariffs -- which in late 1997 still reached as high as 100 percent on some motor vehicles -- in combination with other import restrictions and foreign exchange controls to protect its domestic industry and restrict imports. These high nominal tariff rates -- to which China adds applicable value-added taxes and, on some goods, consumption taxes -- contribute to inefficiencies in China's economy and pose a major barrier to U.S. commercial opportunities.

The same Administration report notes that regarding trade in services,

> ...China's market for services today remains essentially closed. Restrictive investment laws, lack of transparency in administrative procedures, and arbitrary application of regulations and laws limit U.S. service exports and investment in China. Service trade opportunities, particularly in the financial services, telecommunications, audiovisual, distribution, professional services and travel and tourism sectors, have been affected by a variety of limitations on foreign participation throughout China's economy.

What is remarkable to me, Mr. Chairman, is that every year we hear that the importance of the Chinese market justifies the current policy, and every year the current policy fails to remove barriers to access to the Chinese market. Something is clearly wrong.

**PROLIFERATION**

Something is clearly wrong with our non-proliferation policy, too.

Those who support the status quo policy are saying that we need the Chinese government's help in solving the nuclear weapons crisis in South Asia, but Pakistan's nuclear program was developed with China's help, which the U.S. government has consistently ignored.

Without China's help, Pakistan would not have been able to develop or carry out its recent nuclear test. Without China's help, Pakistan would not have the missile capability with which it could deliver nuclear warheads. Without China's help, Pakistan would not be participating in a nuclear arms race in South Asia.

Those who support the status quo policy have touted the agreement that Chinese President Jiang Zemin signed at the summit last October as progress in halting China's proliferation of weapons of mass destruction. Yet less than four months later, the Administration caught China trying to transfer dangerous chemical weapons to Iran, in violation of the very agreement the President is claiming as progress.

There are reports that China is discussing sales of missile test equipment to Iran and helping Libya develop its own missile program. Such actions are in violation of promises made in 1994 by the Chinese government to the United States not to sell dangerous missiles and related equipment, as well as its stated commitment to abide by the Missile Technology Control Regime (MTCR) guidelines.

The Administration has consistently turned a blind eye to China's proliferation of weapons of mass destruction technology to dangerous countries and rogue states, has consistently swallowed Chinese promises to stop these dangerous activities once the activities have been brought into the public eye, and has consistently argued that it is making progress in raising non-proliferation concerns with the Chinese government. Something is wrong here.

**HUMAN RIGHTS**

Those who support the status quo policy point to the forced exile of Wei Jingsheng and Wang Dan as evidence that human rights is improving in China and that the Administration's human rights policy is working, but they gloss over the continued detention, harassment and imprisonment of thousands of others who speak out for freedom in China and Tibet or seek to practice their religious beliefs. Here are the facts on human rights in China.

The Chinese government:

- continues to hold in prison at least 250 people imprisoned since the 1989 Tiananmen Square massacre, and more than 2,000 political prisoners and religious prisoners including independent Catholics and Protestants, Tibetan Buddhist nuns and monks, and Muslim leaders in Xinjiang; and at least 230,000 prisoners in "reeducation through labor" camps, who are held without charge or trial;
- continues the brutal repression of the religion, people and culture of Tibet;
- maintains official controls over religious belief and practice and continues the persecution of evangelical Protestants and Roman Catholics who choose to worship independently of the government sanctioned (and controlled) church, forcibly closing and sometimes destroying "house churches," and harassing and imprisoning religious leaders;

- continues to harass, detain, arrest or exile labor organizers and political activists and the families of dissidents living both in China and in the United States;
- restricts freedom of press, association and expression;
- has not yet signed the International Covenant on Civil and Political Rights, which it announced it would sign this spring. The Chinese government has also said that it intends to take exception to Article 19, which guarantees the right to freedom of expression;
- has not yet ratified the International Covenant on Economic, Social and Cultural Rights, which it signed in October 1997; and
- is not cooperating with the International Committee on the Red Cross (ICRC) in efforts to grant access to prisoners by international human rights organizations.

According to Human Rights Watch/Asia:

> There has been no substantial improvement in China's human rights record in the past year. Isolated prisoner releases, such as the release of Wang Dan in April and Wei Jingsheng in November 1997, have little impact on the overall state of repression in China. In the six months since Wei's release, others have been detained and arrested. The overall pattern of the government's treatment of political dissidents has not changed.

Mr. Chairman, as we embark on our annual debate over granting China preferential trade status, we must face up to the realities of the U.S.-China relationship. MFN is the centerpiece of the Administration's China policy, a policy which is not working. Instead of an honest, effective and sustainable engagement which would make trade fairer, the world safer, and people freer, we have in place a policy which is actually making matters worse. Trade with China is growing more lopsided; China's proliferation of weapons of mass destruction continues; and China's people are still not free. We have the opportunity to signal to this Administration and to the Chinese government that the status quo is not acceptable by opposing MFN for China. I urge you to take this courageous and important step.

Chairman CRANE. Thank you, Ms. Pelosi.

Our final witness is Mr. Dooley, and if your comments exceed 5 minutes that will be part of the permanent record in printed form, not verbal. Please proceed.

**STATEMENT OF HON. CALVIN DOOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. DOOLEY. Thank you, Mr. Chairman. And thanks to all you Members of the Subcommittee for giving me the opportunity to appear before you today. As you know, I have a been a strong supporter of continued normal trading relations with China, and have worked hard to advance a protrade agenda in Congress. I am concerned about the growing reluctance of the Congress to provide the leadership needed on international issues to make improvements in trade relations and economic conditions throughout the world.

Opponents of extending MFN have discussed China's human rights record, nuclear proliferation, religious freedoms, and barriers. Clearly, problems exist with China and work needs to continue on all fronts. However, Presidents Clinton, Bush, Reagan, Carter, and Ford have recognized that engagement is a better policy than isolationism. They recognize that to wall ourselves off from 20 percent of the world's population is not in the interests of the citizens of China or the working men and women of the United States. President Clinton's trip to China later this month will provide the United States with another forum to pursue improvements in all these areas. Without a policy of engagement, this type of trip and the benefits that it will provide would not be possible.

The reality is that China has one of the fastest growing economies in the world. From 1979 to 1997, China's real GDP grew average rate of 9.9 percent annually, and projected growth is estimated by some at an average rate of 7 percent a year over the next two decades. At this rate China, could double the size of its economy every 10 years.

I represent the San Joaquin Valley, CA. And this highly productive agricultural area produces agriculture commodities worth in excess of $22 billion annually, more than half of which is exported. China is currently the sixth largest export market for U.S. agricultural goods. In 1996, China bought over $1.9 billion of U.S. agricultural products. With 1.2 billion people and limited arable land, China must rely on imports to satisfy its demands for food. USDA estimates that two-thirds of the future growth in U.S. farm exports will be in Asia, and of that increase 50 percent will be in China alone.

We must maintain our ability to be a reliable supplier of agricultural products. Our competitors in world market—Australia, Europe, Canada, and South America—stand ready to fill the needs of China into the next century if we cut off trade.

Our ultimate goal must be to fully integrate China into the world trading arena as a full participant. This means helping to encourage WTO accession to China to ensure that they will abide by internationally accepted trading rules. It also means continued bilateral talks to address specific issues, like intellectual property rights and nontariff trade barriers.

Mr. Chairman, I recognize that problems continue to exist in China, and remain committed to making improvements in the area of human rights, trade policies, and nuclear proliferation. And I appreciate the efforts of some of my colleagues. However, I strongly disagree with the philosophy of this engagement and believe that it would be a mistake to disprove the extension on MFN.

I think many of us, when we look at what is happening in the globalization of the world economy, equate it to the Americanization of the world economy. As we found in, I think, every instance where we have engaged in economic integration with any developing country in the world, it has resulted in our values becoming increasingly instilled, whether it be the U.S. values on human rights; the U.S. values on religious freedom, or movement toward none capitalism and more democracy in these countries which we have chosen not to isolate but to engage.

And that is the issue before us today: How can we most effectively advance the interests of the working men and women of the United States as well as the interest of the citizens of China? I think that clearly argues for us to continue with our approval of China and MFN.

[The prepared statement follows:]

CALVIN M. DOOLEY
20TH DISTRICT, CALIFORNIA

WASHINGTON OFFICE

CALIFORNIA OFFICE

AGRICULTURE COMMITTEE
GENERAL FARM COMMODITIES
LIVESTOCK, DAIRY, AND POULTRY

RESOURCES COMMITTEE

# Congress of the United States
## House of Representatives

STATEMENT OF THE HONORABLE CAL DOOLEY
BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON TRADE
U.S.-CHINA TRADE RELATIONS AND RENEWAL
OF CHINA'S MOST-FAVORED NATION STATUS

June 17, 1998

Mr. Chairman, thank you for giving me an opportunity to appear before your Subcommittee today to discuss the very important issue of continued trade relations with China. As you know, I have been a strong supporter of continued normal trade relations with China, and have worked hard to advance a pro-trade agenda in the Congress. I am concerned about the growing reluctance of the Congress to provide the leadership that is needed on international issues to make improvements in trade relations and economic conditions throughout the world.

Opponents of extending MFN have discussed China's human rights record, nuclear proliferation, religious freedom and trade barriers. Clearly, problems exist with China and work needs to continue on all of these fronts. However, Presidents Clinton, Bush, Reagan, Carter and Ford have recognized that engagement is a better policy than isolation. President Clinton's trip to China later this month will provide the United States with another forum to pursue improvements in all of these areas. Without a policy of engagement, this type of trip and the benefits of it would not be possible.

The reality is that China has one of the fastest growing economies in the world. From 1979 to 1997, China's real GDP grew at an average annual rate of 9.9 percent. Projected growth in China is estimated by some to be at an average rate of 7% a year over the next two decades. At this rate China could double the size of its economy every 10 years.

I represent the San Joaquin Valley of California. This highly productive agricultural area produces agriculture commodities worth in excess $22 billion annually, more than half of which is exported. China is currently the sixth largest export market for U.S. agricultural goods. In 1996, China bought over $1.9 billion of U.S. agricultural products. With 1.2 billion people and limited arable land, China must rely on imports to satisfy its demand for food. USDA estimates that two-thirds of the future growth in U.S. farm exports will be in Asia and 50 percent of that increase will come from China alone.

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We must maintain our ability to be a reliable supplier of agricultural products. Our competitors in the world market, Australia, Europe, Canada and South America, stand ready to fill the needs of China into the next century, if we cut off trade.

Our ultimate goal must be to fully integrate China into the world trading arena as a full participant. This means helping to encourage WTO accession to China to ensure that they abide by internationally accepted trading rules. It also means continuing bilateral talks to address specific issues, like intellectual property rights and non-tariff trade barriers.

Mr. Chairman, I recognize the problems that continue to exist in China, and I appreciate the effort of some of my colleagues in remaining committed to making improvements in the area of human rights, trade policy and proliferation. However, I strongly disagree with the philosophy of disengagement and believe that it would be a mistake to disapprove the extension of MFN. I look forward to working with you and the members of the Subcommittee to address the continuing trade issues related to China, and appreciate the opportunity to appear before you today.

Chairman CRANE. Thank you very much, Mr. Dooley.

Mr. Matsui.

Mr. MATSUI. I have no questions, Mr. Chairman. I'd like to thank all of the panelists for appearing before the Subcommittee today.

Chairman CRANE. Mr. Nussle. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I just wanted to ask Mr. Smith one question: What was the date of Tiananmen Square?

Mr. SMITH. of New Jersey. Nineteen eighty-nine.

Mr. MCDERMOTT. And that was in June, wasn't it?

Mr. SMITH of New Jersey. Yes, it was.

Mr. MCDERMOTT. Did Mr. Bush recommend most-favored-nation status that year?

Mr. SMITH of New Jersey. I'm not sure if it had already been made that year.

Ms. PELOSI. I can answer that, Mr. Chairman. As you know, Mr. McDermott, in our country, June 4, 1989 was the date that—the time was different between here and China—but June 4, 1989, was beyond the time when a President could—it would be up to Congress to reject. We considered it at the time, but it was in a major state of flux, and we didn't realize that President Bush would not go along with signing the Chinese student protection bill, which was the vehicle that we used that year to express our concern about U.S.-China relations. As you know, in the House and Senate, Members voted overwhelmingly to protect the Chinese students and our students with scholars in America. But that was the vehicle that year, which the President vetoed over Thanksgiving, and that—I often wonder how things would be different around here if President Bush had never signed that bill and sent a message to the regime of that time that we had our limits. But, instead of sending that message, he sent Secretary Eagleburger to toast the regime in Beijing, but that's what was——

Mr. MCDERMOTT. In 1991 and 1992, did President Bush recommend—the renewal of normal trade relations with China?

Mr. SMITH of New Jersey. Yes, he did, and let me make it very clear that when President Bush recommended renewal of MFN objections were bipartisan and I spoke out very strongly as did Mr. Solomon and others, and thought it was very ill-advised that a so-called constructive engagement—they didn't perhaps put that same word on it——

Mr. MCDERMOTT. I just wanted to bring some balance to this discussion. It seemed like all the problems in our relationships with China started when President Clinton was elected, and suddenly we gave up fighting for our national interests.

Mr. SMITH of New Jersey. Not at all. But let me just say, Mr. McDermott, that Mr. Clinton, President Clinton, made—could I respond? Let me just say that many of us thought that President Clinton, then candidate Clinton, had it right. And I publicly, as did other Republicans, spoke out and said that he was right when he criticized President Bush and said that he was "coddling dictators" meaning Li Peng and the rest of the gang in Beijing after Tiananmen Square and because of the human rights abuses. What we find so bewildering is that Mr. Clinton, after he issued his executive order and things went from—and remember, the operative

language in that executive order was "significant progress" in human rights—there was significant regression in every area, and Mr. Weldon talked about confronting and dealing and meeting with the Chinese. I've led three human rights trips to China; met with Li Peng, Peng Peiyun who runs the coercive population control program and many, many others in their regime. So, I do believe we need to meet them across the table, but destructive appeasement—which is what we're engaged in now, which destroys the people—you know, I said it earlier, Mr. McDermott, and I know you can reject it. Maybe you do——

Mr. MCDERMOTT. The problem, Mr. Smith, is that you don't like what we're doing. But tell me, what is your solution for the Chinese population? How, if you were President or the Prime Minister of China, would you deal with these issues?

Mr. SMITH of New Jersey. Voluntarism. Unless you're——

Mr. MCDERMOTT. Voluntarism? Do you know the history of famine in that country?

Mr. SMITH of New Jersey. I also know that coercion should be totally unacceptable.

Mr. MCDERMOTT. I'm not saying that coercion is the answer. I'm not defending the Chinese way.

Mr. SMITH of New Jersey. But you're asking me what I would do; I am answering.

Mr. MCDERMOTT. Your plan would be just to tell the people of China, "Please don't have any more kids." That would be your plan.

Mr. SMITH of New Jersey. That's what voluntarism is all about, and the premise of your question is that you would allow them to engage in coercion as a means to an end. The means justifies the end?

Mr. MCDERMOTT. You wouldn't have any kind of education program teaching about the various methods of family planning?

Mr. SMITH of New Jersey. Education, with a bedrock of——

Mr. MCDERMOTT. Would you have a family planning education program?

Mr. SMITH of New Jersey. I would have no problem with voluntary—the emphasis is on voluntary——

Mr. MCDERMOTT. But all kinds of family planning? All kinds?

Mr. SMITH of New Jersey. Would you let me finish?

Mr. MCDERMOTT. Mr. Smith, I just want to hear the answer. Would you advocate all kinds of family planning or not?

Mr. SMITH of New Jersey. It's up to the individual, but not abortion. Abortion takes the life of a baby.

Mr. MCDERMOTT. So, there's some kinds of family planing that you would not tolerate.

Mr. SMITH of New Jersey. You're suggesting that——

Mr. MCDERMOTT. So, you're going to tell the Chinese how to do everything, even "voluntarily".

Mr. SMITH of New Jersey. You're suggesting abortion is birth control? Is that what you're saying? That's the core of what you're saying.

Ms. PELOSI. If I may, Mr. Smith, our responsibility is what to advise the American President as Members of Congress. And we're advising the American President to have a different policy so that

the Chinese people can decide for themselves what form of government and what systems they want to live under.

Chairman CRANE. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman. I'd like to make a statement at this time. I want to thank the Chairman for scheduling this hearing before the upcoming summit between the United States and China next week. As a long-time supporter of free and open trade, I believe that retaining normal trade relations with China is the key to fostering a great mutual understanding between our two countries. And I appreciate the opportunity to hear from our panel of witnesses today.

All of us here understand the importance of open relations with China. The economic effects of enhanced trade help build the United States economy and help strengthen international markets. The open exchange of goods and services has been a critical component of fostering understanding between nations for centuries and has helped bring about regional, economic, and diplomatic stability. Creating an environment of normal relations and ongoing engagement only serves to lower the walls of fear and suspicion while building a spirit of cooperation through joint ventures.

More specifically to today's headlines, with the weakening Yen and the inability of Japanese officials to halt their current recession, China will play an even larger role in helping to stabilize the Asian economy. But what should be our ultimate objective with China with respect to trade relations? I believe that liberalized trade with a communist society in the process of opening itself up the world community will someday deliver to our trading partners our most precious gift, and that is freedom. Indeed, we are already starting to see the effects of China's more liberalized trade policies. The number of Chinese citizens employed in private business continues to escalate. Between 1986 and 1996, the number of employees in private enterprises jumped from 65.9 million to 232.9 million people. This trend is also borne out by the fact that the share of industrial output by the nonstate sector in China is increasing rapidly while the share of the state sector continues to decline.

Since the government of the PRC must continue to produce economic growth or face the internal stability threats brought about by high unemployment, I expect to see further gains by these private enterprises. Continuing normal trade relations with China for this year is critical, and I look forward to the day when their normal trade status with the United States is made permanent. It is well beyond the time to realize that not granting normal trade relations to China is unacceptable. It would be equivalent to severing all United States-China relationships. Even if we do absolutely nothing to pressure China to release political prisoners, to grant total religious freedom, to hold elections nationwide, to allow more property ownership, or to contain proliferation, a country that denies the human spirit cannot sustain the wave of personal freedom that accompanies open relations with the rest of the world. Only isolation breeds rigid conformities.

The need to have a strong Chinese economy to anchor Asia is even more true as we enter a new era of nuclear proliferation in South Asia. Over the last month, I have heard a great deal of criticism regarding Congress' stance on some of the new questions that

have arisen in this area. I want to take a look at a couple of these issues today, because to ignore them is to ignore reality and to be naive.

First, let's look at some facts. On May 1, 1998, the CIA reported that China now possesses 18 long-range missiles—nuclear missiles armed with nuclear warheads—13 of which are aimed at United States cities. It's been widely reported that they continue to develop and fine tune short-, middle-, and long-range missiles. The PRC played a large role in the development of nuclear technology in Pakistan through the 1970's, and it provided defense applications of nuclear technology for them throughout the 1980's. Now, we are hearing that similar technology is being sold in Iran.

When reports begin to surface about the administration's approval to transfer sensitive missile technology to China from companies—in view of China's inappropriate diversion of U.S. aeronautic manufacturing equipment to the their defense facilities—and the agreement of the United States to sell Clipper computers to China capable of greatly advancing their nuclear capabilities, Congress must respond. This is particularly true when you consider that much of this was done over the objection of the Pentagon, whose analyst argued that national security could be jeopardized.

This sort of intelligence immediately requires a response from Congress, whose responsibility is to protect the national security interests of the United States. As you all know, the United States policy toward China is multifaceted and nuanced. The importance of opening up their markets to United States goods, eliminating religious persecution, permitting political dissent, and promoting rule of law cannot be overstated. At the same time, protecting the freedom and the safety we hold precious in this country must be our primary goal when it comes to relations with any country; it's in a category by itself above these other important objectives.

As the world's most populated country and a growing superpower, China is becoming a major player on the world stage as we enter the millennium. We cannot place an overimportance on one aspect of our relationship with China without asking the tough national security questions that will always demand Congress' attention.

Mr. Chairman, I look forward to participating with other Members of Congress and this inquiry in answering these important questions. But I believe that we are in a historic period of change around the world, and China, as much as any other country, is a microcosm of the many difficult issues we will face as policymakers. I firmly believe that our past policy of engagement with China has greatly enhanced the relationship between our two countries, so it is even more critical as we move forward together in an increasingly uncertain world. I thank the Chairman for his willingness to hold this hearing, and I look forward to working with my colleagues on the Subcommittee to defeat the disapproval resolution that would deny China normal trade status for this year.

Mr. STARK. Mr. Chairman, could I ask the gentlelady if she would apply those remarks to Cuba as well? Ms. Dunn.

Ms. DUNN. These are remarks I apply specifically to China.

Mr. STARK. Would you hold that same thing true for Cuba?

Ms. DUNN. No, this is related only to MFN in our relations——

Mr. STARK. So, you wouldn't open up trade to Cuba?

Ms. DUNN. If you wish to be specific about what you are asking me, I would——

Mr. STARK. Just, would you apply your same philosophy to Cuba? Would you open up trade to engage with Cuba, would you trade with them? Why not Cuba? Why wouldn't you include Cuba?

Ms. DUNN. As you know very well, Mr. Stark, there are a number of reasons that we have put sanctions on Cuba——

Mr. STARK. Name one that didn't apply to China.

Ms. DUNN. That we can save for another day.

Chairman CRANE. The time of the gentlelady has expired, and you can continue this conversation——

Mr. STARK. It's an interesting thing, Mr. Chairman, how we can apply one set of standards to one country and another set to another and, somehow, they don't seem to balance.

Chairman CRANE. Next, Mr. Jefferson.

Mr. JEFFERSON. Thank you, Mr. Chairman. I don't have much in the way of questions of this panel. I do want to observe that all of us have been working on one side or the other on this issue for a number of years, some of us since the start of this whole process of the MFN waiver, and some of us come to the debate accustomed to that. As you know, the whole issue started out with the Jackson-Vanik questions about immigration. And we stray far away from that in these discussions now because we use them as an annual opportunity to try and leverage the Chinese to different standards of conduct, more acceptable standards of conduct, ones which are more in line with what we agree with and expect, and also expect of our partners.

I wonder—those who have testified that are opposed to the President's current policy of deleting the trade issue from the human rights questions and recognize that nothing has anything to do—no one has discussed Jackson-Vanik really today; we've discussed other issues. Is there another level of engagement that you argue for with respect to our relationship with China? I know you don't argue for isolation; that doesn't make any sense. The mercury level we're talking about—what is that level of engagement, and what is the stuff you have to take to get there—if there is an approach other than engaging them as freely and as openly as possible in trading and investing opportunities? Is there some other way to get at the engagement? As I said, there has to be a plan other than this, because you can't simply say, Ignore China. So, what is the plan?

Mr. STARK. Mr. Jefferson, if I might try and respond. I may have been here—Mr. Clay may have, as well—when Jackson-Vanik was first initiated. The immigration was really an icon for human rights. Although immigration was at the basis of Jackson-Vanik, it also included other human rights, and many of us travelled to countries periodically just to see whether we would renew most-favored-nation status. Sometimes we did, sometimes we didn't, and it tended to work.

I would suggest that we could do as we did with Romania. In response to an extension of a most-favored-nation status, you might very well give a little more to China. But we've been dealing now, I think over 10 years, and have basically had a denigration or a

diminution of human rights and any positive response whatsoever. In other words, it's been all give on our part. The deficit has grown; their trade policies have gotten worse, and we haven't really seen any significant, bilateral response from China. We might say, Just give them airplanes or, Just give them rice and cotton—which would make some of us more happy in this room—and stop buying sneakers; I don't care.

It is to my experience—I think all of us have visited China—they won't discuss human rights with us or they put that aside and say, Let's talk about trade; let's talk about manufacturing; let's talk about your exporting more technology to us. I'm suggesting that we've just been bad, and whether it's our administration or previous administrations, we've been out-negotiated. We have gotten nothing for our efforts. So, nobody in this room, I believe, is suggesting isolationism.

Not having MFN temporarily is a setback; it's an economic fine, if you will, but there's nobody to suggest for a minute that there wouldn't be trade. There's nothing to suggest you can't go half way, but in the past that hasn't worked and China knows that we won't follow through. We have tremendous pressure from the manufacturers and the agricultural interests in this country who want to ship and sell. We have tremendous pressure from the importers—the K-Marts and the Wal-Marts of the world—who want to sell cheap goods here, and China recognizes we won't override those economic pressures.

So, at some point, we've got to have something different than all or nothing. I think what all of us are saying is that the current policy hasn't worked, whether it's our administration, whether it was the Bush administration, or the Reagan administration. So, why don't we try something different, and then I think we could all work together in great harmony and set some goals. If they don't meet those goals—whether it's in the exportation of weaponry or restricting trade—we've talked about it and China must face consequences.

What are the sanctions we've heard about today that people are asking the White House to put on for the selling of weaponry? What are those sanctions? Let's impose those; that's OK with me. They happen to be some of the same trade sanctions that you would take away if you didn't give them MFN. So, while the people who favor MFN say that we should sanction for weapons violations, what kind of sanctions?

So, I guess all I'm saying is that it's time for change. Our threats mean nothing, China knows it, and that's the kind of frustrating sense that we have. We have no authority, and we are just giving-in every step of the way. I think that doesn't make us credible to enforce any violations, whether it's nonproliferation, human rights, or fair trade practices. They won't listen and we have done nothing, collectively, to suggest to China that we mean business.

Mr. SMITH of New Jersey. Mr. Jefferson, if I could respond briefly. No one's suggesting that we recall our own ambassador or close down our diplomatic mission in Beijing or any of the consulates that we have there. What we're talking about is a response to a dictatorship where we have some real tools that can make a dif-

ference. The balance of trade, as we all know, is $60-plus billion to about $13 billion of our exports going there.

I led the effort, along with Tony Hall and Frank Wolf, in the 1980's to suspend most-favored-nation status for Romania. I'll never forget all those years, after all of those human rights trips to Romania, hearing how great and different and how grand Nicholas Ceaucescu was. Now I can't find anyone who will say Ceaucescu was a great guy, because now the records have come forward—and we knew some, but it was only the tip of the iceberg then—as to how repressive he was.

Now, we're talking about a dictatorship. Much of what we do enhances the People's Liberation Army. They have, as I said in my testimony—I don't think there are too many communists anymore, in the old-line style of communism. These are real fascists; they're making money.

Recently one of our colleagues was in Moscow and asked their chief China watcher what the difference is between China and what happened here in Russia? He said the military is part of the gravy train. They're becoming the fat cats, but they're also getting a technological transfer that is almost exponentially beefing up their military capabilities. And unless we see a change in their mindset, their vision, and the way they treat their own people, we don't want to be enhancing them.

I was one of the few Republicans on the International Relations Committee in the early 1980's who broke with Republican ranks and said, Apartheid is such an egregious human right violation, I'm going to vote for those sanctions to end Apartheid and to stop all investing. There were some short-term troubles; some people even got poorer. Some blacks even got poorer, but, thank God, it was the catalyst that eventually greased the skids for the end of Apartheid.

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. Thank you for your leadership on this important issue. Thank you for calling today's hearing on the renewal of normal trade relations with China. I'm going to be very brief, because we have other panels waiting. But, Mr. Chairman, I just want to join in the remarks of my distinguished colleague and friend from Washington State, Ms. Dunn.

I also want to say that it's hard for me to believe that anyone would ignore one-fifth of the world's population. One out of five of the world's consumers happen to live in China. And while I respect the good faith position of the adversaries of this normal trade relationship with China, to me it seems obvious that we could have a greater impact on human rights if we were engaged, if we're physically there—American workers, American companies actually are there—than if we disengage. It seems to me that a policy of disengagement would be nothing more than cutting off our nose to spite our face.

When you look at the figures, you see that normal trade relations are critical to jobs—absolutely critical to jobs. Merchandise exports alone to China in 1995 totaled $12 billion, supporting 170,000 American jobs. By the way, those jobs pay, on the average, 16 percent more than nontrade related jobs. Certainly, we in Minnesota understand what that means. In 1996 alone, we exported over $60 million worth of goods to the growing Chinese market. We're cur-

rently working on improving that number through the Minnesota trade offices—Minnesota-China initiative. Thanks to corporate leaders like Ernie Micek of Cargill, who's here today to testify today on the third panel, we are expanding our export opportunities as well as the job opportunities for people in Minnesota.

So I applaud your efforts, Mr. Chairman, in extending normal trade relations with China and, at the same time, being engaged and doing something about their abysmal human rights record. Again, engagement, in my judgment—and the judgment of many thoughtful people, some of our distinguished colleagues from this panel notwithstanding—seems to me the right thing to do and the preferable thing to do. So, I look forward to hearing from the rest of our panels, from the other witnesses and, again, thank you, Mr. Chairman, for this hearing today.

Chairman CRANE. Thank you, Mr. Ramstad.

There is one final observation I'd like to make about an open letter to Congress in today's New York Times: In addition to sponsors of normal trade relations with China, such as George Bush, Jimmy Carter, and Gerald Ford, virtually all of their Secretaries are cosigners of this letter calling for preservation of normal trade relations. I would recommend it to our colleagues. And with that, I want to express appreciation to all of you. Notwithstanding our differences, we have opportunities to work together as well as to oppose one another's views. I thank you for coming and testifying today.

Our next panel is Susan Esserman, General Counsel, Office of the U.S. Trade Representative; and the Honorable Stanley O. Roth, Assistant Secretary of State for East Asian and Pacific Affairs, U.S. Department of State. And if you folks will be seated, please.

Let me again reiterate that, if you can, please keep your verbal presentations to 5 minutes or less. Any printed statements will be made a part of the permanent record. And, with that, ladies first.

## STATEMENT OF SUSAN ESSERMAN, GENERAL COUNSEL, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Ms. ESSERMAN. Thank you very much, Mr. Chairman, for this opportunity today to discuss China's most-favored-nation status. China will play a crucial role in the major international issues that our country must address in the decades to come. These include security in Korea, nuclear tests in South Asia, proliferation of advanced weapons, crime and drugs, the environment, human rights, religious freedom, and trade. The administration, thus, has a policy of comprehensive engagement with China. This does not mean endorsement of Chinese policies. Instead, it is the best way to further our interests across a broad range of issues, finding mutual interest where possible and addressing differences in a forthright way.

I'd like to use the time to explain why engagement and MFN in particular is a far better approach than the alternative. Fundamental to engagement is MFN status. MFN is a misnomer. It is normal trade relations, the same tariff status we grant nearly all our trading partners. It confers no special benefits on China. Renewing MFN is in our economic interest. Since it was granted in 1980, U.S. exports to China have grown from an insignificant level to nearly $13 billion. China has become our sixth largest agricul-

tural market, and exports to China and Hong Kong now support over 400,000 American jobs.

It is also in our broader strategic interest. One example is China's response to the Asian financial crisis. Trade has given China a stake in economic stability beyond its borders. This has led China to contribute to the IMF recovery packages for Thailand and Indonesia, and to resist pressure to devalue its currency.

By contrast, to revoke MFN status would be to sever our trade relationship. Across a wide range of economic and security interests, there would be consequences that we would come to regret. Assistant Secretary Roth will speak to the severe consequences in areas beyond trade. I'd like to just focus briefly on the economic consequences. Revoking MFN would raise tariffs from 6 percent to a trade-weighted average of 44 percent on Chinese goods, raising prices consumers pay for basic goods. In every region of the country, it would threaten the jobs of manufacturing workers, the incomes of farmers, as well as adversely affect retail, service, marketing, and transportation workers that are connected to U.S.-China trade. It would derail WTO negotiations and jeopardize the access we have achieved in our bilateral agreements.

Revoking MFN would also badly damage Hong Kong with severe impacts on Hong Kong trade and jobs. This would occur at the worst possible time, as the Asian crisis poses real economic difficulties. And Hong Kong just held its first election as the Hong Kong Special Administrative Region; this is why all leading Hong Kong figures support China's MFN status.

Revoking MFN status would worsen the Asian financial crisis. A disruption of the magnitude of revoking MFN would introduce new financial and economic instability to Asia with unpredictable and very negative effects in the region and on the American economy. In short, to renew MFN is to protect fundamental U.S. interests and values.

I would like to take one minute, if I could, to talk about our trade agenda, with MFN as the foundation for our relationship. The administration has two principal goals in its trade policy with China: First and foremost, we continue to actively pursue market opening initiatives on a broad scale for U.S. goods, services, and agricultural products. Especially in light of our trade deficit with China, we must see greater balance in our trade relationship with high growth in our exports. Continuing to open China's markets—not isolation and termination of our trade relationship—is the best way to tackle that part of the deficit due to trade barriers in China.

Second, a fundamental principle of our policy has been working to ensure that China accepts the rule of law so that China's trade and economic policies are consistent with international trade practices and norms. We have pursued these objectives both through WTO discussions and bilateral initiatives relying on a full range of U.S. trade laws. Engagement in this manner has helped us to advance both our trade and economic interests and broader values.

There are many examples of engagement, but I want to just highlight one in particular because I think it is very helpful, if I might for just one minute, Mr. Chairman. Not long ago, China's intellectual property laws were weak and piracy was widespread. Two sets of negotiations, in which we threatened retaliation twice,

and actually invoked retaliation under section 301, won landmark agreements in 1995 and 1996. Under these agreements, China significantly reduced the scale of piracy and began to establish a modern, legal infrastructure for the protection of intellectual property rights.

These gains were achieved not only through hammering out the terms of trade agreements, but through intensive, continuous, and ongoing work with Chinese and administration officials, with active assistance from our industry. Surely more needs to be done; problems remain, but the key here is intensive engagement to continue the advancement in this area. The same is true in the WTO. I refer you to my statement, which will be in the record.

Let me just conclude by saying that trade policy is about access and fairness, but the effect extends beyond commerce to fundamental national interests, values, and ideals. While many difficult problems lie ahead, the long-term trends in our trade relationship are important. These trends are not only good for China, they are good for America. The direction we are moving in gives the best opportunity to maintain our gains and tackle the array of trade problems that persist which, I assure you, we will continue to pursue relentlessly.

So the administration strongly supports China's MFN status, and we very much look forward to working with you, Mr. Chairman.

[The prepared statement follows:]

**Testimony of Susan Esserman**
**General Counsel**
**U.S. Trade Representative**

**Renewal of MFN Tariff Status for China**
**House Ways and Means Committee**

**June 17, 1998**

Thank you, Mr. Chairman, for calling this hearing and inviting the Administration's comments on China's Most Favored Nation tariff status.

## ENGAGEMENT WITH CHINA

On June 3rd, President Clinton sent to Congress the formal waiver recommending extension of Most Favored Nation tariff status for China. This status is the foundation of a broad strategy of engagement on the full range of issues, based on the President's judgment of the national interest of the United States.

China's evolution in the next decades is profoundly important to the American people. As the world's most populous country and fastest-growing major economy, China will play a crucial role in the major international issues our country must address in the decades to come. The United States interest in these issues is best served by a secure, stable and open China. The President believes, as have all Presidents since Richard Nixon, that we can best guarantee the evolution of a secure, stable and open China through comprehensive engagement.

Engagement does not mean endorsement of Chinese policies. It is, instead, the best way to further our interests across the range of issues China policy must address. As the President noted last week, these include security in Korea and the four-party talks; a united international approach to the nuclear tests in South Asia; controls on proliferation of nuclear, chemical and biological weapons and ballistic missiles; international crime and drug trafficking; pollution and climate change; human rights; religious freedom; and trade and prosperity.

## MFN STATUS

A fundamental part of engagement is normal trade relations, or Most Favored Nation tariff status. "MFN," of course, is a misnomer. It is the standard tariff treatment we accord virtually all our trade partners, and the foundation of our commercial relationship with China. MFN status was granted to China in 1980, shortly after the signature of our commercial agreement in 1979, and has been renewed by every President, every year, ever since.

Renewal of MFN is in our economic interest. Since 1980, exports to China have grown from an insignificant level to $12.8 billion. China has become our sixth largest agricultural market. And together, exports to China and Hong Kong now support over 400,000 American

jobs.

It is also in our broader strategic interest. One example is China's response to the Asian financial crisis. Trade has given China a stake in economic stability beyond its borders. This has led China, for reasons of its own national interest, to contribute to the IMF recovery packages for Thailand and Indonesia; and still more important, to resist pressure to devalue its currency.

And it serves American values as well as interests. Computers, fax machines, television satellites, cell phones, books, music and movies are more than goods and services crossing oceans and borders -- they are the exchange of ideas and values. They already allow Chinese university students to debate US-China relations and economic reform on university bulletin boards, contributing to grass-roots inquiry and debate. And trade agreements themselves are expressions of broader international values: transparency, peaceful settlement of disputes, limits on the arbitrary power of the state, and the rule of law.

**EFFECTS OF REVOKING MFN STATUS: TRADE**

With respect to trade, the effects of revoking MFN status would be severe. To revoke MFN, would, in fact, amount to the severing of our trade relationship.

Technically, revoking MFN would raise tariffs on Chinese products from approximately 6% today to a trade-weighted average of 44%. This would make American consumers pay approximately $590 million more each year for goods such as shoes, clothing and small appliances. Manufacturers would see the cost of goods made with Chinese components rise sharply, reducing the competitiveness of our goods in domestic and international markets.

China would likely retaliate against US exports by increasing tariffs and other measures. This would endanger not only direct goods exports valued at $12.8 billion last year, but a significant part of our $15 billion in exports to Hong Kong. This would threaten the jobs of manufacturing workers, the income of farmers, the employment of young workers in retailing, software engineers and workers in every other walk of life. Their jobs and the export opportunities of their employers would go to Japan, Europe and other competitors.

Revoking MFN status would also derail our bilateral and multilateral negotiations. China could, for example, reduce or end its efforts to enforce our intellectual property agreements, reversing our successful effort to build an infrastructure of laws and law enforcement in this crucial field. And negotiation on WTO accession would stop, creating uncertainty about the future evolution of China's markets.

**EFFECTS OF REVOKING MFN STATUS: BROADER ISSUES**

And the effects of revoking MFN would go well beyond trade. Let me mention three areas of strategic concern to the United States.

First, revoking MFN would likely endanger cooperation with China in areas outside trade. It would call into question our recently developed good working relationship against drugs and international crime. It would make progress on human rights, as symbolized by the recent release of several well-known Chinese dissidents, very difficult or even impossible. And it could threaten cooperation in national security questions such as the four-party talks on Korea, nuclear testing and proliferation and elsewhere.

Second, revoking MFN status would badly damage Hong Kong. Hong Kong's economy is based on trade and services. Fifty percent of US-China trade goes through its port. MFN revocation would seriously disrupt that trade, lead to uncertainty among the Hong Kong people, and lessen the international business community's confidence in Hong Kong as a trade and financial center.

Hong Kong authorities estimate that MFN revocation would slash its trade volume by up to $34 billion, and income by $4.5 billion. This would come at the worst possible time, as Hong Kong's growth has slowed and its unemployment rate is at a fifteen-year high; and just after it has conducted its first election as the Hong Kong Special Administrative Region, with the highest voter turnout ever in any Hong Kong election. That is why all leading Hong Kong figures, including Chief Executive C.H. Tung, Civil Service Chief Secretary Anson Chan, and Democratic Party leader Martin Lee, support China's MFN status.

And third, revoking MFN status would deal a severe blow to our larger efforts to solve the Asian financial crisis. East Asia now faces high unemployment rates and deepening recession. This already affects our own economy, as we can see through a drop in exports to the Asian region, layoffs at companies which export to Asia, and instability in our own financial and stock markets. The stability of the Chinese economy during this difficult period, and the efforts of both the central Chinese government and the government of Hong Kong to avoid devaluing their currencies, have helped to prevent further deterioration. And a disruption of the magnitude of revoking MFN status would introduce new financial and economic instability to Asia, with unpredictable but likely very negative effects in the region and on the American economy.

Altogether, the vote on MFN is not an endorsement of Chinese policies, but on protection of fundamental U.S. interests. The Administration thus strongly supports renewal of MFN status.

**US-CHINA TRADE RELATIONS**

Again, however, neither MFN status nor the broader policy of engagement means endorsement of Chinese policies. That is true in trade as in other areas.

With MFN status as the foundation, our trade relationship with China has large potential. Today China's economy is among the largest in the world, and the growth of such leading American industries as telecommunications, aviation, the services trades and professions, high-

tech manufacturing and agriculture depend in part on access to China.

Significant problems remain in this relationship. The best means of addressing them is to use all the tools at our disposal, including our own trade laws, bilateral negotiations, regional talks and the multilateral system. And that is the approach we take under the engagement policy.

The $75.4 billion in bilateral US-China trade last year represents $62.6 billion in goods imports from China and $12.8 billion in goods exports from the United States to China. Service export figures are not yet available for 1997, but are quite small; in 1996 we exported $3.1 billion in services to China while importing $2.0 billion, resulting in a small surplus. The total trade deficit -- nearly $50 billion in 1997 and still growing this year -- has many causes, most important among them the strength of the U.S. economy. But trade barriers are a factor.

China restricts imports through means including high tariffs and taxes, non-tariff measures, limitations on which enterprises can import, and other barriers. The result is a pervasive and multilayered web of trade barriers in China. Due to limitations of space and time, I will cite only some of the major types of obstacles we have identified in China. They fall into two main areas.

The first are broad structural impediments. These include transparency, where while we have seen improvements, publication of laws and regulations is still incomplete, and sometimes offset by opaque customs procedures, administrative guidance and other procedures. Another is trading rights, where China restricts the right of individuals and companies to import and export. State-owned enterprises produce about 40% of China's industrial output, producing subsidies and conflicts of interest for government bodies which both own and regulate enterprises. And government procurement presents a large set of issues, beginning with the fact that China has no laws or regulations on the subject.

The second area is that of more formal and familiar trade barriers. Tariffs, though reduced from an average of 42.1% in 1992 to 17%, remain very high and particularly high in sectors which China has targeted for industrial policy, like chemicals and some motor vehicles. Non-tariff measures include non-transparent and WTO-inconsistent import licensing, quotas and other barriers. China's market for services remains essentially closed. Agricultural tariffs remain very high, and in cases like meat can be prohibitive. China's phytosanitary and veterinary import quarantine standards may not be based on science, unevenly applied and not backed up by modern laboratory testing techniques.

We have used all available tools, including our own trade laws and bilateral talks as well as regional negotiations and multilateral fora, to address these market access restrictions and establish predictable and fair rules. The bilateral agreements we reach, and vigilant monitoring and enforcement of these agreements, continue to be an important means to address specific sectoral problems. The Administration has been willing to threaten or impose sanctions when

necessary to achieve its objectives, as was the case on intellectual property rights and textiles. Let me discuss each of these.

**U.S. TRADE POLICY: THE CASE OF INTELLECTUAL PROPERTY RIGHTS**

In the past, pirated works and US brand names have been common in China. Since our IPR Agreement in 1996, however, the scale of piracy has been significantly reduced. In 1995, American copyright firms reported losses of over $2 billion from piracy of software, CDS and CD-ROMs, books, audio and videocassettes in China. They faced further losses in third markets, as Chinese pirates began to export their product. Long and intense negotiations won agreements in 1995 and 1996 committing China to pass and enforce copyright, patent and trademark laws and shut down pirate operations. Since then:

-- China has closed over 64 CD and CD-ROM production lines and the Chinese have destroyed the masters and molds being used to produce these products.

-- China has arrested more than 800 people for IPR piracy.

-- China has seized more than fifteen million pirated CDS and CD-ROMs, including those illegally smuggled into China.

-- China issued 114,000 patents and 121,000 trademarks in 1997, many of which went to U.S. companies.

-- Just this week, the government of Guangdong Province announced that it had seized and destroyed 2.8 million pirate video compact discs. Guangzhou has been one of the key transit points for VCDs smuggled into mainland China from Hong Kong and Macao.

This does not mean our work is at an end. Pirated retail CDS, CD-ROMs, and VCRs remain available in some Chinese cities. Chinese Customs and local anti-piracy officials must be more vigilant in enforcement. Illegal use of software in Chinese government ministries is a problem, and we are urging the Government of China to issue a State Council Directive prohibiting unauthorized software use. Protection of well-known trademarks is inadequate in China, and trademark counterfeiting remains widespread. And while the 1992 bilateral agreement permits U.S. pharmaceutical companies to obtain up to seven years of "marketing exclusivity" for products still under patent in the United States, China's Ministry of Public Health may be violating the agreement by granting overly broad marketing approvals to competing Chinese pharmaceutical companies as U.S. applications for marketing exclusivity are pending.

We also have concerns about protection of intellectual property rights in Hong Kong and Macau. This year we noted an increase in piracy in Hong Kong, and placed Macau on the Priority Watch List of our annual Special 301 report. An IPR team from our office is working

with Hong Kong and Macau, and both governments are taking steps to address our concerns.

## U.S. TRADE POLICY: THE CASE OF TEXTILES

Textiles are another example of success achieved through engagement.

In 1994, and in February of 1997, the Administration concluded bilateral agreements to achieve fair trade in textile products. In 1997, for the first time, our bilateral agreement provides for market access for U.S. textiles and apparel into China's market. China has also agreed to ensure that non-tariff barriers do not impede the achievement of real and effective market access for US textile and apparel exports. Following on cutbacks in China's textile quota growth rates under the 1994 agreement, the 1997 agreement further reduced the overall quota to address enforcement issues. China, having once been our largest source of apparel, is now our fourth.

Illegal transshipments of textiles from China has been a significant concern. We remain resolved to act against such imports. In 1994 and 1995, the Administration found and charged transshipped products against China's quotas. In 1996 we triple-charged China's quotas, and we did so again this year to account for such illegal transshipment. We will continue to be vigilant to prevent transshipment.

That said, we must note that the Chinese government appears to be making progress in preventing transshipment. Last year we detected less than $2 million in illegal transshipments out of total Chinese textile exports of nearly $6 billion.

## BILATERAL PROBLEMS REMAIN

We continue to work on these issues and a range of other bilateral problems.

In agriculture, China has not resolved sanitary and phytosanitary issues with respect to citrus, Pacific Northwest wheat and meat. And at times China has taken unpredictable measures which reverse our progress. Last October, for example, China raised the tariff on soybean oil to 20%, just as U.S. soybean oil products were entering world markets. Through quick action we were able to reverse this.

Earlier, China issued a decree requiring foreign financial information services to pay royalties to the Chinese government news agency. Again, we have prevented the implementation of this requirement.

And just last April, China announced an arbitrary ban on direct sales, intended to block scam schemes but also affecting well-regarded, law-abiding foreign operations. We are working with U.S. industry and Chinese authorities to address this issue.

## PRINCIPLES OF WTO ACCESSION

In addition to bilateral negotiations, China's accession to the World Trade Organization presents us with a comprehensive means to address the broad range of official and unofficial barriers to the China market.

China's application to join the WTO is, of course, an historic event in itself. For decades, China -- together with Russia -- was one of the great antagonists of the principles the WTO embodies: open and transparent markets, the rule of law, and peaceful settlement of disputes. Thus the United States welcomes and supports China's application to join the WTO. However, we and other WTO members believe accession must be on commercially meaningful grounds.

The WTO is a contractual set of commitments, deepened continuously since the establishment of the GATT in 1948. These have developed from tariffs to include government procurement, standards, intellectual property, dispute settlement and more. And the sectors covered by the WTO have expanded from industrial goods to agriculture and services including basic telecommunications and financial services. All applicants, including China, must make commercially meaningful commitments in these areas.

## STATUS OF WTO NEGOTIATIONS

This is a daunting task. Our negotiations include basic WTO rules on non-discrimination, national treatment, transparency, judicial review, uniform application of laws, state trading, customs procedures and more. They address tariff rates on more than 6,000 individual tariff lines. They cover agriculture; industrial products including information technology; services; and nontariff measures including importing licensing and quotas. We will insist that accession be upon the merits.

But although daunting, our task is also achievable and we see some positive signs. We have won commitments from China to publish all its laws and regulations and give WTO members the opportunity to comment on them before they become effective. We have made progress on judicial review of administrative decisions. We have some good signs on trading rights and non-discrimination as well. In intellectual property, China has agreed to implement the WTO/TRIPS agreement upon accession. And on agriculture, China agreed not to use export subsidies.

And in market access, China has proposed to reduce the overall tariff level for industrial products. At the summit in Washington last October, President Jiang committed China to join the Information Technology Agreement (ITA), eliminating tariffs on all information technology products such as, computers, semiconductors, telecommunications and related equipment. Previously, China had refused to participate in any zero sector arrangement. And while we remain far apart on the services sector, we have entered detailed negotiations on distribution, professional services, audiovisual and financial and telecommunications services.

Much more work remains ahead in all areas. We have more to do on protocol issues and the working party report. We have more to do on tariffs. China's most recent written services offer did not sufficiently address U.S. requests in distribution, telecommunications, financial and professional services. Negotiations on agricultural market access have only just begun.

And China is not moving down the field toward a set of fixed global goalposts. China first indicated an interest in GATT membership in 1986. By 1994, as negotiations continued, we had completed the Uruguay Round, deepening coverage of agriculture, subsidies, government procurement, intellectual property; binding tariffs; and requiring binding dispute settlements. By the beginning of this year, the WTO had advanced through the Information Technology Agreement, the Agreement on Basic Telecommunications and the Financial Services Agreement. Next year we will open negotiations through the WTO's "built-in agenda" on agriculture, services, intellectual property and other issues as well. In the future lie talks on government procurement, bribery and corruption and other issues. The WTO is a single undertaking, and thus, the longer China delays making a commercially meaningful offer, the more comprehensive a commercially meaningful offer must become.

**TRADE AND BROADER VALUES**

One final point. Trade policy, in its narrowest sense, is about access and fairness. Our negotiations and our discrete policy objectives focus on the details: tariff lines, copyright enforcement, phytosanitary inspections and so on. And our basic goal is fairness for American companies, workers, farmers and ranchers.

But the effects of trade policy will extend beyond commerce to fundamental national interests, values and ideals. We already see that in the contribution of our trade relationship to personal opportunity for Chinese citizens, the development of the rule of law in China, and China's growing stake in a stable, peaceful Pacific. In the future, the correct policy will help these healthy trends deepen and accelerate.

**CONCLUSION**

And that brings me back to the broader point of engagement with China. Our discussions of China policy, including trade, concentrate on the problems. Rightly so. But on occasions like this hearing, we should also remember to step back and take the long view.

Just twenty years ago, when our trade relationship began, we did very little business in China. Very few Americans visited the country. Very few Chinese read foreign books, saw foreign news or traveled abroad. Few foreign firms -- indeed, few private businesses -- operated in China. And China remained among the world's most closed societies.

Today, with all the problems that remain, we see American business operating widely in China. American goods and brand names are available; and counterfeiters of those brand names

are arrested and punished. The share of the state in the economy has fallen. The range of political debate has widened. And China is more open to the world than at any time since the Second World War.

These trends are not only good for China; they are good for America. And they show that the engagement policy is working. To revoke MFN status would be to threaten all of them; and to threaten fundamental American interests as well. So again, the Administration strongly supports China's MFN status, and looks forward to working with the Committee to ensure its renewal this year.

Thank you, Mr. Chairman. I look forward to your questions and those of the Committee.

Chairman CRANE. Thank you, Ms. Esserman.

Mr. Roth.

**STATEMENT OF STANLEY O. ROTH, ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS, U.S. DEPARTMENT OF STATE**

Mr. ROTH. Thank you, Mr. Chairman. I have submitted a rather lengthy statement for the record, and I won't attempt to read it within the 5 minutes you've given us. Let me simply point out that the first section deals with U.S. interests in China and what the stakes are. This Subcommittee is very familiar with that. The second section, which I wasn't even going to mention at all, deals with engagement and what the proofs of engagement have been; I wanted to lay out a record. But let me simply state at this point that there were a number of assertions in the previous panel that we have no benefits, no results, in human rights, nonproliferation, economic issues—and I think that's simply a distortion of the factual record. So, I would like to refer you to some of the specific examples I've pointed to in the statement. I tried not to overstate. I'm not saying there are no human rights, nonproliferation, or economic problems remaining, but I think we shouldn't rewrite history and claim there are no successes so far for the engagement policy.

Now, let me turn to the specific issue on the table which is MFN. A lot of the basic arguments on the consequences of denying MFN have already been laid out by my colleague from USTR. Let me add a few points. First I think, in addition to what effect it would have on Hong Kong, it's important to point out it would also have a major negative impact on Taiwan, another one of our major friends in the region, and that's certainly a fact that I think this Subcommittee, this Congress, will want to take into account. This would be a very major, negative blow to Taiwan at a time when its own currency and market are under attack as part of the Asia financial crisis.

A second point—we can talk about more in questions if you want—is the impact upon China itself. I think it's very important to recognize that China has undertaken some major, structural, economic reform that we're encouraging, including the privatization of its state economic enterprises—a massive undertaking including banking and financial reform, development of mortgage and housing industries. If we were to deny MFN, which would have a significant impact on their economy, I think we would be undermining the very reform sectors that we most want to support, and this would have real serious consequences for us over a period of time.

Finally, let me talk about some of the consequences that it would have toward U.S.-China relations, because I think a key point is that this is not only a commercial issue. Revocation of MFN would affect our relationship with China across the board. By denying what is essentially normal trade ties, we would be reversing engagement and, therefore, we'd be imperiling the gain that we have achieved thus far—a difficult enough process as it is. And I think we would be eliminating the prospects for future progress.

Let me just give you a few examples—and this is not an exhaustive list—of what the world might look like if we revoked MFN for China. I think it would undercut our strategic cooperation, particu-

larly in defusing escalating tensions in South Asia but also dismantling North Korea's nuclear program and pursuing a permanent peace settlement on the Korean peninsula. It would undoubtedly encourage more belligerent and xenophobic foreign policy on the part of China's leadership. They have a number of maritime territorial disputes with a variety of countries, and I think we might well see those exacerbated. It would have to handicap our efforts to strengthen China's integration into nonproliferation regimes, and it would limit our ability to curtail technology transfers to unstable regions.

Finally, an aspect that isn't talked about nearly enough: It would risk support for the U.S. initiatives at the United Nations. This is not a minor point: China is a permanent member of the Security Council. They are perfectly capable of exercising the veto, which they have really not done. If one recalls Soviet behavior during the height of the cold war, you know just how devastating the relentless use of the veto can be as a tool for blocking U.S. foreign policy objectives, and we should take this into account. It would also jeopardize Chinese cooperation on global issues, some of which we've made important progress on: combating drug trafficking and alien smuggling—an area we hope to make more progress—and climate change.

Finally, let me get to the threshold question: Would risking vitally needed cooperation on all the above fronts get the United States anything positive in return? In my view, denial of MFN could actually hinder our efforts to improve human rights in China. It would create a tense, hostile atmosphere in which Chinese leaders would be less inclined to take the kind of action we have worked painstakingly to encourage: releasing political dissidents, allowing international visits with prisoners, signing and ratifying international human rights covenants, and engaging international religious leaders.

Furthermore, the loss of the U.S. market might have the unintended effect of weakening some of the most progressive elements of Chinese society. Private entrepreneurs have been able to expand personal freedom by being independent of the State, and our trade and investment have helped to expand the habits of free enterprise and independent thinking. We need to encourage this sector, not stunt its growth; we can only do that providing access to American markets and ideals.

Mr. Chairman, in conclusion, as Secretary Albright has often said, there is no greater opportunity for challenge in U.S. foreign policy than to encourage China's integration into the world community. President Clinton's decision to extend MFN status to China reflects our commitment to this goal. Thank you very much.

[The prepared statement follows:]

TESTIMONY OF

STANLEY O. ROTH

ASSISTANT SECRETARY OF STATE FOR

EAST ASIAN AND PACIFIC AFFAIRS

WAYS AND MEANS COMMITTEE

TRADE SUBCOMMITTEE

JUNE 17, 1998

Mr. Chairman, thank you for the invitation to address the Ways and Means Committee Trade Subcommittee on the important issue of China's MFN status. This is, of course, a timely hearing, with President Clinton's historic trip to China just a week away. I thus welcome this opportunity to make the Administration's case for MFN renewal and look forward to engaging Committee members in a productive dialogue on this matter.

My testimony today will be divided into three parts. First, I will review the reasons why a stronger, more constructive relationship with China is in the U.S. interest. Second, I will outline the Clinton Administration's strategy of engagement, highlighting what we have accomplished while noting the obstacles we still face. Finally I will examine the issue of MFN within the broader context of our overall China policy, examining the serious impact revocation would have on our ability to engage the Chinese.

**China Affects U.S. Interests**

Mr. Chairman, peace and stability in East Asia and the Pacific is a fundamental prerequisite for U.S. security and prosperity. Nearly one half the world's people live in countries bordering the Asia Pacific region and over half of all economic activity in the world is conducted there. Four of the world's major powers rub shoulders in Northeast Asia while some of the most strategically important waterways on the globe flow through Southeast Asia. The U.S. itself is as much a Pacific nation as an Atlantic one, with the states of Alaska, California, Oregon and Washington bordering on the Pacific Ocean and Hawaii surrounded by it. American citizens in Guam, American Samoa, and the Commonwealth of the Northern Marianas live closer to Asian capitals than to our own, vast numbers of Americans work in the Asia-Pacific region, and an increasingly large number of Americans trace their ancestry back to the Pacific Rim.

For these and many other reasons, the U.S. has remained committed to the Asia-Pacific region and has spent its resources and blood defending and strengthening our stake in the region. Since coming to office, President Clinton has repeatedly made clear that America will remain an Asia-Pacific power. We maintain a sizable military presence in Asia; enjoy a vibrant network of mutual security alliances with Australia, Japan, the Philippines, the Republic of Korea and Thailand; and have significant economic ties with most countries in the region.

China's sheer size means we must deal with China in our capacity as an Asia-Pacific power. China is home to one quarter of humankind and occupies vast territory that borders on 14 nations. But China's remarkable economic achievements, increasing diplomatic prominence and growing military strength make it a nation that affects not only our interests in Asia but our vital national interests across the board.

In terms of security, China is already a global player. China holds a permanent seat on the UN Security Council. It possesses nuclear weapons, the world's largest standing army, and a rapidly advancing industrial and technological capacity. It borders some of the globe's most troubled regions: the Indian Subcontinent to the West, the Korean Peninsula to the East, and the opium-producing region known as the Golden Triangle to the South.

Its economic importance is no less profound. The Chinese economy is already one of the largest in the world, and many observers predict that if current growth rates can be sustained, it will be *the* largest within several decades.

With 1.3 billion people rapidly modernizing, moreover, China is having and will continue to have a global impact on the environment. Early in the next century China will be the world's largest producer of greenhouse gases. China will thus be key to finding a solution to the pressing problem of climate change.

**Engagement Works**

China, therefore cannot be ignored. In recognition of this reality, the Clinton Administration is working to encourage the emergence of a China that is stable and non-aggressive; that tolerates differing views and adheres to international rules of conduct; and that cooperates with us to build a secure regional and international order. Our strategy has been to engage China by working to identify areas on which we agree while continuing to forthrightly confront issues on which we do not.

We have made significant progress in many aspects of our relationship with China since this committee last heard testimony about MFN renewal in June 1997, and I would like to take this opportunity to note some of those achievements.

First, the Chinese have played a constructive role in working to defuse tensions on the Korean Peninsula. China encouraged North Korea to come to the negotiating table and

now joins us in Geneva at the four party talks. China hosted recent North-South negotiations and is actively addressing the humanitarian crisis in North Korea as its largest donor of food and fuel.

Second, China is playing a similarly important role in seeking to roll back escalating tensions on the Indian subcontinent. China chaired a recent meeting of the permanent members of the U.N. Security Council. It has condemned both parties for conducting nuclear tests and has joined us in urging them to refrain from further testing; sign the CTBT; avoid deploying or testing missiles; tone down their rhetoric; and work to resolve their differences - including over Kashmir - through dialogue. These efforts have been complementary to our own. By contrast, if China were on the sidelines or actively opposing us, this message would be both less effective and the prospects of a solution more distant.

On the non-proliferation front, we have built upon the successful efforts of this and previous administrations to help bring about Chinese adherence to international norms. Within the past year the Chinese have: committed to phase out nuclear cooperation with Iran; reaffirmed their commitment to refrain from assisting unsafeguarded nuclear facilities anywhere; implemented strict, nation-wide nuclear export controls; passed in principle and are prepared to publish regulations controlling the export of dual-use items with potential nuclear use; joined the Zangger NPT exporters' committee; signed and ratified the chemical weapons convention; and adopted chemical export controls -- which they have just expanded.

There is, of course, still much work to be done. We continue to be concerned about reports of missile equipment and technology transfers to Iran and Pakistan and reports that Chinese commercial entities have done business with Iran's chemical weapons program. Still, we have come a long way and there is good reason to believe that continued engagement will lead to a further positive evolution of China's attitudes and actions vis a vis non-proliferation norms.

Even in the contentious area of human rights, engagement with China is yielding tangible results. Just six months ago members of this Congress as well as the international community at large had grave concerns regarding the health and status of two of China's most prominent political dissidents, Wei Jingsheng and Wang Dan. Against a backdrop of intensive dialogue with the United States and continued,

public U.S. criticism of China's human rights record, the Chinese authorities have released both Mr. Wei and Mr. Wang on medical parole and have permitted some other dissidents to depart China. China has also signed and submitted for ratification the UN Covenant on Economic, Social, and Cultural Rights and has pledged to sign the UN Covenant on Civil and Political Rights. President Jiang Zemin also recently hosted a delegation of U.S. religious leaders, and the Chinese government has agreed to follow up this visit with further dialogue and exchanges. These exchanges can and do produce results, as the recent release from prison of Bishop Zeng Jingmu demonstrated.

This is not to suggest that human rights abuses in China are a thing of the past. On the contrary, we have reported to Congress that serious and widespread human rights abuses continue in violation of internationally accepted standards and norms. But the steps the Chinese have taken within the space of just a few months are nonetheless noteworthy, even if systemic change to protect fundamental rights remains inadequate.

These are not meant to be exhaustive examples of the fruits of engagement; nor are they meant to mask the persistence of serious differences between our two countries. They are intended simply to show that engagement *is* working and that we have made progress in encouraging China's development as a full and responsible member of the international community.

**MFN: A Critical Component of Engagement**

MFN provides a vital underpinning for this strategy of engagement. Access to the American market is the most tangible evidence there is of the benefits of being part of the international community. China's economic ties with the world give it a huge incentive to participate in and abide by the rules of the international system. If the United States, the world's largest and most open economy, were to deny China a normal trading relationship, China's stake in the international system would shrink significantly.

Withdrawal of MFN would devastate our economic relationship. Denial of MFN to China could invite Chinese retaliation against our $13 billion in exports; endanger the roughly 170,000 jobs in the United States those exports support; hurt American consumers through price increases on basic goods; disadvantage American business people hoping to compete in China's burgeoning market; and derail ongoing multilateral and bilateral trade negotiations intended to

increase access to the China market and ensure China's compliance with international trade rules.

The Administration is concerned about our growing bilateral trade imbalance with the PRC. But the most prudent way to address this problem is to get China into the WTO on a sound, commercially viable basis. We need to remove barriers disadvantaging our exports to China, not create barriers to imports from China, which would actually harm our own consumers as well as manufacturers who depend on Chinese inputs for their products. We are pursuing this goal with all the tools available, including WTO accession negotiations and bilateral trade negotiations. Progress in these talks would certainly be jeopardized should MFN be revoked.

For the PRC, loss of MFN status would of course hurt its export sector. But more important for the United States, it would threaten China's ambitious plans for structural economic reform. China has unveiled a bold plan to reform China's mammoth state sector and troubled financial system. This plan is intended to rapidly accelerate China's transition from a command to a market economy and thus is very much in line with our own economic interests.

China's plan can only succeed, however, if growth can be sustained. And yet growth in China slowed from 8.8% this time last year to 7.2% in the first quarter of 1998, fueling speculation that China will be unable to carry through with its reforms. Should the export sector -- already under pressure due to significant regional currency depreciations -- suffer an external shock along the lines of MFN revocation, reforms that are profoundly in our interest would be endangered. This would increase uncertainty in the Asia-Pacific just when stability is most desperately needed for regional recovery, with MFN revocation likely prompting China to abandon its universally lauded pledge to not devalue. Devaluation of the yuan would in turn set off another round of competitive devaluations in the region, raising the specter of destabilized financial markets in Asia and beyond.

MFN revocation would also harm our friends in Taiwan and Hong Kong. Taiwan has over $36 billion invested in the PRC, much of which is in export industries. Hong Kong firms, for their part, own, finance, supply or service thousands of export factories throughout China's booming southern region. Hong Kong, moreover, handles almost 50% of U.S.-China trade, making it highly dependent on continued normal trade relations between the U.S. and China. Hong Kong authorities

estimate that MFN revocation would slash trade by up to $34 billion, jobs by about 85,000 and income by about $4.5 billion. Hong Kong leaders across the political spectrum, including opposition leader Martin Lee, have thus spoken out strongly in favor of MFN renewal.

In short, severing normal trade ties with China would have severe economic consequences, and would hurt U.S. interests as much if not more than those of the PRC.

Revocation of MFN, moreover, would not only damage our growing commercial relationship; it would affect our relationship with China across the board. MFN, despite its name, is not a privilege we extend to only our closest allies. It is, rather, the standard tariff treatment granted virtually every nation in the world, including many with whom we have substantial disagreements. To the leadership in Beijing, therefore, the cessation of normal trade ties would be tantamount to a reversal of engagement, thereby imperiling gains painstakingly achieved and eliminating prospects for future progress.

More specifically, Mr. Chairman, revocation of MFN could:

- Undercut our strategic cooperation, particularly in defusing escalating tensions in South Asia, dismantling North Korea's nuclear program, and pursuing a permanent peace settlement on the Korean Peninsula.

- Result in a more belligerent and xenophobic foreign policy.

- Handicap our efforts to strengthen China's integration into non-proliferation regimes and limit our ability to curtail technology transfers to unstable regions.

- Risk China's support for U.S. initiatives at the U.N. as well as cooperation on global issues such as drug trafficking, alien smuggling and climate change.

While risking vitally needed cooperation on all of the above fronts, what would the United States get in return? Denial of MFN could actually hinder our efforts to improve human rights in China. Revocation of MFN would create a tense, hostile atmosphere in which Chinese leaders would be less inclined to take the kind of actions we have worked painstakingly to encourage: releasing political dissidents, allowing international visits to prisoners, signing and

ratifying international human rights covenants, and engaging international religious leaders.

Furthermore, the loss of the U.S. market might have the unintended effect of weakening some of the most progressive elements of Chinese society. Private entrepreneurs have been able to expand personal freedoms by being independent of the state, and our trade and investment have helped to expand the habits of free enterprise and independent thinking. We need to encourage this sector, not stunt its growth, and we can only do that by providing access to American markets and ideas.

Mr. Chairman, as Secretary Albright has often said, there is no greater opportunity - or challenge - in U.S. foreign policy today than to encourage China's integration into the world community. President Clinton's decision to extend MFN status to China reflects our commitment to this goal.

The Administration shares fully many of the concerns expressed in Congress and elsewhere about some Chinese policies and practices. But our concerns can best be addressed and our interests best advanced by continuing to engage Chinese leaders on the full range of security, economic and political issues. This will simply not be possible if we revoke MFN. Revocation of MFN could derail the entire US-China relationship, eliminate prospects for cooperation, strengthen the hand of those in China seeking to undermine reform, limit our ability to influence China's development, and imperil innocent bystanders in the region in the process.

The historic task of integrating China into the international community requires nothing less than a comprehensive, rational strategy of engagement. This strategy has met with considerable success thus far, and I am confident that with Congress' support, we will continue to make progress in the run up to the summit and beyond.

Chairman CRANE. Thank you, Mr. Roth.

Ms. Esserman, my understanding is that Charlene's airborne right now; is that correct?

Ms. ESSERMAN. That is correct.

Chairman CRANE. En route to China. All right, well, you tell her when she gets back that we're sorry we missed her.

Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman, and thank you for your testimony. It was very, very interesting, I think, especially the results of our closing down on MFN and how it would affect us and our friends in the Asian economy.

I want to ask you, Mrs. Esserman, to take a moment to focus more directly on the importance of MFN to nations other than China, in particular, Hong Kong and Taiwan. I think that people forget that this is not simply a situation between us and China. As we well know, in that relationship there are obstacles in the road, and we want to consider all those obstacles. But we also believe thoroughly that trade is terribly important in providing us with an environment where we can begin to talk about these things.

I wonder if you would just reiterate—for example, we know in China we have something like 1,000 American companies and 3,500 Americans employed by those companies living in China. I wonder if you would take a minute or two—and perhaps you, too Mr. Roth—to talk about the effect on some of the very good friends that we do business with in the Far East.

Ms. ESSERMAN. Thank you, Congresswoman Dunn. You are absolutely right that the revocation of MFN would have a significant adverse affect on Hong Kong. Hong Kong handles over 50 percent of U.S.-China trade, making it very dependent on the normal commercial trade relations status. Hong Kong authorities themselves estimate that MFN revocation would slash trade by $20 to $30 billion, with a resulting loss of jobs between 60,000 to 85,000 jobs. That is why, as I have said, Hong Kong leaders across the board have stated their strong support for the renewal of MFN.

It is also crucially important that we continue to extend the normal trading relations to China now, at this very sensitive time. With the Asian crisis, it is particularly important for Hong Kong that we extend China MFN, and this is the case for other countries in the region also.

Mr. ROTH. Why don't I say a little bit about Taiwan? As you know, Taiwan has invested massively in China. It's actually been one of the stabilizing elements in that relationship. But much of that investment is geared to export industries—Korea exports, the United States is one of the largest markets. I think it's pretty obvious that if you start massively curtailing exports from China to the United States by virtue of revoking MFN then you're going to be hurting Taiwan-owned industries. Some of these will go out of business and then there's going to be a major loss of investment on the part of Taiwanese investors.

And as is the case with Hong Kong, the majority of the leaders in Taiwan have made no secret that they, too, would like to see MFN extended.

Ms. DUNN. Thank you very much. I must say that there have been strong proponents of this point-of-view that you just ex-

pressed: last year Governor Chris Patton came to Washington, DC and spoke articulately about this. This year as Wei Sie Chen visited us here in Washington, DC, and also my hometown of Seattle, WA at a forum that was led by Robert Kapp, president of the United States-China Business Council, and she expressed this point-of-view.

I think it's a terribly important point for us to remember that our friends—who are not just all over the world, but specifically in Taipei, Taiwan, and also in Hong Kong—are depending on our extending MFN.

I yield back.

Chairman CRANE. Mr. Jefferson.

Mr. JEFFERSON. Thank you, Mr. Chairman.

As I read the President's message to the Congress transmitting his notification of his waiver of the application of Jackson-Vanik, it is, of course, limited to the issue of freedom of immigration and freedom to encourage further progress of immigration. So, it's unfair to the President to say, don't you think, that if he makes those two findings and submits it to Congress that he is somehow not discharging his responsibility on the MFN issue? Because these other issues that we've heard discussion about don't apply, technically or legally, at all to the Jackson-Vanik discussion, which is the essence of what the President has to make a determination about. Isn't that correct?

Mr. ROTH. Well, the President's specific report to the Congress deals with the narrow parameters of the legislation itself and treats it as a legal issue. But I think all of us——

Mr. JEFFERSON. That is all he has to do, isn't it?

Mr. ROTH. Yes.

Mr. JEFFERSON. That's his whole responsibility. So, if he does that, he's met his responsibility, correct?

Mr. ROTH. Yes.

Mr. JEFFERSON. Now, with respect to the other issues, they fall within the realm of what we—when the President says he delinks human rights from the trade issues, it doesn't necessarily mean that one has less priority than the other; does it? I'm trying to follow these witnesses who say when you delink, it means one has less priority than the other. They may have equal priority in their spheres of discussion and consideration. Isn't that correct?

Mr. ROTH. Exactly.

Mr. JEFFERSON. And so with the issue of human rights, religious freedom, and political freedom that we all care about: aren't they on track for discussion and for resolution, but in another sphere of consideration? Not with respect to the trade and investment side, but with respect to the diplomatic side. The State issues and all those matters are always present and the administration's pressing on those issues. Isn't that true?

Mr. ROTH. Yes, you're making my case better than I did.

Mr. JEFFERSON. I'm trying to; now, the issue. With respect to the other matters of non-proliferation and all the discussion we've heard about those: What has been the record of cooperation that recognizes that these issues are separate from the issues that are really before this Subcommittee? Nonetheless, let me ask you:

What has been the record in the last year of the Chinese Government with respect to the proliferation issue?

Mr. ROTH. Overall, I think you would characterize it as improving. We reached some significant agreements at the last summit, particularly with respect to stopping the sale of antiship cruise missiles to Iran and to dual-use export controls on nuclear items. And we've seen excellent Chinese compliance with the commitments made at the last summit.

We are working to try to broaden areas in which we're getting Chinese commitments. For example, right now, we're trying to achieve further progress on missile proliferation. But overall, the trend has been positive.

Mr. JEFFERSON. With respect to the India-Pakistan question: What has been the Chinese response to them?

Mr. ROTH. The Chinese response has been very supportive of United States policy. We have worked jointly at the permanent five at the United Nations. China was the Chair, actually, at the special session in Geneva to deal with the response to the nuclear test. And our positions are very similar in terms of wanting adherence to the comprehensive test ban: for them to both renounce future tests, to agree not to produce additional fissile material, and to agree to serious talks to try to diffuse the situation on the Indian subcontinent. It was a very good relationship of which we're trying to achieve a common strategic objective.

Mr. JEFFERSON. With respect to the bilateral agreements we reached with the Chinese over the last few years, what is the record of compliance with those agreements, specifically with respect to prison labor, intellectual property rights, textile transhipment, market access, property rights, those questions?

Ms. ESSERMAN. Let me start on the trade side. Their record has been pretty good overall. There are areas, for example, in the 1992 MOU agreement where they have fully complied, that is, in lowering tariffs and removing licenses and certain quotas.

Where they haven't been so good is in respect to agriculture. Agriculture is a very difficult issue; China is a very important market to the United States and we are pressing very hard to resolve some of these barriers. I might add that some of the barriers that we see in China are the same that we see around the world—in Europe in particular, where we're continuing to have difficult problems with them.

In the area of intellectual property, we have been working intensely with Chinese authorities and provincial authorities to not only implement the agreement, but to establish a real legal infrastructure so that there is effective intellectual property protection.

In the area of CD's and CD–ROMs, the compliance has been quite good and continuing. There are issues that remain: There are other piracy problems as well as market access issues that we are addressing.

Mr. JEFFERSON. On the transshipment—because you didn't mention it, I want to ask you to speak to that one too.

Ms. ESSERMAN. Yes. We have been vigorous in monitoring our textile agreements with China. And where we have found any evidence of transshipment, and we have followed the appropriate legal

procedures and taken action and we have triple charged against their quotas.

Mr. JEFFERSON. I see my time is up. Mr. Chairman, thank you for allowing me——

Chairman CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

First of all, let me say, Ms. Esserman, I'm a big fan of your boss. It's a pleasure to work with Ambassador Barshefsky in a bipartisan, pragmatic way on these important trade issues.

Let me ask you this: Everyone is concerned, of course, about the financial instability in Asia and about the Chinese currency. In your judgment, do you think China will eventually devalue in order to stay competitive with its Asian neighbors?

Ms. ESSERMAN. I wouldn't want to speculate in this hearing, but I would say that we believe that their actions to date, where they have chosen to maintain their currency despite pressure, have been very, very helpful to the situation.

Mr. RAMSTAD. Have they, therefore, been rewarded in terms of the trade negotiations?

Ms. ESSERMAN. Absolutely not. We think, again, that this is another product of continued and intensive engagement with them. But as we have always said, our trade negotiations will be on the merits. In respect of WTO accession, we will work with them. Any WTO package will be strictly on the merits and on terms that other members have been required to follow.

Mr. RAMSTAD. Good. Let me ask you another question, Ms. Esserman. In your statement you talked about the status of WTO negotiations, that they indicated some positive signs. You mentioned that China agreed not to use export subsidies for agriculture. What implications for U.S. agriculture are in these signals?

Ms. ESSERMAN. Well, we think that is a very important step. That's very, very important to our agricultural community. It is, of course, one step. In the area of agriculture, as I mentioned, there is already a significant market for agriculture producers. China is our agriculture producers' sixth largest market, but many problems remain and we are working intently on them. They are in the form of high tariffs, tariff rate quotas, as well as these so-called safety standards that are really not based on science. So we have a ways to go in the agriculture area.

Mr. RAMSTAD. Finally, Ms. Esserman, will you support the bill that Chairman Crane and I and others have sponsored to change the nomenclature from most-favored-nation status—which is misleading—to normal trade relations with China? That term is much more descriptive and accurate.

Ms. ESSERMAN. Absolutely. It goes a long way to help clear up the issue.

Mr. RAMSTAD. Thank you, Mr. Chairman, Ms. Esserman. I yield back.

Chairman CRANE. Thank you.

Mr. Houghton.

Mr. HOUGHTON. Thank you very much. Mr. Ramstad said that he was a big fan of your boss. I'm a big fan of you, Ms. Esserman. [Laughter.]

And, Mr. Roth, it's nice to see you. I guess the basic question is: Where do we come at this? Some people don't think China is doing the right thing economically. There's force directed on economic placing, many times, of slave labor. In terms of the employment we've got problems. Also in terms of abortion, many times the concept of religion, intellectual property rights, and all sorts of things like that. But I think the question is, Do we sort of stare them down and flag them and tell them they're bad, or do we sort of work through them?

I wasn't here for Chris Smith's testimony, but it's hard to separate the basic trading from the other issues. I basically come from the standpoint that it's better to work with people, particularly when you have this enormous powerhouse out there. And we are now so inextricably intertwined with the economy and the rest of the world—and now even more so with China—that to wag our finger and threaten them, scold them, just doesn't seem the right thing. But those issues are out there; they're very, very important, and not just in this room.

How do you handle those things? Maybe you'd both like to——

Mr. ROTH. Let me take the first crack at it. But I think in your question itself, you've basically underlined the strategy behind what we're trying to do with engagement. It's not a feel-good strategy to avoid confrontation; rather it's a very pragmatic and realistic strategy designed to try to produce results on all the issues that we care about, whether it's some of the diplomatic foreign policy security issues that I deal with, or the economic issues that my colleagues at USTR and the other economic agencies spend so much time on.

But the real question is, What works, what gets results, and is it a confrontational policy? Would that lead us to progress?

I said in my statement, and I firmly believe that if we revoke MFN, things would go backward on human rights, that they'd go dramatically backward on nonproliferation. I think we'd get less cooperation on key foreign policy issues like the Korean peninsula and South Asia. And my colleague from USTR has explained at great length what the economic consequences might be for the United States, and for some of our key friends in Asia.

So I think the engagement strategy is exactly what you suggested: a means of trying to elicit progress on issues that affect American interests.

Mr. HOUGHTON. So what you, in effect, are saying, is that you do believe strongly in some of these other issues, which are noneconomic; that the best way to resolve them is not to cut off relationships, but to be further involved in changing them, as I guess we have seen in a variety of different areas in China.

Mr. ROTH. Yes.

Mr. HOUGHTON. Ms. Esserman.

Ms. ESSERMAN. Congressman Houghton, I want to add to what Assistant Secretary Roth just said, because I think it is particularly pertinent in the trade area. Obviously, we cannot make progress in our trade relationship if we have no relationship.

But the nature of the trade problems require intensive and painstaking work. And I did mention earlier our intellectual property situation. I think it is very, very interesting.

Actually, this point definitely applies to our WTO accession negotiations: What we did there was we confronted the Chinese with the problem. We were insistent on dealing with the problem. We negotiated an agreement. They weren't complying as we wanted them to do. We threatened, and then actually invoked retaliation. But most importantly, we worked with them to develop the legal infrastructure necessary to make that agreement a success. And what that has required is ongoing and painstaking work, bringing our Customs and Justice authorities and the Patent and Trademark Organization over, working with them and working with our industry to make sure they've developed the kind of infrastructure necessary to ensure that we secure the gains that we must for our intellectual property industries.

So really, the best way to go at this point is to be working intensely with them, and not be afraid to use the targeted trade tools when necessary.

Mr. HOUGHTON. OK, thank you very much. Thank you, Mr. Chairman.

Chairman CRANE. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I'd like to ask a couple questions just to hear your thinking, because I don't really know the answers to these. Maybe there is no answer, but let's just suppose that the Congress turns down most-favored-nation for China; that leads to what consequences in China? Tell me what you think would occur there, in terms of employment, or devaluation of the Renminbi, or whatever.

Mr. ROTH. Well, let me talk more on the foreign policy side and the development of China itself, and then turn the economic questions over to Susan.

First of all, I tried to indicate in my statement that you're undermining the very reformist elements in China itself that we should be encouraging; people that are trying to promote a lot of the steps, whether it's the privatization of the state economic enterprises, or financial reform, and the like.

I think beyond that you're also going to see a movement to the right, as it were—more hardline positions on foreign policy issues. And I think a lot of the cooperation on certain areas that I've described could disappear. I would also have to worry about what the response might be in the Security Council in terms of how they might react.

So I think what you'd get is a combined response: That if you did this you would a worsening of our relationships with China, you would be hurting your reform movement within China, and you would be hurting American economic interests simultaneously.

Mr. MCDERMOTT. Just as an aside, I think I heard Secretary Rubin say that if we didn't pay our arrears and dues to the U.N., that we will lose our vote on the Security Council at the end of this year; is that correct? And if we miss this year then we lose our vote in the General Assembly?

Mr. ROTH. I haven't heard it for Security Council.

Mr. MCDERMOTT. Oh, it's in the General Assembly; we would lose our vote.

Mr. ROTH. Let me get you his exact comment and response. I want to see what he said.

Mr. McDermott. OK.
[The information follows:]

June 17, 1998
Pg. 84, Ln. 1807-16

Asst Sec Roth m FN

**Question:** memo

Just as an aside, I think I heard Secretary Rubin say, that if we didn't pay our arrears and due to the U.N., that we will lose our vote on the Security Council at the end of this year, is that correct? Did I miss this year then in the General Assembly?

**Answer:**

During a speech to the Foreign Policy Association on April 28, 1998, Secretary Rubin stated that "we have failed to pay our arrears to the United Nations -- and if we fail to pay by the end of the year, we will lose our vote in the General Assembly." Other U.N. bodies, including the Security Council, are not affected by failure to pay arrears.

To further clarify the issue, we are providing the following for your information:

**Possible Loss of U.S. Vote in the UN General Assembly.** Loss of the U.S. vote in the UN General Assembly (UNGA), effective January 1, 1999, is a possible outcome -- but not certain -- if no arrears payments are made this year.

**UN Rule on Loss of Vote.** The UN Charter (Article 19) requires that a member state lose its UNGA vote when arrears amount to the member's assessments from the two preceding years. The General Assembly may override this requirement if it is satisfied that the failure to pay is due to conditions beyond the control of the member state. Other UN bodies, including the

Security Council, are not affected by Article 19. Voting privileges in the UNGA are restored when a members' arrears fall below the two year threshold.

**Loss of Vote Threshold for the U.S.** U.S. assessments for the UN regular budget, UN war crimes tribunals, and UN peacekeeping operations amounted to $708 million in 1997 and are projected at $572 million this year. Hence, if U.S. arrears exceed $1.28 billion on December 31, 1998, UNGA voting privileges will be revoked effective January 1, 1999.

The probability of the U.S. facing the loss of its vote is increased by the fact that, since the early 1980s, Congress has appropriated funds for UN assessments on a "deferred" basis. This means that, for instance, the U.S. will not begin paying its UN assessments for calendar year 1998 (technically due last January) until U.S. fiscal year 1999 (which begins October 1). And much of that funding is subject to legislated certifications over the course of the U.S. fiscal year, which slows payment further.

**UN Notification Process.** The UN will send a letter to the U.S. this November if UN projections show the U.S. is facing possible loss of its UNGA vote owing to arrears. Such a letter would lay out the amount the U.S. needs to pay the UN by the end of the year to avoid loss of vote. If the Administration then projects that insufficient funding is available to avoid loss of vote, it will be up to the Congress and the Administration to

determine if extraordinary measures should be taken to preserve the U.S. vote in the UNGA in 1999.

**Determinants of U.S. Payments.** Whether the U.S. will exceed the loss of vote threshold at the end of this year is uncertain at present, being dependent on a number of variables, including the possible enactment of UN arrears legislation, legislative certifications attached to annual funding, the level of UN peacekeeping expenditures, and the speed at which annual payments can be made during the first quarter of fiscal year 1999. If an arrears payment plan is not enacted this year, to avoid loss of vote at a minimum the U.S. will need to make certifications and first quarter payments from the fiscal year 1999 budget more rapidly than in previous years.

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
Remarks as prepared for delivery
April 28, 1998
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SECRETARY ROBERT E. RUBIN
FOREIGN POLICY ASSOCIATION

It is a pleasure to speak with you this evening and I am honored to accept an award from such a distinguished group which focuses on the broad range of the nation's foreign policy concerns. By honoring me, you honor President Clinton's entire national security and economic policy team, as well as the career men and women in the White House, the Treasury Department and throughout the government with whom I've had the privilege of working the past five years. Most importantly, you honor President Clinton, who, in this period of new challenges in foreign policy, has brought to these challenges a deep understanding that we live in a global economy and that our economic well-being depends on strong U.S. leadership and engagement in the global economy. I well remember at the time of the Mexico crisis, I went to the Oval Office to tell the President that the Federal Reserve Board and Treasury felt that Mexico was on the verge of likely default. At the same time, I told him that a recent poll showed that 80 percent of the American public did not want us to provide help to Mexico. He saw that default in Mexico would not only profoundly affect Mexico, but would also profoundly affect our national security and economic interests. So the President said that this is something we have to do, let's go ahead and do it.

Having said that, however, I am deeply concerned -- and I know the President shares this concern -- that public support for forward looking international economic policies may be waning at a time when this country's economic, national security and geopolitical interests require just the opposite. We have all seen the signs over the past few years of a creeping tendency toward turning inward in America, and at times, even a rejection of the reality that what is happening in the rest of the world affects us. As I speak tonight, for example, the United States lacks fast track trading authority, and our trading partners are now moving forward with new trade agreements without us; we have failed to pay our arrears to the United Nations -- and if we fail to pay by the end of the year, we will lose our vote in the General Assembly; and we have failed to approve funding for the International Monetary Fund, at a time when a sufficiently funded IMF to deal with potential crises is critical to our economic and national security interests and the rest of the world is waiting to fund once we do.

Tonight, I want to speak about the importance of building support for forward-looking international policies. Let me start by placing this discussion in the context of the end of the Cold War and the emergence of the global economy and global financial markets.

With the end of the Cold War, the foreign policy consensus lost its centerpiece. In the wake of that transformation, there have been two significant -- and related -- developments I would particularly like to discuss this evening. First, there has been an increased focus on international economic policy as a result of the globalization of the economy. At the same time, there has been an erosion of the traditional base of support for international economic engagement, and, at the same time, a re-ignition of one historical strain in American thought, a rejection of the outside world.

Over the last twenty-five years, we have seen the rapid evolution of the global economy and global financial markets. A quarter century ago, imports plus exports equaled 15 percent of our economy. Today, they equal 30 percent. Large U.S. corporations once viewed themselves as American companies with a few offices abroad. Now they see themselves as global corporations headquartered in the United States. Vast international flows of trade, capital, information and technology have sped the world's economies toward integration.

Perhaps the changes have been the greatest in developing countries. Twenty-five years ago, the flow of aid to developing countries was much greater than private capital flows. Today, after so many developing countries have embraced market reforms, the annual private flows of capital to developing countries around the world are more than seven times larger than official flows. In 1996, more than $250 billion in private capital flowed to emerging markets -- compared to roughly $20 billion ten years ago. This has helped lift millions of people out of poverty in the developing world and turned these countries into important participants in the global economy; for example, they now absorb more than 40 percent of our country's exports. That is why, in my tenure as Treasury Secretary, I've visited a whole host of developing and transitional countries, including Vietnam, Brazil, Ukraine, the Philippines, India, and China, and this summer I will visit Africa -- countries and regions far from the traditional focus of Treasury Secretaries.

This new era of the global economy and global financial markets has brought tremendous benefits for U.S. workers, farmers and businesses. Millions of Americans owe their jobs directly or indirectly to trade, and all of us benefit through the lower prices and greater choice that international competition fosters. It is no exaggeration to say that our economic well-being is inextricably linked to the rest of the world.

But with the opportunities and benefits, have come new challenges and risks. How effectively we meet these challenges will have an enormous impact on support for forward-looking international policies and our economic well-being in the years and decades ahead. Let me focus on three critical challenges.

First is the challenge of greatly broadening participation in the benefits of the global economy. Global financial integration benefits the great majority of Americans, but one of the concerns often expressed -- and it is a concern that I share -- is this: in the United States, and other

industrialized countries, those who are well-equipped to compete in the global economy are doing better and better, and those who are not so well-equipped risk falling further and further behind. Dynamism in the global economy does fuel rapid change, and that change benefits the vast preponderance of workers, farmers and businesses. But it also can create dislocations, although I think it is worth observing that technology contributes far more to dislocations than trade.

Looking at the developing world, despite vast global economic growth over the past decade, over half the people of the world still live in poverty and that is a problem not only for the countries with high poverty rates but for all of us. The developing countries are our markets for the future, and their economic well-being promotes our well-being. Moreover, social instability, disease, and environmental degradation in those countries can affect us.

The response to all of this ought not to be to turn inward, or to dismantle the global economy that has benefited so many. The response is for the United States -- and all nations -- to make it easier for those who are dislocated to re-enter the economy successfully; to focus on education and training to equip citizens with the tools to prosper in the global economy; to build social safety nets to protect the people who would otherwise be left behind; to work for broad implementation of core labor standards throughout the globe; and to promote good governance, democracy and human rights. The benefits of the global economy will only be realized if we and all other nations build broad-based support at home for forward-looking international economic policies. Garnering that support would be greatly enhanced if these benefits are more broadly shared.

A second critical challenge is to strengthen the architecture of the international financial markets to help prevent financial crises, or better manage them should they occur. Fifty years ago, foreign policy experts met at Bretton Woods and devised the architecture of the international financial system. That architecture has served us well for over a half century, but it needs updating in an age of a vast and complex international financial system. We must make the architecture as modern as the markets.

The need to update the architecture has been brought home most recently by the financial crisis in Asia. As you well know, by doing everything sensible to help these Asian countries get back on track we support our exports to the region and help strengthen their currencies. This, in turn, helps the competitiveness of our goods in world markets and reduces the risk that financial instability will spread to other developing countries. It also lessens the chance of contagion, which would compound all these problems. That is why the United States has exercised very strong leadership throughout this situation towards helping resolve the Asian crises.

Even before the turmoil in Asia, the United States and the international community had been working to strengthen the international financial architecture. We began this effort four years ago at the Naples G-7 meeting and we launched the first steps the following year at the summit in Halifax. These issues are very complex -- intellectually and politically. Unlike the Bretton Woods institutions, which were essentially put in place at one time, I believe what will happen here will be that reforms will take place in pieces over an extended period of time.

Our approach has focused on three areas:

First, providing better information through improved disclosure and transparency. This is partly a problem of making useful information available, and partly a problem of investors using the information wisely, and analyzing risk better. In Korea, we were surprised by how little risk assessment investors and creditors had done.

Our second area of focus is on building strong national financial sectors. A common element amongst the countries involved in the crisis in Asia -- and, for that matter, in virtually all countries experiencing financial crises around the world -- is a badly flawed domestic financial sector.

Our third area of focus is to work to ensure that the private sector more fully bears the consequences of its credit and investment decisions, including in periods of crisis. In today's world, where trillions of dollars flow through international markets every day, there is simply not going to be enough international assistance for the crises that could take place. There is also a risk associated with official financing which economists call "moral hazard:" that providing such assistance shields creditors and investors from the consequences of their actions and sows the seeds of futures crises. Some protection of creditors may result as a by-product of the overarching objective of restoring financial stability, but this protection should be kept to the minimum possible.

While we are focusing on strengthening the architecture for the longer term, it is absolutely imperative that IMF resources now be sufficient to deal with new crises should they occur. In fact, IMF resources are at historic lows. While the probability of the crisis worsening or spreading or of a new major crisis is low, the potential impact on our economy of any significant crisis is simply too great to risk not having the capacity to respond effectively. It is critical that Congress approve the President's request for IMF funding as quickly as possible.

The third and final challenge we face is to rebuild the consensus about the critical importance of U.S. leadership and engagement in the world to the national security and the economic well-being of the American people. This challenge has not been met.

In 1947, George Marshall gave a speech at Harvard proposing the plan that would bear his name to help rebuild Europe. He said, "An essential part of any successful action on the part of the United States is an understanding on the part of the people of America of the character of the problem and the remedies to be applied. Political passion and prejudice should have no part." Afterwards, President Truman, Senator Arthur Vandenberg and members of both parties launched a campaign to educate the public about the Plan and build support for it. The Marshall Plan, which was initially met with skepticism and opposition, eventually passed overwhelmingly in both houses of Congress.

We need a similar focus today. There needs to be a redoubled effort by all of us -- public sector officials, the business community, foreign policy experts -- to communicate with the American public about the dynamics of the new global economy and the importance of U.S. leadership in the global economy to the economic well being of the American people.

A poll once showed that Americans, when asked what we spend on foreign aid, said fifteen percent of the budget. When asked what we should spend, they said five percent. We actually spend a little over one percent of our budget on these aid programs, including our contributions to the international financial institutions and the UN. Unless there is broad based public understanding of the importance to U.S. interests of strong U.S. leadership in the global economy, we will fail to support the UN and we will lose our vote; we will fail to support the IMF, and be more vulnerable to economic crises; and without fast track, we will stand by as the rest of the world moves forward and liberalizes trade, with us on the outside of the tent, rather than the inside. All of this has enormous consequences to our economic well-being and our national security. That's why it's so critical to develop broad public understanding of global interdependence and the importance of U.S. leadership to our interests-- and that is where all of you -- individually and institutionally -- have a critical role to play.

The members of the Foreign Policy Association have contributed enormously to the conduct of American foreign policy by the focus, thought and seriousness it has brought to the subject. But in the world today, your role has never been more important -- as individuals, in the businesses and firms for which you work, and as an organization -- in developing public support for forward looking foreign policy.

Our success in meeting the challenges I've discussed this evening -- and again, let me emphasize, the overarching challenge is to promote public support for global leadership -- is critical to our country's economic well-being for years and decades to come. As this century draws to a close, it offers a very clear lesson. Withdrawal from international affairs cannot work and engagement in international affairs leads to prosperity. Thank you very much.

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Ms. Esserman, could you give us a feeling for what would actually happen economically if we did not extend most favorite nation to China? Without making it seem worse than it is, I want a realistic estimate on your part of what that would do to the Chinese economy.

Ms. ESSERMAN. Well, I think most fundamentally what has caused great concern at this juncture is that the act of—the magnitude of—revoking MFN would really cause destabilization within China and within the region. And I think that is a very, very serious concern.

Mr. MCDERMOTT. But by what mechanism would it cause destabilization? Like when the stock market fell last week and confidence fell in Asian economies, or would it actually be closing of markets and loss of exports? What would be the mechanism by which that destabilization would occur?

Ms. ESSERMAN. Well, it would be through a variety of means. It would create great instability in affecting confidence in the region, and it would affect opportunities for China in the United States. But of course, and most fundamentally, that kind of instability in Asia will have an effect on the United States' interests, and there are a range of concerns—economic concerns—that we have about the revocation of MFN. Its impact on our own economy here, in terms of increased costs of consumer goods, potential loss of jobs, would be felt in a wide array of areas, including the concern that we would lose the gains that we have fought so hard to achieve in the intellectual property area. And the gains that we have made in the WTO accession negotiations, while very slow and painstaking, that progress would simply stop.

Mr. MCDERMOTT. What's the likelihood that you would expect the RMB to be devalued?

Ms. ESSERMAN. I'm sorry, I didn't hear your question.

Mr. MCDERMOTT. The currency devaluation; what's the likelihood that that would happen if we withdrew most-favored-nation trading sting? Is it more likely, or less likely, or would it have no effect?

Ms. ESSERMAN. Well, I wouldn't want to comment on what the Chinese plans are on devaluation. Let me simply say that we are pleased with their actions to date, and certainly any kind of dramatic action like revoking MFN would have a destabilizing effect on China.

Mr. MCDERMOTT. It's my view that destabilizing China through this kind of action, both politically and economically, leads to more human rights abuses. Is that a fair estimate?

Mr. ROTH. Yes, I would not want to have a straight-line projection, but I would certainly say that, in the context of a very bad U.S.-China relationship, as well as a suffering Chinese economy, the leverage that we and the international community would have on China to improve the human rights situation would certainly be diminished.

Ms. ESSERMAN. And I think if you look at history, during the times of the greatest closure in China—between the early 1950's and the early 1970's—that's a time of great abuse.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Matsui.

Mr. MATSUI. Mr. Chairman, I am sorry I was late. I was meeting with some constituents back there, and I want to apologize to both Ambassador Esserman, and certainly Secretary Roth as well. Perhaps these questions have already been addressed.

Secretary Roth, in terms of the—and I was just saying to Chairman Crane here that it's so difficult to address hypothetical questions. It may be difficult for you to even respond to some of them, because obviously you don't want to get further out than you may want to get out, or should get out, at this particular time.

But in terms of what the Chinese are doing with respect to India and Pakistan now, with the nuclear weapons having been detonated by both countries: Could you say, one way or the other, whether China has been playing a positive role now in helping us? Because I know the whole issue of how to set up roles between the two countries—just as we did with the Soviet Union during the Cold War—those are some areas that need to be addressed by the rest of the free world.

Now, if you can't answer it I would not expect it, but if you could, that would be helpful.

Mr. ROTH. Actually, I don't think that's a hypothetical question. I think you're asking what role China is playing now, which is a factual question.

Mr. MATSUI. Right.

Mr. ROTH. As I tried to indicate previously, I think that the Chinese have been helpful in response to this immediate wave of nuclear tests in both countries. They did chair the Permanent Five, P–5 session in Geneva, in which we're trying to come up with a coordinated P–5 response to what happened. And they took substantive positions there, pretty much parallel to our own in terms of what they want: adherence to a comprehensive test band, competence-building measures, direct talks between India and Pakistan, adherence to limits on fissile materials, and the like.

So they had a very robust nonproliferation package that mirrored our own. I think it's a very helpful response.

Mr. MATSUI. Thank you. In terms of the issue of intellectual property protection, Ambassador Esserman, I know that 2 years ago we entered into an agreement with the Chinese with respect to protection of our intellectual property. Obviously we've had some rough roads over the last 24 months.

So with respect to the enforcement of the agreement, could you tell me how that agreement is going right now, how would you rate it in terms of the monitoring that your agency has been conducting?

Ms. ESSERMAN. I would say that in certain areas the implementation of the agreement has been very, very good and very successful. In the area of CD and CD–ROM piracy, the agreement has been very successful. And as I had mentioned earlier, we have been working intensely with the Chinese and provincial authorities to establish a legal infrastructure. And the Chinese Government has taken extensive action: arresting intellectual property violators, closing down 64 CD and CD–ROM production lines, and taking a number of other measures.

That does not mean that all the work is done. We have a considerable amount of work to do dealing with software piracy, and

we're working intensely on that. We also have a range of other issues such as trademark, and we need to make much more progress in the area of market access.

Mr. MATSUI. One last question.

Secretary Roth, in the area of human rights abuses and religious freedom, are you seeing—maybe this isn't within your bailiwick, because you do have a secretary in charge of the human rights. But are you seeing some changes now in China, in those areas?

I know that Reverend Billy Graham and a number of others have said we must continue to engage the Chinese, continue most-favored-nation status. Obviously, they want the President to continue his efforts and take the trip as well. Perhaps you might talk about some of those areas.

Mr. ROTH. Without in any way wanting to minimize the problems that still remain—and they're formidable—I think I would say that we've seen some progress on human rights. Some of it is very well known to this Subcommittee: the release of prominent dissidents on medical parole in the U.S., Wei Jingsheng and Wang Dan. The signing of one U.N. covenant last year, and the announcement that the Chinese are going to sign the political covenant later this year.

We've had very positive major steps—the receiving of a religious delegation that the United States sent, which included a 1-hour meeting with President Jiang—and all these are an atmosphere that things are somewhat improving.

I think even more important, Secretary Albright came away from her recent trip there stating that China is changing. She had meetings on her trip that physically wouldn't have been possible 2 years ago. We had a meeting at our Ambassador's residence with local Government leaders, think-tank people, members of various levels of government in which they talked about the process of change in China. We discussed legal reform, rule of law, and other issues.

These things weren't on the agenda. Two years ago you couldn't find the phrase "rule of law" in a Chinese newspaper; now it's a headline issue. You're seeing village elections in some places, and in a few cases even the election of the nongovernment party candidate.

So there is a process that's starting some change, but there's a long way to go, and I'm not by any means trying to suggest that we do not have formidable problems remaining.

Mr. MATSUI. Are our Defense Department and also our Justice Department continuing meeting on a regular basis with the Chinese, in terms of assisting the Chinese in how to establish a court system with due process? Second, regarding some of the military conversion efforts I know Secretary Perry has been involved in: Are those efforts, where we have face-to-face engagement with the Chinese on conversion and also maybe setting up a judicial system continuing?

Mr. ROTH. One of the outcomes of the previous summit was that we did agree to engage with the Chinese on a regular basis across a series of issues, and you've highlighted two of them.

For example, on the law enforcement issue we have a vigorous rule-of-law program with a lot of different programs being considered—about exchanges, training of lawyers and judges—that's

quite promising, and that happens regularly. The Justice Department is also involved in this, although a lot of the work happens through NGOs.

On the military side, we have a working relationship as well, military-to-military, but it's not on the conversion side. Unfortunately, that program was shut down by the Congress on the other side, and so our activities are in other areas. But we're concentrating on things like peacekeeping, on search-and-rescue, on transparency, trying on getting them to produce a more accurate analysis of their own budget, their white papers, what their doctrine is.

But we are trying to engage the Chinese military in these areas without, of course, getting into any relationship on military sales.

Mr. MATSUI. If we should eliminate most-favored-nation—and I know my time is up, Mr. Chairman—eliminate most-favored-nation status, would you believe that those would all continue? Or would they—perhaps the Chinese would—what would your——

Mr. ROTH. Clearly, the Chinese would take it quite seriously as a major step backward if the United States were to revoke MFN, and they would wonder what engagement meant if that happened. While I would not want to give you a roadmap of what they might do, I think that one could expect very serious consequences in multiple areas.

Mr. MATSUI. Thank you. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Neal.

Mr. NEAL. Thanks, Mr. Chairman. I just have a quick question and an observation. The MFN vote, as you might expect, generates some of the toughest letters that Members of Congress receive, in some measure, because there's so little information surrounding the entire question.

But given your experience, isn't it really an issue of both sides telling a bit of the truth, and you just have to proceed with an element of faith? There have been some democratic reforms or near-democratic reforms that have been instituted by the Chinese Government, and things are better than they were, but not quite what we desire that they be.

I've given up trying to write back to constituents about that. Instead, I call them on the phone and try to talk it through with them. If you can't convince them of the merit of your argument, at least you can persuade them to postpone a final decision on what you've done.

I think that's part of this engagement process, because we have not succeeded very well when we try to hit them over the head. Even with much of the controversy that surrounds the president's visit, the truth is that even if we come back with an approval 51 to 49, we once again have advanced the democratic arguments, haven't we?

Mr. ROTH. I think that's a fair point, and I think you illustrated the fact that there is a bit of dilemma because there is truth on both sides. Most of the issues we've been talking about is good news and bad news. Some areas progress, some areas not enough progress.

Not too many areas I'm happy to say were there setbacks. But this is a complex picture, where you can't give one straight, simple answer across the board.

Ms. ESSERMAN. And I would just extend as well, in the trade area it is a complex picture. The point is, looking back since the beginning of our grant to MFN, we have made a fair amount of progress.

Businesses are now having access to China; they are operating in China and transmitting our values. The level of state ownership has declined. There has been long-term gains. These are good trends, but many, many problems remain. The real question is how you best address that. And our strongly held belief that terminating the relationship will not help at all to advance these many concerns that people have rightly pointed out across the range of issues.

Mr. NEAL. Thank you. That's pretty much where I come down. Thank you both.

Chairman CRANE. I want to express appreciation to our panelists for their performance today, and relieve you from further duty. And as I say, any written remarks will be made a part of the permanent record, Mr. Roth.

Ms. ESSERMAN. Thank you very much, Mr. Chairman.

Chairman CRANE. Thank you. And with that I would like to call our next panel, Ernest Micek, Chairman and Chief Executive Officer of Cargill Incorporated; and Clark Johnson, President and Chief Executive Officer of Pier 1 Imports Inc. And I would like for Mr. Micek to be presented to our panel here by Mr. Ramstad as Cargill and his district.

And I had the pleasure of visiting up there with Mr. Ramstad before, and had the opportunity to be at the Cargill Headquarters. And when you get up there it impresses you overwhelmingly as a magnificent campus. But it's very beautiful and doing outstanding work.

With that, I'd like to yield to Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman, and welcome to you, Ernie Micek. Certainly as CEO of the largest privately held company in the world, with operations in 72 countries and 79,000 employees worldwide, your expertise is certainly welcomed here today. We appreciate your coming to Washington to testify.

Also, I want to thank you especially for your outstanding leadership and advocacy in support of free and fair trade. Your efforts to open new export market and create jobs throughout the world are most impressive, and exemplary. You've been a real leader in the corporate world, creating jobs. Certainly, nobody's been a better corporate citizen in our State of Minnesota than Cargill, and with your leadership, we appreciate that as well.

I just want to conclude by saying, and challenging your counterparts out there in the corporate world. If every CEO would exert half the effort and influence you have, we wouldn't have to battle MFN each year as we do. We wouldn't have to go scrapping for each and every vote, and have these close calls, when jobs are on the line, when American prosperity is on the line, when economic growth is on the line. We'd also have Fast Track Authority, which is so important to the administration to have to open new markets and to create jobs for the American people.

So I want to thank you and welcome you here today, Ernie. You certainly are not only one of the best and the brightest, but you've been a real friend of free trade, and that's deeply appreciated.

Thank you, Mr. Chairman, I yield back.

Chairman CRANE. Thank you.

Mr. Matsui.

I'm sorry. Mr. Micek, you're next.

**STATEMENT OF ERNEST S. MICEK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CARGILL, INC. AND CHAIRMAN OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE**

Mr. MICEK. Mr. Chairman, Mr. Ramstad, and Members of this Subcommittee, thank you very much for those kind remarks.

Good afternoon. My name is Ernie Micek. I'm Chairman and Chief Executive Officer of Cargill, Inc. Today I am testifying as Chairman of the Emergency Committee for American Trade, known as ECAT, on behalf of its member companies about the need to renew China's MFN treatment, a priority for ECAT member companies.

Cargill has been doing business in China for nearly 30 years. Our presence in China does not mean that we approve of everything that happens there. We believe that a great deal must change to transform China into a pluralistic society, governed democratically, and driven by a market economy.

Our experience of doing business in more than 70 countries convinces us that walling off a neighbor cuts off any opportunity to change that neighbor's behavior, and makes the global neighborhood a more dangerous place. We believe that lesson applies to China as well.

I have five points I would like to make in my presentation today, and refer you to the written version of my testimony for more detail.

First, MFN treatment does not confer any special status to China beyond what is normal trade status for the majority of U.S. trading partners. ECAT does not believe that there should be any change in China's MFN status because of recent allegations concerning the possible transfer of sensitive technology to China.

These allegations should be properly investigated, and any illegal conduct should be punished by applicable U.S. law. America's vital bilateral relations with China should not be put on hold while the investigations are carried out.

Second, the renewal of China's MFN status is essential for the continued expansion of U.S. trade and investment in China. Since the first extension of MFN treatment to China in 1979, U.S. exports of American goods and services have grown nearly 20-fold to $16 billion in 1997, while U.S. investments in China have grown to $25 billion.

U.S. exports to China support nearly 200,000 U.S. jobs across every sector of our economy. China already is one of the top five largest markets for U.S. agriculture exports, buying an average of 8 to 10 million tons of grain per year, with the potential to import 30 million tons of grain by the year 2010.

In addition to grain, Cargill ships orange juice and phosphate fertilizer, as well as cotton, corn, soybeans, soybean products, and meat from the United States.

Cargill has invested in facilities in China, and we now employ over 500 people in China. We're proud of the fact that we and many other U.S. firms have made a positive impact on the lives, attitudes, and behaviors of our employees in China through improvements in workplace habits, supplying better products, and paying higher wages and benefits.

Cargill has brought safety, quality, and ethics programs, and good management and environmental practices to China. For example, we require our workers to wear hard hats, safety shoes, safety glasses, and ear plugs when necessary—all new practices in China. Even the guardrails we installed around our work site were a foreign concept to the average Chinese worker.

Cargill's corporate quality program and guiding principles—our code of conduct—have been translated into Chinese and taught to our employees.

Cargill's trade with China also provides important benefits here at home. The export of phosphate fertilizer to China and elsewhere enables our Florida fertilizer facilities to operate year round.

Jim Johnson, one of our union employees in Tampa, spent a week in Washington last year, telling that story to Members of Congress as part of the effort to secure passage of fast-track legislation. He and others like him at our many export-dependent facilities know the United States needs to compete in today's global economy, and needs fast-track trade negotiating authority to get the best competitive terms it can.

Doing business in China is not without challenges, as described in my written statement. The important point I'm making with this detail on Cargill's experience in China is this: We are struggling, but we are building our business as we have learned to do in many other countries, responsibly and honorably. Our limited success to date and our hopes for the future, like the hopes of other American companies, will be jeopardized if China's MFN status is withdrawn.

My third point is that withdrawal of China's MFN treatment will jeopardize U.S. security interests and the spread of Western influence in China. More than just commercial interests are at stake. Withdrawal of China's MFN status would undercut important gains the United States has made in achieving greater strategic cooperation with China, and would undermine the remarkable transformation of Chinese society over the past two decades, resulting from its opening to the West. The Chinese people today enjoy higher living standards, greater economic freedom, and more access to outside information than ever before.

Fourth, the continuation of China's MFN status is essential in maintaining the health of Hong Kong's economy and preserving Taiwan's prosperity and autonomy. Hong Kong remains a vitally important gateway to China, and its open economy is a major influence on mainland China. Maintaining China's MFN status, in turn, is crucial to Hong Kong's economy and to the one-China policy and efforts to preserve economic relations with Taiwan.

Finally, we should not lose sight of the importance of maintaining a broad vision and moving toward a more stable relationship

with China built on greater mutual understanding and trust. U.S. extension of permanent MFN status to China and China's entry into the WTO on commercially reasonable terms, would solidify this relationship.

An important step in the process was the agreement last fall to hold regular summits between the United States and China. President Clinton's state visit this month is another chance to move ahead the U.S. agenda, and make progress in commercial and diplomatic relations.

In conclusion, granting China MFN status advances U.S. national interests. It is essential to the expansion of U.S. trade in China and the Asia-Pacific region, maintaining a strong U.S. economy, and promoting U.S. security interests.

Cargill, the Emergency Committee for American Trade, The Business Coalition for U.S.-China Trade, and many other business groups, strongly support the renewal of China's MFN status. I appreciate this opportunity to appear before the Trade Subcommittee on behalf of ECAT, and I look forward to responding to your questions.

Mr. Chairman, in closing, I'd like to make one more statement. I want to thank you for the excellent letter that you sent with Speaker Gingrich and Chairman Archer to the President, supporting renewal of China's MFN treatment. Your letter is helping to frame the debate over MFN renewal in a constructive manner.

I would also ask that the statement of the Business Coalition for U.S.-China Trade in support of MFN renewal, and the Business Coalition letter to Speaker Gingrich supporting MFN, be entered into the record of this hearing. Thank you very much.

[The prepared statement follows:]

EMERGENCY COMMITTEE FOR
AMERICAN TRADE

# STATEMENT OF THE

# EMERGENCY COMMITTEE

# FOR AMERICAN TRADE

TO: COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

ON: U.S.-CHINA RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS

BY: ERNEST S. MICEK
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**TESTIMONY OF**
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**OF CARGILL, INCORPORATED**
**AND**
**CHAIRMAN OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE**
**BEFORE**
**THE HOUSE WAYS AND MEANS**
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**WEDNESDAY, JUNE 17, 1998**

## I. Introduction

My name is Ernie Micek. I am Chairman and Chief Executive Officer of Cargill, Incorporated. Cargill is a privately held agribusiness company founded over 130 years ago in Iowa. Today, Cargill is headquartered in Minneapolis, Minnesota, and is involved in marketing, processing, and distributing agricultural, food, financial, and industrial commodities. The company employs some 79,000 people in 72 countries.

Cargill has had nearly 30 years' experience in doing business with China. Our corporate vision is to raise living standards around the world by delivering increased value to producers and consumers. In China, this has meant finding and training employees, providing them career opportunities outside the state system, teaching them to use their creativity to solve problems, and equipping them to think and act for themselves. It has meant finding customers and providing them with food or the means to produce food, raising their living standards by giving them more than they had, and providing them with

the opportunity to succeed on their own rather than to depend on the government. These have been challenging tasks, but the progress we have made has been a rewarding experience.

Our presence in China does not mean that we approve of everything that happens in China. We believe that a great deal must change within China to transform that country into a pluralistic society, governed democratically and driven by a market economy. We believe that such changes will be good for the Chinese people. Our experience through our participation in the process of economic development in over 70 countries convinces us, however, that walling off a neighbor cuts off any opportunity to change that neighbor's behavior and makes the global neighborhood a more dangerous place. We believe that lesson applies to China as well, and our experience is that China is changing in exciting and significant ways.

Today, I am testifying as Chairman of the Emergency Committee for American Trade (ECAT) on behalf of the heads of ECAT member companies about the necessity of renewing China's MFN treatment. Renewal of China's MFN treatment is a priority for ECAT member companies. ECAT members are major American companies with global operations representing all principal sectors of the U.S. economy. The annual sales of ECAT member companies total over $1 trillion, and the companies employ approximately 4 million persons.

MFN treatment does not confer any special status to China. It simply means that we are agreeing not to discriminate against China's goods in favor of a third country. In return, China must agree to extend the United States the same benefit. MFN is a well established principle under international commercial law and is a core obligation under the WTO rules. The United States grants MFN treatment to virtually all of its trading partners, with the exception of Afghanistan, Cuba, Laos, North Korea and Vietnam. Therefore, the extension of MFN status to China simply confers what is normal trade status for the majority of U.S.

trading partners.

The decision to extend MFN treatment to China has been supported by Republican and Democratic Administrations for nearly two decades and has served U.S. interests well. It has enabled the expansion of U.S. trade and investment in China, as well as greater cooperation on security issues and progress on human rights. It has promoted economic reforms in China that have raised living standards and encouraged greater personal freedom for the average Chinese citizen. It has allowed for coordination between the United States and China in responding to the Asian financial crisis. The potential for greater cooperation continues, as the United States and China have now established an ongoing process of engagement that is yielding progress on human rights, non-proliferation, environmental cooperation, and other areas. It is important to evaluate the gains from engagement over time and to avoid the trap of overreacting to any particular event. Building mutual understanding and trust takes time, patience, and a steady hand.

That is why maintaining stable relations with China into the next century must remain a national priority. China is now the largest emerging economy in the world. It could become the largest economy in the world within the next 20 years. It is playing an increasingly important role in the global economy. China also is becoming increasingly important to the economic vitality and political stability of Asia. Its conduct during the period of recent Asian financial turmoil has been positive and stabilizing. Its role in maintaining security in the region clearly is gaining in importance. If we are to advance U.S. interests in Asia as a whole, we must continue to strengthen and broaden our relations with China and encourage its integration into the global economy.

ECAT is mindful of recent allegations concerning possible transfer of sensitive technology to China. These allegations should be properly investigated, and any illegal conduct should be punished under applicable U.S. law. ECAT does not believe, however, that America's vital bilateral relations with China should be put on hold or that China's MFN

treatment should be suspended while the investigations are carried out.

The United States also must maintain a broad vision for the future of its relations with China. ECAT believes that America's national interests are best served by moving away from the uncertainties of annual MFN renewal. A firm foundation of mutual understanding and trust must be built on lasting ties, including such important steps as granting permanent MFN treatment to China and bringing China into the WTO on the basis of a commercially acceptable protocol of accession. For this to happen, China must be willing to abide by the WTO rules and to open further its markets to U.S. goods, services, and agricultural products.

## II. Extending China's MFN Status Promotes U.S. Trade and Investment in China

The renewal of China's MFN status is essential to the continued expansion of U.S. trade and investment in China.

### A. Importance of the China Market

As the largest emerging economy in the world, China has enormous potential as a market for U.S. exports. Since 1979 when the United States first agreed to extend MFN treatment to China, U.S. exports of American goods and services have grown nearly twenty-fold to roughly $16 billion in 1997. Over the same period, U.S. investment in China has grown to $25 billion. U.S. exports to China support more than 200,000 U.S. jobs in the manufacturing and agricultural sectors, as well as tens of thousands of additional U.S. retail, service, transportation, marketing, consumer goods, telecommunications, and finance jobs. Moreover, we are just scratching the surface of this market.

China already is the fourth largest market for U.S. agricultural exports. In recent years, China has imported large quantities of U.S. grains, cotton, poultry, vegetable

oils, and other farm products. The American agricultural community has called China its most important growth market for the 21st century. Achieving this potential, however, requires building a more open system serving China's burgeoning food demand.

There is vast potential for further sales of U.S. products and services in China. China has huge developmental needs to improve the living standard of its people. It remains committed to spending $750 billion on infrastructure projects over the next decade. Participating in the economic transformation of the world's most populous country is an opportunity the United States should embrace with enthusiasm. A foothold in the China market is also key to expanding access to other Asia-Pacific markets which, in the long term, hold important potential for growth in U.S. trade.

**B. Cargill's Experience in China**

Cargill has been trading with China since shortly after President Nixon re-established relations with that country in the early 1970s. China is one of Cargill's largest markets for U.S. exports of grain, proteins, fertilizers, and other agricultural commodities. Until recently, when a controversy over TCK smut arose, China was buying an average of 8 to 10 million tons of grain per year, and the number may rise as high as 30 million tons by 2010. Cargill ships orange juice and phosphate fertilizer from plants in Florida, as well as cotton, corn, soybeans, soybean products, and meat from their principal U.S. production areas.

Cargill also has expanded its trade with China by investing in facilities in China. Cargill has built its two largest animal feed plants in Jiaxing and Zhenjiang in the Yangtze River Basin, near Shanghai. We have invested in a 90-percent owned bulk fertilizer blending plant near Tianjin. We also own and operate a soybean crushing plant in Jinan, and have trading offices in Beijing and Shanghai. We now employ over 500 people in China.

We are proud of the fact that we and many other U.S. firms have made a positive impact on the lives of our employees in China through improvements in workplace habits, supplying better products, and paying higher wages and benefits. For example, Chinese farmers historically have had to buy all their fertilizer from the Chinese government. In 1996, Cargill started operating our bulk blending plant in Tianjin, the first of its kind in China. We are now able to sell directly to farmers and small farm stores a blended product that is cheaper, more effective, and more environmentally balanced. In only one year, Chinese farmers have been able to double the size of their cabbage plants--a staple in the Chinese diet--thanks to the application of Cargill's blended fertilizer.

In another instance, a farmer saw his corn yield increase by one-third using our fertilizer blend. No one would believe his claims until he showed them his crop. Now, he is planning on using his increased income from higher crop yields for his children's education -- his eldest daughter is in college, and the government has been cutting back on school subsidies. Similarly, the use of Cargill's scientifically-developed feed by farmers near our feed mills in China has helped them produce higher quality hogs and poultry more economically.

Cargill also has brought with our investment dollars our safety, quality, and ethics programs, and our management and environmental practices to China. At our oilseed crushing plant near Jinan, we require workers to wear hardhats, safety shoes, safety glasses, and earplugs, new practices in China. Even the guardrails that we installed around the work site were a foreign concept to the average Chinese worker. We also built an employees' dining room and installed new bathrooms and showers for the workers. Beyond the direct physical benefits of these changes is an attitudinal difference that affects behavior in and beyond the workplace.

Our Corporate Quality Program and the Cargill Guiding Principles, our code

of conduct, have been translated into Chinese, and have been taught to our employees. In addition, we have begun transferring Chinese nationals to other sites in Asia and in the United States for management training. Our ultimate goal is to have an entirely Chinese workforce running Cargill's operations on the mainland, as we do now in Taiwan.

Like many U.S. firms in China, Cargill provides its employees with income and benefits higher than prevailing wages. Our presence in China also has brought intangible benefits to our employees through our openness to new ideas and creativity and our willingness to give greater responsibility to those who are capable and ambitious.

Cargill's trade with China also provides important benefits here at home. For example, Cargill's exports of fertilizer to China help support Cargill's capital intensive phosphate mining and processing operations in Florida. Cargill's export of phosphate fertilizer to China and elsewhere enables our Florida fertilizer facilities to operate year round. Jim Johnson, one of our union employees at our Tampa fertilizer operations, spent a week in Washington last year telling that story to members of Congress in an effort to secure passage of fast-track legislation. He and others like him in our many export-dependent U.S. facilities are prepared to come again because they know the United States needs to compete in today's global economy and needs fast-track trade negotiating authority to get the best competitive terms it can.

Doing business in China is not without challenges. China's infrastructure is poor, and our ability to participate in some of its markets remains restricted. As one of our managers recently observed, the central government controls grain production, pricing, and distribution. The government also controls how much fertilizer and agricultural chemicals are imported, what prices will be paid for grain and cotton, and how much of these commodities can be exported. The government maintains monopolies on grain and fiber purchases, as well as on the main distribution channels for agricultural inputs. China's futures markets do not function well and are excessively influenced by state-owned

companies. There are frequent embargoes on shipments of agricultural commodities from one province to another.

We have learned the hard way about the difficulties of doing business in China. Our Jinan soybean plant started out as a joint venture cottonseed plant in 1988. Frankly, it seemed like everything that could go wrong did. The first supply of cottonseeds deteriorated in quality before plant construction was finished, and one of the venture partners did not meet his commitment to deliver cottonseed. Boll weevils wiped out 40 percent of the new cottonseed crop, and a change in government pricing policies for cotton, corn, and wheat caused Chinese farmers to plant crops other than cotton. This series of problems led us to buy out our partners and redesign the plant to process soybeans. The Jinan plant now produces twice the volume of soybeans as the average Chinese plant, using both locally-sourced beans and beans exported from the United States. Yet it still is not economically viable.

We have faced other problems as well. We have had to close a small corn drying plant. We have had difficulty collecting on contract obligations, even from branches of the government. Nonetheless, these obstacles have been valuable learning tools. They are part of the tuition we expect to pay in a developing economy--where contracts are seen as the beginning point of negotiation and the government believes that agricultural commerce and production must be planned and managed by the state.

The important point I am trying to make with this detail on Cargill's experience in China is this: we are like a new immigrant to a country; we have struggled to overcome difficulties; we are beginning to make headway -- and an impact -- in this developing country; but ours remains a fragile existence filled more with plans and hopes than successes; and we are building a business as we have learned to do it in many other countries, responsibly and honorably. Our limited success to date and our hopes for the future -- like the hopes of other American companies -- will be jeopardized if China's MFN

status is withdrawn. Such an act would unfairly penalize U.S. companies by undermining the strides they have made over the last 10 years in improving their competitiveness in China. This is an important opportunity for American farmers and workers that needs nurture rather than censure.

## III. Withdrawal of China's MFN Treatment Would Jeopardize U.S. Security Interests and the Spread of Western Values in China

ECAT also believes that more than just commercial interests are at stake. The withdrawal of China's MFN treatment would undercut the important gains the United States has made in achieving greater strategic cooperation with China. The United States has received China's assistance in persuading North Korea to end its nuclear weapons program, brokering a peace settlement in Cambodia, and trying to halt the arms race between India and Pakistan. The United States also has been successful in gaining China's adherence to key multilateral non-proliferation regimes, including the Nuclear Non-Proliferation Treaty and the treaty banning nuclear testing. China also is playing a critical stabilizing role in Asia by maintaining the value of its currency to help prevent a further worsening of the Asian financial crisis. Withdrawal of China's MFN treatment would destabilize bilateral relations and undermine ongoing and future efforts to broaden strategic cooperation with China in these areas.

Revocation of China's MFN treatment also would undermine the remarkable transformation of Chinese society that has occurred over the last two decades as a result of its opening to the West. The Chinese people now enjoy higher living standards, greater economic freedom, and more access to outside information than ever before. Private home ownership, unthinkable to the average Chinese citizen 10 years ago, is now being actively encouraged by the Chinese government. Use of the Internet by Chinese citizens is burgeoning, bringing an even greater flow of outside information and ideas into China. Several hundred million Chinese have now participated in village-level elections, and

opportunities for religious expression are increasing.

Withdrawal of China's MFN treatment would greatly reduce if not eliminate the positive force of U.S. trade and investment in raising Chinese living standards and promoting wider individual freedoms.

## IV. Revocation of China's MFN Treatment Would Undermine the Economic Stability and Vitality of Hong Kong and Taiwan

Continuation of China's MFN treatment is essential to maintaining the health of Hong Kong's economy and preserving Taiwan's prosperity and autonomy.

### A. Importance of China's MFN Status to Hong Kong's Economy

Hong Kong remains a vitally important gateway to China, and its open economy is a major influence on mainland China. The maintenance of China's MFN treatment, in turn, is crucial to the continued health of Hong Kong's economy. If China's MFN treatment were removed, Hong Kong's trade would decrease by approximately $32 billion, and employment would fall by over 80,000 jobs. MFN for China is particularly critical at this time when Hong Kong is striving to preserve the stability of its financial markets. In addition, the influence of Hong Kong on the mainland's social and political structures would be diminished were Hong Kong's economy to suffer as a result of China's loss of MFN.

### B. China's MFN Treatment and the Prosperity of Taiwan

Under the 1972 Shanghai Communiqué, the United States adheres to a "one-China policy," whereby the United States formally recognizes the People's Republic of China, acknowledges that Taiwan is part of China, and maintains only unofficial,

commercial relations with Taiwan. This policy has enabled the United States over the last two decades to make progress in developing its political and economic relationship with China, while maintaining commercial ties with both China and Taiwan--both major U.S. export markets.

The one-China policy also has allowed China and Taiwan to develop their trade and investment ties. Trade flows between Taiwan and mainland China are in excess of $17 billion annually. Taiwanese companies have invested over $35 billion in the Chinese mainland over the last decade. Taiwanese investment in China is likely to increase even further as a result of the Asian financial crisis, as investors view the Chinese market as one of the more stable and secure investment environments in Asia. At the same time, Taiwan has lifted a long-standing ban prohibiting Chinese-owned companies in Hong Kong from investing in Taiwan. The relaxation of the ban indicates the important role that Hong Kong may have in fostering a closer relationship between China and Taiwan.

Withdrawal of MFN treatment from China would undermine the one-China policy and our efforts to preserve our economic relations with Taiwan in a way that allows its economy to prosper. It also would threaten Taiwan's admission to the WTO, since there is an informal understanding among WTO members that Taiwan will not be permitted to accede to the WTO until after China has been admitted. If China's MFN treatment is withdrawn, the prospects for any progress on our negotiations with China on WTO accession would be very dim.

## V. China's Trade Deficit with the United States Does Not Warrant the Revocation of China's MFN Treatment

Our rising trade deficit with China does not warrant withdrawal of China's MFN treatment. Removing China's MFN treatment would only result in the erection of further barriers to U.S. goods and services in the form of retaliatory Chinese tariffs that would cut

off U.S. exports and lead to a worsening of the bilateral trade balance. Instead, we must continue our efforts to remove the significant market access barriers that remain in China to U.S. goods and services by continuing our negotiations with China to secure its accession to the WTO on the basis of a commercially acceptable protocol of accession. Until that goal is achieved, we should ensure that China abides by all of its existing market access commitments.

It also is important to put the U.S. trade deficit with China in perspective. First, flaws in the Department of Commerce's methodology used to compile trade data have overstated China's deficit with the United States by as much as one-third. Second, 90 percent of U.S. imports from China represents items that were previously imported from other countries, as manufacturing of low-wage consumer products such as toys and footwear moved from countries such as Taiwan and Hong Kong to China. Reflecting this shift in production, our trade deficits with Taiwan and Hong Kong have fallen sharply. Finally, a portion of the U.S. trade deficit with China is due to U.S. unilateral sanctions imposed against China, such as restrictions on the export of high speed computers.

## VI. Importance of Moving Toward a Restructured U.S.-China Relationship

While we are now focused on the renewal of China's MFN treatment, we should not lose sight of the importance of moving toward a more stable relationship with China built on greater mutual understanding and trust. U.S. extension of permanent MFN treatment to China and China's entry into the WTO on the basis of a commercially acceptable protocol of accession would go a long way toward establishing such a relationship. Removal of U.S. unilateral sanctions against China would be another aspect of such a relationship.

An important step toward strengthening bilateral relations occurred last fall with the agreement to establish a regular summit process between the United States and China.

Important progress was achieved during the summit last fall on several areas, including human rights, non-proliferation, and environmental cooperation. President Clinton's planned state visit to China later this month provides an opportunity for further progress in these areas, as well as others including advancing China's WTO accession negotiations.

The terms under which China eventually joins the WTO are important. They will be an essential part of integrating China into the global economy and ensuring that the largest emerging economy in the world is subject to the rules of the international trading system.

Clearly, China's membership under appropriate conditions in the WTO will advance U.S. interests. A commercially acceptable outcome would improve market access for U.S. goods, services, and investment. Furthermore, WTO consultation and dispute settlement procedures would provide a far more effective means to enforce China's market access commitments and adherence to WTO rules than unilateral U.S. sanctions.

China's admission to the WTO will promote U.S. exports, as a result of lower MFN tariff rates negotiated as part of the accession package and China's elimination of discriminatory import treatment. It also would promote the expansion of U.S. service industries through the liberalization of China's telecommunications and financial services markets. In addition, China's WTO accession will further the goal of structural reform in China, given that fundamental changes in China's economic regime will be required as part of the process of joining the WTO and accepting its obligations.

The United States cannot take full advantage of these benefits unless it extends permanent MFN treatment to China. Permanent MFN treatment is a core obligation under Article I of the GATT and the WTO. The Jackson-Vanik provisions of Title IV of the Trade Act of 1974 prohibit the United States from granting permanent MFN treatment to China. Once China is admitted to the WTO, if the United States extends WTO benefits to China, the Jackson-Vanik provisions could immediately be challenged by the Chinese as denying

MFN treatment in violation of Article I. The United States has therefore taken the position that it would not apply WTO benefits to China until the Jackson-Vanik provisions have been amended to allow the extension of permanent MFN treatment to China.

Although progress has been achieved in WTO accession negotiations with the Chinese, particularly in the area of WTO rules, the Chinese have yet to make sufficient offers in a number of areas, including market access for goods and services, trading and distribution rights, and agricultural access issues covering tariffs, tariff-rate quotas, and discriminatory application of sanitary and phytosanitary standards to wheat, citrus, and meat products.

The upcoming summit provides the opportunity for further progress in the accession talks. China's admission to the WTO must be based on a commercially acceptable protocol of accession under which China agrees to provide meaningful market access to U.S. goods, services, and agriculture and to abide by WTO rules. Progress within the summit toward that objective would be welcome; a commitment to conclude the accession negotiations within a fixed time frame without achieving these conditions would not be helpful.

## VII. Conclusion

The extension of China's MFN treatment advances the U.S. national interest. It is essential to continuing the expansion of U.S. trade in China and the Asia-Pacific region, maintaining a strong U.S. economy, and promoting U.S. security interests. It is strongly supported by Cargill, the Emergency Committee for American Trade, the Business Coalition for U.S.-China Trade, and many other business groups.

I appreciate this opportunity to appear before the Trade Subcommittee on behalf of ECAT.

Chairman CRANE. Thank you. We appreciate your testimony.

And the bells have gone off, and inasmuch as we are on tight time constraints over there—now they've changed the guidelines and don't leave the lights on. And I think we should recess, subject to call of the chair. We'll go over, respond to this vote. And we'll come back as quickly as possible and get Mr. Johnson's testimony.

Mr. JOHNSON. Thank you, Chairman. Fine.

[Recess.]

Chairman CRANE. The committee will come to order. And I apologize to our witnesses for this interruption, but it turned out to be three votes.

And now, Mr. Johnson, if you would be so kind to make your presentation.

**STATEMENT OF CLARK A. JOHNSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PIER 1 IMPORTS, INC.**

Mr. CLARK JOHNSON. Thank you, Mr. Chairman. My name is Clark Johnson, and I'm chairman of the board and chief executive officer of Pier 1 Imports. I'm here to testify today on behalf of the National Retail Federation, as well as my company, Pier 1 Imports.

The National Retail Federation is the world's largest retail trade association, with membership that includes department stores, specialty stores, discount, mass merchandises and independent stores, as well as 32 national and 50 state associations.

The NRF membership represents over 1.4 million retailers in the United States, covering 22 million people, or 1 out of every 5 people in the United States work in retail. Last year companies in our organizations had combined sales of over $2.5 trillion.

While there's several issues that I could talk about that in my judgment should compel the Congress to extend MFN, I want to cover just two subjects.

The first subject is the negative impact on low and middle income American citizens if MFN is not renewed. The mission of a retailer in American is to provide an assortment of a wide range of goods from everywhere in the world, and present that merchandise to our retail customers in a fashion that represents significant value for the customers.

China makes products that working families can afford. One of the strengths of China is that products that require a high labor content and are low value-added products really is what China is noted for.

Let me give you an example of shoes, because we heard something about shoes here earlier today. Forty percent of all of the shoes sold in the United States come from China, and 60 percent of the low-priced shoes come from China.

As an example of how meaningful that is to Americans, I was in one of our members retail establishments this summer up in North Carolina, and they had a sale, three pair of leather shoes from China for $8.81. So when you ask yourself the question how do low and middle income Americans get by with four or five children? One of the ways they do is buy good quality products that are imported from China and elsewhere.

Imports generally have helped keep American inflation low. Although we've gone through some tenuous times in America, where

American industry has had to restructure to become competitive with overseas suppliers, most of that has passed now, and today America is as competitive as any country in the world.

I think the final question is, if we weren't buying some of these products of yesterday from overseas and from China, where would the labor come in the United States to do make these products?

It's been estimated by the International Business and Economic Research Corporation that failure to renew normal trade relations for China would cost every American an extra $300 a year in higher prices for goods. In effect, that's a tax increase put on Americans, and in our collective judgment that's not the way to do that.

The second factor that I'd like to touch on is China's potential as a market for the future of the United States and U.S. goods.

Pier 1 Imports has been in China since 1975. I made my first trip there in 1985, and in the 13 years that I've been going to China, I have seen tremendous improvements. In fact, I was in China last week for two days, in Beijing, and when I commented that I had been coming to China for 13 years, one of my business associates said there's been more change in China in the last 13 years than in the 1,000 years before that. Remember, China's a country 3,500 years old, and we're 222 years old, so they've been through a lot over there. But I've seen significant signs that progress is being made.

There have been a series of interesting articles running in "The Washington Post" on China. One that was in "The Post" today was particularly timely for this hearing, and stated that as of 1997 there were 263 million Chinese, out of a population of 1.2 billion, working in private industry.

In 1978, just 20 years ago, there were 150,000. So they've gone from 150,000 in 1978 to 263 million. To me that is one of the strongest signs of the fact that China is moving in the right direction.

Sixty-seven percent of all the Chinese live in state-owned housing. They have a major program underway to convert that state housing to independent ownership. Only 2 percent of Americans live in state or government housing.

When I was there I was the guest of the Bureau of Experts. This bureau in China in 1997 facilitated the arrival of 80,000 experts from all over the world, that came to China to help them modernize every aspect of the Chinese society. Of the 80,000 experts, 14,000 were from the United States.

So as we heard earlier, if China is a country that's closing down rather than opening up, why then the fact that they would let 80,000 people from all over the world come on an independent basis, and promulgate whatever their trends were, is important.

Could I have one more minute, Chairman, to conclude my remarks?

Chairman CRANE. Yes, you may.

Mr. CLARK JOHNSON. Do you have another vote?

Chairman CRANE. Okay, we're still in business.

Mr. CLARK JOHNSON. Okay. Well, let me just finish here, and I'll be rapid, Mr. Chairman.

Beyond MFN, which is important, America's world trade activities today represents 30 percent of our gross domestic product, $2.4 trillion worth of activity. The same activity that retailers represent.

The way that we will enhance the standard of living of all Americans going forward is to continue to aggressively open up markets for American's goods around the world, for those goods that Americans are known for, technology, software, entertainment, airplanes. But what we need to be is dependable, consistent, predictable suppliers and customers to our world markets.

There is a rush toward market economies all around the world, and the Chinese people are entrepreneurial, and are moving to their version of capitalism in a very rapid fashion. When this process is finished with MFN, Mr. Chairman, I think it's mandatory that we put Fast Track back on the front burner.

My trade specialist that I listen to said that the world ahead of us is going to evolve into three trading blocks; Europe and Eastern Europe, the hemisphere that we live in, and Eastern Asia. And that it is ludicrous that the United States is losing the business in Central and South America—that we are—to the Germans, to the French, to the Japanese, and to others, because we haven't been able to go down there with Fast Track and really tell the American story. That's our legitimate market down there, and the time for us to get position is after this battle is over.

I appreciate the opportunity of having been here today, and my associate and I will be happy to respond to any questions.

[The prepared statement follows:]

NATIONAL RETAIL FEDERATION

**TESTIMONY OF CLARK A. JOHNSON**

**PRESIDENT AND CEO, PIER 1 IMPORTS, INC.**

**ON BEHALF OF THE NATIONAL RETAIL FEDERATION**

## I. Introduction

My name is Clark Johnson, Chairman and CEO of Pier 1 Imports. I am testifying today on behalf of the National Retail Federation. NRF is the world's largest retail trade association with membership that includes the leading department, specialty, discount, mass merchandise, and independent stores, as well as 32 national and 50 state associations. NRF members represent an industry that encompasses over 1.4 million U.S. retail establishments, employs more than 22 million people or 1 in 5 American workers, and had registered sales in 1997 of more than $2.5 trillion.

There are several reasons that the National Retail Federation, Pier 1 Imports, and other NRF member companies strongly support the continuation of China's most-favored-nation (MFN) trade status, or, to use the more accurate term, normal trade relations. In particular, maintaining normal trade relations with China:

- Helps us cultivate an important and growing export market for U.S.-made products.
- Creates new, well-paying jobs in the United States through U.S. exports to China and imports from China.
- Helps working American families make ends meet.
- Continues a long-standing, bi-partisan policy of engagement with China that helps to promote social, political, and economic reform in China.
- Is critical to advancing financial, economic and political stability in Hong Kong and throughout Asia.

## II. Normal Trade Relations with China Helps the U.S. Economy

Maintaining normal trade relations with China helps create high-paying jobs in the United States. Many are familiar with the statistics showing that U.S. exports to China support more than 170,000 American jobs each year. These jobs include many in high-paying, high-skilled growth industries such as telecommunications, information

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technology, and aircraft. It also includes jobs in other key industries in which the United States is particularly competitive, such as agriculture and financial services.

If MFN were revoked, China would, in retaliation, stop buying U.S. goods and services, thereby endangering the billions of dollars in U.S. agricultural, manufacturing, and services exports to China and the tens of thousands of American jobs. China would then simply buy these goods and services from U.S. competitors in Europe, Japan, and Canada, who would benefit at the expense of American companies and workers. In addition, American jobs tied to U.S. investments in China would also suffer if China also took action against those investments in retaliation against a U.S. denial of MFN.

But U.S. jobs tied to exports to and investment in China would not be the only ones threatened by failure to extend MFN. What is not widely known is that U.S. imports from China, which are more directly affected by MFN tariff treatment, support an even larger number of high-paying American jobs than U.S. exports to China. The Trade Partnership estimates that U.S. imports from China in 1997 supported more than 2.5 million American jobs in such high-paying sectors as manufacturing, finance and insurance, transportation, wholesaling and, of course, retailing. Failure to renew China's MFN status and the ensuing fall in supply and rise in prices would force lay-offs of workers by many companies in these sectors. Moreover, thousands of other American jobs in ports, transportation, distribution centers, and our retail establishments would be adversely affected should MFN for China lapse.

I have two points in response to those who argue MFN should be revoked because of concern over our trade problems with China, including a growing trade deficit and poor protection of intellectual-property rights. First, the premise underlying this argument is the nonsensical notion that the way to deal with our trade deficit and trade problems is to stop all trade. Ending trade with China by revoking MFN will only prevent us from opening China's market to more American products and addressing our trade problems with China in a constructive and effective manner.

My second point is that according to most economists, a merchandise trade deficit with one country is really not very important to the U.S. economy as a whole. But for those who are concerned about trade issues with China and the impact on jobs, evidence shows that much of the increase in imports from China can be attributed to a shift from other foreign countries, like Taiwan, rather than production in the United States. Also, many of the goods China exports are too expensive or impractical to make in the United States. That situation will not change by revoking MFN.

## III. Normal Trade Relations with China Helps American Families

Perhaps no one understands better than U.S. retailers the importance that normal trade relations with China plays in helping American families afford a comfortable lifestyle on often limited budgets. Maintaining normal trade relations allows cost-conscious, working Americans to buy the widest selection of well-made, reasonably priced goods.

Every day, Pier 1 Imports and other NRF member companies search throughout the United States and the rest of the world for consumer goods that meet American families' demands for a good selection of quality products at affordable prices. Trade with China gives our industry the opportunity to provide the widest array of the products American consumers demand at prices that fit within their increasingly tight budgets. For some of these products, such as toys and consumer electronics, China provides better quality at a reasonable price than other producers. For other products, such as high-quality silk apparel, China is the only source for the products we sell.

Thus, maintaining normal trade relations with China helps American working families make ends meet. And it is American working families who would be disproportionately hurt if MFN were revoked.

China is the principal supplier of certain products to the United States, such as toys and silk apparel. It is also a leading supplier of other products, such as certain kinds of consumer electronics, inexpensive shoes, and low-priced bicycles. Failure to renew MFN would result in substantial increases in the customs duties -- as high as 66 percent -- paid on these and other goods from China—as high as 66 percent for toys. To the extent these products would still be available in U.S. stores, the cost of the increased duties would ultimately be paid for by American families through substantially higher prices. In effect, these increased duties would be a new, government-imposed excise tax on the American public.

There would also be higher prices on non-Chinese products as the artificial supply shortage created by the tremendous decline in imports from China forces other producers to raise their prices as well. Thus, the cost of the higher customs duties would not only work as a tax on American families, but could also help fuel inflation. Overall, the International Business and Economic Research Corporation estimates that failure to renew China's MFN status would cost the average American family an extra $300 a year—a price that low-income families in particular can ill-afford.

## IV. Normal Trade Relations with China is in Our National Interest

There are those who suggest that the United States should revoke MFN to punish China for alleged human-rights abuses and religious and ethnic persecution. Others express increasing concern over the potential threat China's growing military power poses to its neighbors and the United States. They argue that, in the interest of national security, we should try to isolate or take a tougher stand against China by restricting trade and revoking its MFN status.

Like all Americans, we in the retail industry also abhor human rights abuses and religious and ethnic persecution, wherever they occur. We strongly believe, however, that the most effective way to bring about broad and meaningful change in China is by continuing our long-standing, bi-partisan policy of engagement, of which MFN is a crucial component. It is our view that engagement with China gives us the most leverage and the broadest array of policy tools to push China in the right directions.

We also recognize that there are legitimate national security concerns with respect to China. Nonetheless, U.S. security interests would not be enhanced, and could indeed be jeopardized if relations with China worsen as a result of revoking MFN. Furthermore, failure to renew MFN would further de-stabilize the Pacific Rim region economically and politically at a time when many Asian countries are experiencing their worst financial and economic crises in the post-war period. Increasing turmoil in the region would also slow economic and social reforms in China, and could very well spread to countries outside the region, such as Russia.

There are increasing problems in Asia that must be handled carefully -- a growing nuclear arms race in South Asia, financial and economic crises, defining China's role in the global political and economic system. We need China's cooperation on all these issues. Revoking normal trade relations with China will only make it difficult, if not impossible, to address those issues. A punitive and confrontational policy only ties our hands in conducting relations with China, limits our ability to work with and influence China on a broad range of issues, and serves to make matters worse. Improving human and religious rights, encouraging social, political and economic reform in China, ensuring China's cooperation on economic issues of importance to the region, and enhancing our national security are doomed to failure if attempted in an atmosphere of increasing hostility and confrontation.

As has often been pointed out, there are only six countries in the world with which the United States does not currently conduct normal trade relations. Revoking a country's MFN status puts it among these pariah states and has been accurately described as tantamount to a declaration of economic war. Such a rash decision in and of itself would abandon any pretense of cooperation in our relationship with China and, in effect, define that relationship as one of only confrontation.

Given its growing economic, political, and military power, our relationship with China is clearly one of the great foreign policy challenges facing the United States. China has one-fifth of the world's population. Although it is still a poor country, China has the world's third-largest economy and is now our fourth-largest trading partner. It is a nuclear power with the world's largest standing army. Clearly, China is simply too important to ignore or treat in an openly hostile manner. It is in our national interest to find a way to live together and work out our differences in a constructive manner without employing ham-handed, self-defeating, and ultimately destructive options, such as revoking MFN, even for laudable policy goals.

## V. Conclusion

I just returned from a trip to China, and I have a few concluding observations. We all recognize that there are troublesome issues with China, many of which are not going to be solved easily or quickly. While this situation may be frustrating, our Members of Congress must resist sledge-hammer policy options, like revoking or limiting MFN. Such options would be futile and end up harming the United States and other Asian countries as much or even more than China. More creative and effective policy options,

based on engagement, not confrontation with China, need to be used. This approach calls for true statesmanship, vision, ingenuity, and patience, not political expediency, myopia, and facile, ill-conceived solutions.

Therefore, on behalf of America's retail companies and the millions of Americans employed in our industry, I urge Members of Congress to support continuing normal trade relations with China and to reject well-meaning, but misguided efforts to revoke or limit it.

Chairman CRANE. We appreciate your willingness to participate and contribute toward this hearing. You made a very astute point there about the importance of trade in our national economy. We constitute less than 5 percent of the population on the face of this earth. Where are the customers? They're beyond our borders. Trade has been the most dynamic component of our economy and it's better than one-third of our total economy today, and still growing, but that could stagnate absent Fast Track, as you've pointed out.

One of the things that's interesting to me is the news that I saw in today's paper, that the European Union is now going to open up free trade relations with sub-Saharan Africa. And I say that because we reported that bill out of our committee back in March, and out of the House in March, and the Senate had its first hearing on that today. And I was over there with Charlie Rangel and some other colleagues to testify. But at least the EU's getting the message. We aren't getting it here at all.

So I think that we've got to lift the blinders, and recognize the importance of what has to be done. And stop playing games in these critical areas.

Mr. CLARK JOHNSON. Mr. Chairman, we don't have shooting wars anymore, but we have an economic war, and it's as vicious as any physical wars we've had in the past. We need to be on the front lines armed with the tools to promote the well being of America and our citizens.

Chairman CRANE. Well, that vicious war though works to the benefit of all consumers. You better come forward with the most competitive best quality product at the lowest price if you want to survive. And thank the good Lord we've been in the vanguard of that effort worldwide in trade thus far, but there are categories.

Some of the imports, for example from China, you've touched upon. I mean, you know, low cost items. Like shoes, textiles, and apparels. I mean these are products that are not being manufactured here to meet the competitive world price, at least to the degree that guarantees that we aren't importing a lot of that. And those are categories where the biggest dollar amounts of imports are coming. But then you examine who are the consumers. The consumers here in the United States are people in lower income brackets.

So you could put a great wall of China around the United States and say we're not going to import any of that anymore, but who pays for it.

Mr. Micek, you said in your testimony that the agricultural sector in China, where your firm operates, remains under heavy government control. And you mentioned the central government controls grain production, pricing, and distribution.

Is this in the process of changing at all?

Mr. MICEK. Well, we'd like to think it would change, but as long as we operate on a year-by-year basis on renewing MFN, as important as food is to China with 1.3 billion people, the Chinese just simply cannot take the risk of depending on someone like the United States to supply them food in light of the risk that trade could be disrupted.

So we must become a more reliable supplier going forward. One way to accomplish this would be to grant permanent MFN status,

so that we do not have this annual argument about the renewal of China's MFN treatment. For example, in our company, if we have to rely on a particular raw material, we surely would look at a supplier that would give us reliability and consistency over a period of time. In China today, the United States is not looked at in this way, certainly from the agricultural standpoint.

The net result is that we are a residual supplier to China today, at a time when the U.S. farmer is as competitive as anyone in the world. We see this as unfortunate. If China had permanent MFN status, I think it would be an important step in the right direction.

Chairman CRANE. Well, I do, too. As I say, we have several items on the table. CBI parity is another, and our Sub-Saharan Africa bill, or going forward with MFN, or normal trade relations. We want to change that designation because it's misleading to the average person. I've mentioned this is simply normal relations, which we have with all but six countries on the face of this earth, and people are startled to hear that because they have different interpretations of the meaning.

At any rate, it's an annual battle, and hopefully, we'll see WTO accession on the part of China and conformity to guidelines to guarantee that we can provide permanent normal relations at that time.

Mr. MICEK. I'm looking forward to that.

Chairman CRANE. Mr. Portman, do you have any questions that you would like to put to the witnesses?

Mr. PORTMAN. Mr. Chairman, I want to thank you for having the hearing and for bringing some focus to this.

I just caught the tailend of the testimony.

I couldn't agree with you more. If we could call this normal trading relations, we would have a chance. It's just as good an acronym as MFN, isn't it?

Mr. CLARK JOHNSON. Oh, categorically. Couldn't agree with it more.

Mr. PORTMAN. No, it's just that I'm sorry I was not here today to hear your testimony. I appreciate the support you all are giving us. I'm sure you've heard this Cargill, Pier 1, and other companies, to the extent you can get out and explain to your shareholders and your employees the importance of international trade generally and with China specifically. It would be most helpful for the policymakers. Because we hear a lot from the other side and a more informed point of view would be very helpful. So thank you, gentlemen for being here.

Mr. CLARK JOHNSON. Thank you very much.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman CRANE. Thank you both for your testimony. We will now call our next panel: The Reverend Robert A. Sirico, president, Acton Institute for the Study of Religion and Liberty; William R. O'Brien, director, Global Center, Beeson Divinity School; Martin J. Dannenfelser, Jr., director, Government and Media Relations, for Family Research Council; and Lorne Craner, president, International Republican Institute.

Gentlemen, if you will take your seats. Then in the order that I presented you, if you will give your testimony, and try and keep your oral remarks to five minutes. All printed statements though

will be made a part of the permanent record. With that, we'll commence with Reverend Sirico.

**STATEMENT OF REVEREND ROBERT SIRICO, PRESIDENT, ACTON INSTITUTE FOR THE STUDY OF RELIGION AND LIBERTY**

Reverend SIRICO. Mr. Chairman, I'm Father Robert Sirico——

Chairman CRANE. Sirico, I'm sorry.

Reverend SIRICO [continuing]. That's all right.

Chairman CRANE. I apologize.

Reverend SIRICO. I represent the Acton Institute for the Study of Religion and Liberty, a nonprofit research organization that promotes international contact between scholars, students, and civic organizations in pursuit of a classically liberal world view of peace, prosperity, enterprise and religious freedom.

At the outset, let me say that my fundamental concern on the issue of trade with China—especially in saying some things today before Congress that will upset some of my usual friends and allies—is how to better the human rights situation in China with particular regard to the growing religious community there. I take trade as a means to this end.

Some people think that denying MFN to China would constitute a much needed rebuke to the Chinese regime and compel the government to change its policies regarding minority religions. I agree that the political rulers of China are in need of a moral rebuke, but one that is effective and is itself moral. As a Catholic priest, although not speaking for the Bishops' Conference, who has visited with members of the underground Catholic and Protestant churches, I feel a strong spiritual bond to members of the clergy who have been jailed for speaking out against Government policies—or even for preaching the gospel.

What I do not understand is how cutting China off from membership in the world community of trading nations is going to bolster religious freedom in that country. I have yet to hear a persuasive argument that it would do so. I think it is imperative that those who favor revoking MFN for China understand that free trade is not solely about economic matters of profit for corporations. It is also about freedom and strengthening the civic order in that country.

From my conversations with missionaries, Christian business people, and members of the Church hierarchy, it is clear that there is a struggle taking place in China but not of the Marxist variety. It is a struggle between the growing civil sector made up of churches, business associations, and local governments over against the state bureaucracies still dominated by old ways of thinking. Economic exchange within China and with the rest of the world is helping strengthen this civil sector.

The dissemination of technologies—like phone systems, computers, access to the Internet—allow dissident religious groups to be in contact with others and with groups around the world, and thereby draw attention to the plight of those persecuted for their beliefs. Business can promote this by donating computers to churches, providing communications technology to civic groups, and obtaining for dissident groups access to books they could not other-

wise afford. We have noted in the last months and years a rise in the contact that we have with Chinese groups on our website on the Internet.

In this context, permit me to directly confront the issue of China's one child per family rule. It is a gruesome policy. As a longtime pro-life activist, I want it to be clear that I find China's population control methods to be a ghastly crime. They must end. I would like to see the U.S. take stronger measures to make sure that not one dime of U.S. taxpayer dollars goes toward providing any kind of moral sanction to this policy. But we must also realize the role that rising prosperity in China has played in reducing the numbers of forced abortions in China. I point you to Seth Faison's fascinating report in the August 17, 1997 issue of The New York Times.

It is important to understand where the one-child-per-family policy comes from in the first place. It was an essential part of the socialist project. If a government is going to plan production, dictate lines of work, tell people where to live—they're also going to have to tell people how many children they must have. But with that socialist dogma finding fewer and fewer adherents and free enterprise now flourishing in huge sections of the country, the population control part of the central planning regime is also breaking down. You see the practical, pastoral, and moral considerations can reinforce each other. Quite simply, there is no case to be made that injuring trading relations with China's private sector will accomplish the worthy ends sought by those advocating denying MFN today.

However, these commercial relationships cannot proceed without a clearer view of China's abysmal record on human rights. Here I must agree with the critics of MFN for China and disagree with others who might be allies in trying to keep free trade open. I can only echo the words of Pope John Paul II "that every decision to invest involves a moral choice and implies certain moral obligations." If they are to profit from dealings with China, they must also reciprocate by being forces for good and for freedom in that country as well.

The same is true in our diplomatic posture. I find the Clinton administration too willing to sweep important human rights issues under the rug and too quick to claim that calling the Chinese leaders to account would constitute a breach of protocol. That is why I call upon President Clinton on the occasion of his upcoming visit to China to speak out forcefully, principally, and publicly about the human rights violations occurring in China precisely when the eyes of the world are upon him—in the presence of the Chinese leadership in Tiananmen Square.

We need not choose between morality and economic progress. Pressure should be brought to bear against the government in Beijing, but not against the Chinese people. Along with the revival in the economic sector, there comes a religious revival as well. It was set in motion after officials loosened some specific laws but they could not have known what would follow.

Christian, Buddhist, and Islamic faiths are replacing the previous state religions of Marxism and Maoism. Once-empty Buddhist temples now team with worshipers. Christianity is more vig-

orous today in China than at the height of the Jesuit influence in the 17th century or the Protestant evangelical efforts of the 1920's. All three represent a challenge to the status quo. Religion has become a powerful force for further change in this society.

We must also remember that the rights to freedom of worship assembly and speech are facilitated by the natural and sacred right to own and trade property. I'm also bound to point out that the Holy Father has spoken out in very strong terms about the evils that sanctions can visit upon a country. They punish people, not governments, He has said. One Vatican diplomat recently pointed out to me that in places where there is no trade with the outside world, there are weak church organizations and civil society is virtually non-existent. He cited North Korea, Cuba, and Vietnam as cases in point.

In sum, it is understandable that Americans do not want to see their tax dollars used to back regimes that are unfriendly to their core values. Neither should American firms doing business in China avert their eyes from violations of human rights. Rather they should serve as advocates for greater freedom. But the upshot of denying China most favored nation trading status would be to risk scuttling the opportunity to be a force for good, to keep contact with the rising civic sector, and to improve the lot of the Chinese people.

In countries where religious minorities are treated poorly, we face a choice. We can erect a wall that shuts out our influence or we can keep the door open using moral suasion, commerce, and diplomatic ties to encourage and extend the process of reform. A policy of peace and trade promotes a wider range of freedoms. It actually holds out the prospect for making the right kind of difference and provides a genuine moral center for international, political, and economic relationships. Thank you.

[The prepared statement follows:]

# Testimony in Favor of MFN Trade Status for the Peoples' Republic of China

## Delivered to the House Ways and Means Committee

June 17, 1998

By Father Robert A. Sirico
President
The Acton Institute for the Study of Religion and Liberty
Grand Rapids, Michigan

Mr. Chairman, members of the subcommittee, as we all know, there is little new about the debate regarding the renewal of Most Favored Nation Status for China. We have debated this before, and once again the debaters have fallen into two groups, the engagers and the sanctioners, and I frankly find problems with the views of both, while still coming down squarely in favor of a continued open relationship between the two countries.

At the outset, I would like to make the point that my fundamental concern in this regard, especially in saying some things today before Congress that will upset some of my usual friends and allies, is how to better the human rights situation in China, with particular regard to the growing religious community there. I take trade as a means to this end.

Some people think that denying MFN to China would constitute a much-needed rebuke to the Chinese regime, and compel the government to change its policies regarding religions. I agree that the political rulers of China are in need of a moral rebuke, but one that is effective and is itself moral. As a Catholic priest (although not speaking for the Bishops' Conference) who has visited with members of the underground Catholic and Protestant churches, as well as others in the Patriotic Association, I am all too aware how poorly treated I might be if I lived and ministered in China. I feel a strong spiritual bond with the members of the clergy who have been jailed for speaking out against government policies, or even for merely preaching the gospel. I too would like to see these abuses end, and I believe we all have a moral responsibility to speak out whenever religious freedom is hindered, especially when it involves acts of violence and repression against individuals and groups.

What I do not understand is how cutting China off from membership in the world community of trading nations is going to bolster the religious freedom in that country. I have yet to hear a persuasive argument that it would do so. On the other hand, we do know that imposing sanctions against China would seriously injure entrepreneurs, consumers, and impede the developing networks of

civic and religious contacts on all sides. It would hinder, as well, China's technological development, injure standards of living, and quite possibly throw China into recession.

Now, one may or may not think that it is worth the price, but there is no sense in denying that the price of these sorts of restrictive and isolationist measures would be high indeed. But what I cannot understand is how deliberately setting out to harm the ability of foreign peoples to build a prosperous future for themselves contributes to compelling a foreign government to suddenly begin recognizing the equivalent of our first amendment.

Moreover, I think it is imperative that those who favor revoking MFN for China understand that free trade is not solely about economic matters of profit for corporations. It is also about freedom and strengthening the civic order in that country.

From my conversations with missionaries, Christian business people, and members of the Church hierarchy, it is clear that there is a struggle taking place in China, but it is not of the Marxist variety. It is between the growing civil sector made up of churches, business associations, and local governments, over against the state sector bureaucracy still dominated by old ways of thinking.

Economic exchange, within China and with the rest of the world, is helping to strengthen this civil sector. It is creating pockets of independent wealth that allow people to separate themselves from material dependence on the state. This is especially important to churches, which have to depend, to a great extent, on the charitable sector to flourish.

There is no guarantee that either trade or trade sanctions will make for a free China. But the dissemination of technologies like phone systems, computers, and the Internet allow dissident religious groups to be in contact with each other and with other groups around the world, and thereby draw attention to the plight of those persecuted for their beliefs. Business can promote this by donating computers to churches, providing communications technologies to civic groups, and obtaining for dissident groups access to books they could not otherwise afford. At the Acton Institute, for example, we supply students, clerics and academics in China with materials that promote the ideas of a free and virtuous society both through the post and increasingly by means of our web site.

In this context, permit me to directly confront the issue of China's one-child per family rule. It is a gruesome policy, and as a long-time pro-life activist, I want it to be clear that I find China's population control methods to be a ghastly crime. They must end, and I would like to see the U.S. take stronger measures to make sure that not one dime of U.S. taxpayer dollars goes toward providing any kind of moral sanction to this policy. But we must also realize the role that rising prosperity in China has played in reducing the numbers of forced abortions there. I point you to Seth Faison's fascinating report from Dazu, China that appeared in the New York Times on August 17, 1997:

"In many parts of China, the one-child policy is melting away. The country's strict population control program, begun in the late 1970s and by no means gone, is becoming significantly looser in many places because-as with so much in China today-relentless economic growth is eroding the old system of control over ordinary people's lives, creating loopholes large and small. ... [T]he worst excesses of local officials seem to have diminished in recent years, and millions of Chinese who want multiple children are now having them.

"[A]s state subsidies to local government dwindle, many local officials have turned to money-making and found it a better route to influence than the old way of cowing residents with threats and pressure. As a result, in countless towns and provinces, officials now accept a flat fee in exchange for permission to bear an extra child.[1]"

It is important to understand where the one-child per family policy comes from in the first place. It was an essential part of the socialist project. If a government is going to plan production, dictate lines of work, tell people where to live, they are also going to tell people how many children they must have. It is a logical part of the socialist dogma. But with that dogma finding ever fewer adherents, and free enterprise now flourishing in huge sections of the country, the population control part of the central planning regime is also starting to break down. There are two ways we can further the process. First, we must denounce in no uncertain terms the brutal methods of birth control that continue to be used in large cities. Second, and this is where the sanctioners go wrong, we must do what we can to encourage the growth of free enterprise, which allows people greater and greater control over their own destinies.

So you see, the practical and pastoral considerations can blend and even reinforce each other. Quite simply, there is no case to be made that injuring trading relationships with China's private sector will accomplish the worthy ends sought by those who are advocating denying MFN status.

There is no doubt that the American consumer benefits greatly from imports from China, and that the Chinese people greatly benefit by having a reliable market for the products of their labor and from the influence brought by U.S. companies operating in China. But it goes beyond that, as the *New York Times* pointed out recently, namely that "contacts between the two countries are now primarily characterized by a deeply enmeshed commercial relationship-not to mention an array of educational and cultural exchanges-that leaves the two governments to play a steadily smaller and less significant role."[2]

Despite making bureaucrats and politicians on both sides of the Pacific less

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[1]"Chinese Happily Break the 'One Child Rule," by Seth Faison, *The New York Times*, August 17, 1997, p.1

[2]"What China Sees in Clinton," *The New York Times*, June 14, 1998, *Week in Review*, p. 6

relevant to the future of U.S.-China relations, the situation that the *New York Times* describes sounds to me like precisely what we should desire. We are on the right track. For the sake of prosperity and human rights in both countries, these contacts and relationships should continue.

However, these commercial relationships cannot proceed without a clearer view of China's abysmal record on human rights. And this is the other familiar part of the debate that is leading many to question what it is that the U.S. Congress can do to promote human rights in China, ten years after the Tiananmen Square massacre. And here, I must agree with the critics of MFN status for China and disagree with many who are otherwise allies with me in trying to keep trade free and open. I believe that the Clinton administration, as well as many in the business sector, have been insufficiently attentive to the moral dimension of the trade debate.

Commercial relations should not take place in a moral vacuum. U.S. business doing work in China are in many cases in a better social position to discourage and denounce violations of freedom when they do take place. Yet, I know that many lobbyists for engagement would prefer to avert their eyes to the reality of persecution around them. This must cease. U.S. business leaders in China have a moral obligation to promote wider freedom in China, greater civil liberties, and refuse to truck with butchers or party hacks who are on the wrong side of history. Speaking as a Catholic priest, I can only echo the words of Pope John Paul II that every decision to invest involves a moral choice and implies certain moral obligations. If they are to profit from dealings with China, they must also reciprocate by being forces for good and for freedom in that country as well.

The same is true in our diplomatic posture. I find the Clinton administration far too willing to sweep important human rights issues under the rug, and too quick to claim that calling the Chinese leaders to account would constitute a breach of protocol. That is why I call upon President Clinton, on the occasion of his upcoming visit to China, to speak out forcefully, principally and publicly about the human rights violations occurring in China when the eyes of the world are upon him, in the presence of the Chinese leadership, in Tiananmen Square.

Neither do I think it is right to in any way to hook American taxpayers into paying or subsidizing trade in China, as certain policies of the Export-Import Bank and the World Bank have done. Either free enterprise stands on its own, and takes its place within a strict juridical framework of human rights, or its merits become morally and economically dubious and even counterproductive.

The crux of the issue involves how our government is going about its conduct of foreign policy in that part of the world. Will trade and commercial interests, and the use of American tax dollars to guarantee investments and promote Chinese business take a back seat to moral considerations? Or will the administration and this Congress take a stronger role in bringing moral and diplomatic pressure against China so long as it continues policies that set it apart from the civilized world? We need not choose between morality and economic progress.

My plea to you here today is to recognize that the trading relationship between the private sectors of both countries need not be sacrificed or abandoned in order that the appropriate level of moral pressure can be placed on the regime itself. But let me be clear on my position: Pressure should be brought to bear against the government in Beijing but not against the Chinese people .[3]

Revoking MFN would accomplish exactly the reverse of what we need to be focusing on. Consider the results of a Congressional Research Service study conducted when this issue came up in the 104th Congress. "It is clear," says the study, that "the termination of China's MFN status would result in substantial increases in the cost of imports from China." Based on a survey of individual items, the average cost of importers products would rise between 25% and 65%, but on toys substantially more. In plain terms, this would amount to a huge tax increase on the American people .[4] Many goods would be priced out of the U.S., which is no small matter.

If our concern is the well-being of the Chinese people, we need to be aware that this policy would directly hit workers in China and cloud the economic future of millions of people there. That seems to me to be an outrageously irresponsible action that would do nothing to improve human rights in China. Indeed, if we are to think of economic freedom as essential to human rights, it would damage the liberty and well-being of average Chinese people.

Some of those desiring serious sanctions against all goods coming from and going to China, tend to portray that country as a giant prison camp, essentially unchanged from the days of Mao. This overlooks a crucial fact. In the last twenty years, China has set the world record for economic expansion, adding 8 to 10 percent to its GDP on an annual basis, precisely the period in which China has enjoyed MFN status with the U.S. Taking off from an initially low starting point, the per-capita income in China has reached $2,740 per capita per year, which makes China middle income according to the World Bank.[5] It is not uncommon now to see average Chinese carrying cellular phones, drinking American soft drinks, and owning their own homes. This is a country truly being Americanized and developed at a rapid rate.

There have been two keys to bringing about the Chinese miracle. First,

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[3]Stephen Yates, writing for the Heritage Foundation, makes a compelling case in this regard. "Out of the MFN Trap: The China Policy Act of 1997," Executive Memorandum No. 494, September 26, 1997 (Washington D.C.:The Heritage Foundation.).

[4]CRS Issue Brief #92094, "Most-Favored-Nation Status of the People's Republic of China," December 6, 1996.

[5]"The Great Tax Cut of China," by Alvin Rabushka, *The Wall Street Journal*, August 7, 1997.

trade, and second, tax cuts, and third, privatization. From 1978 to 1995, the tax burden fell to 10.7 percent of GDP, a cut of more than 20 percentage points. This policy shifted one-fifth of all resources from government hands to the private sector, and the government sector is shrinking still further. According to economist Alvin Rabushka, spending by China's government sector accounts for a lower percentage of GDP than the U.S.'s.[6] As a result, millions have joined the ranks of the middle class. China now sports cities the size of Houston and prospects are very bright for the future of millions more.

Once again, my point here is not merely about material prosperity, but about the potential and actual civil and social effect of that prosperity: It means a smaller role for government in the lives of the Chinese people, which in turn means a lessening of power on the part of the state to violate human rights.

Along with this revival in the economic sphere has come a religious revival as well. It was set in motion after officials loosened some specific laws, but they could not have known what would follow. Christian, Buddhist, and Islamic faiths are replacing the previous state religions of Marxism and Maoism. Once empty Buddhist temples now teem with worshippers, and Christianity is more vigorous today in China than at the height of the Jesuit influence in the 17th century or the Protestant evangelistic efforts in the 1920s. All three represent a challenge to the status quo. Religion has become a powerful force for further change in society. We must also remember that the rights to freedom of worship, assembly, and speech are facilitated by the natural and sacred right to own and trade property.

Let us not pretend that the human rights violations that are taking place constitute the only part of China that should interest us. The fact is that with the advent of free enterprise and prosperity in China, and the promise of even more of the same, the rights and well-being of average Chinese people have ballooned. When the advocates of sanctions talk about there not having been any improvement in China since the opening to the West, I wish they would spend more time visiting with average Chinese families and businesses, who present a very different side to the story.

Just so that I am not misunderstood, I do not think that the moral case for continued diplomatic and economic openness with China rests solely on the results of the most recent survey from human rights groups or economic prosperity. Rather, I do not believe that isolating China from the world economy would accomplish the ends sought be those who advocate doing so. Economic freedom, though disparaged or discounted by some who themselves depend on its fruits, is an essential dimension of many other freedoms. China is slowly and systematically becoming part of the community of nations, and continued engagement combined with pressure will help to assure, with God's help, that it will continue to move in this direction.

China's economic revival is still in its infancy. For the sake of human rights,

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[6]Ibid.

and the livelihoods of average Chinese people, this must continue. We cannot be party to doing anything that would harm the prospects of these people. As a priest, I am also bound to point out that the Holy Father has spoken out in very strong terms about the evils that sanctions can visit upon a country. They punish people, not governments, he has said. One Vatican diplomat recently pointed out to me that in places where there is no trade with the outside world, there are weak church organizations and civil society is virtually non-existent, and he cited North Korea, Cuba, and Vietnam as cases in point.

Many problems remain, and I don't doubt the authenticity of horror stories that the advocates of sanctions relate. Everyone is in their debt for keeping the world's attention focused on them. But in all my meetings with average people and political dissidents, never once has a persecuted Christian intimated to me that sanctions are the answer. Quite the opposite. These people desire more contact with U.S. business, American consumers, and missionaries from around the world. They understand, unlike some activists in the U.S., that their plight will be mitigated by more contact and trade, not less.

In sum, it is understandable that Americans do not want to see their tax dollars used to back regimes that are unfriendly to their core values. Neither should American firms doing business in China avert their eyes from violations of human rights. Rather they should serve as advocates for greater freedom. But the upshot of denying China Most Favored Nation status would be to do far more than end special loan deals, morally blind profiteering, and campaign finance capers. It would risk scuttling the opportunity to be a force for good, to keep contact with the rising civil sector, and to improve the lot of the Chinese people.

In countries where religious minorities are treated poorly, we face a choice. We can erect a wall that shuts out our influence. Or we can keep the door open, using moral suasion, commerce, and diplomatic ties to encourage and extend the process of reform. A policy of peace and trade promotes a wider range of freedoms and actually holds out the prospect for making the right kind of difference, and provides a genuine moral center for our international political and economic relationships.

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The Acton Institute is a research organization that promotes international contact between scholars, students, and civic organizations in pursuit of a classically liberal worldview of peace, prosperity, enterprise, and religious freedom.

Chairman CRANE. Thank you.

Our next witness is Mr. O'Brien.

**STATEMENT OF WILLIAM R. O'BRIEN, DIRECTOR, GLOBAL CENTER, BEESON DIVINITY SCHOOL**

Mr. O'BRIEN. Thank you, Mr. Chairman, and committee for this opportunity today.

I would like to approach this from the standpoint of the development in fields of religion and diplomacy over the last four decades and through a lens of my own experience as an expatriate living in Asia for one of those decades. My youthful intrigue with China developed into more holistic concerns while living in Indonesia from 1963 to 1971. I followed with keen interest political developments, as well as nurturing a concern for Christ followers in China and their churches.

I followed the Vietnam War from Indonesia. Listening to the debates of the U.S. about the domino theory, I scratched my head in wonderment. We happened to be in Hong Kong as a family in January 1965, when Indonesia pulled out of the United Nations and helped form the Conference of the New Emerging Forces. The headquarters were to be built in Jakarta. The member bodies included North Vietnam, Cambodia, North Korea, and China. As the attempted coup in October 1965 unfolded, it was apparent for those of us who lived inside Indonesia that we were watching the implementation of a vice theory—not a domino theory.

If the coup had been successful, conceivably the China in the North and Indonesia in the South—that kind of vice grip—would have been put on Singapore thereby controlling the Sea Lanes between East Asia and the Western routes. If that had happened, history would be different today.

There probably would have been a different perspective on the ethnic Chinese minority in Indonesia, if that had happened. There certainly would have been a different story of Christians and churches in both places. Meanwhile, history took a different turn politically and economically in China to mention nothing of the progressively freer opportunity for the expression of religion in China.

I'm concerned with the fact that we'd not just be pushing our own agenda—what's in the best of the United States—but that we truly get inside the skin of a Middle Kingdom mindset. China—Middle Kingdom is the term China refers to itself by, not the word China. They understood that Bai—meaning north, the north capital, Beijing; Nan—south, Nan Xing, south capital; Xi—Xi on the west capital; but the east capital was not Shang—Shanghai. It would be apparent it would be. But it was Eto, which is Tokyo. So we see the vastness of the territory considered to fall within the geographical and mental boundaries of what we now know as modern China and Japan.

To become a part of an interdependent world whereby the touch of computer keys over $1 trillion is exchanged across the borderless territories every 24 hours is a formidable challenge for Middle Kingdom mindsets. Further for centuries of feudal cultures to be interrupted by a foreign political ideology such as Marxism ala Mao is quite a jar in itself. Then to be jolted once again with a reform

perspective that exposes a mystique best served by secrecy represents another quantum leap.

If Deng Siao-ping believed in the economic reform he initiated, he also obviously felt it could only be kept on track through the Middle Kingdom mindset that perceives the whole is more important than any single part. Therefore, reform must be guarded and guided in such a way so as not to see happen in China what was happening in Russia. The larger communal mindset always takes precedence over individuals, and certainly over individualism.

Now the reform continues to move in ways that cause many to see China as the world economic leader by the end of the first quarter of the 21st century. Peter Drucker affirms this with the caveat that it will not be China, but the Chinese who hold sway economically—see his article in the March 10, 1997 Forbes magazine.

Chinese multinational corporations are already owned by families and clans. The 50 million overseas Chinese have built vast networks of commerce well-connected on the mainland. These corporations, as most other Chinese relations, work on the basis of friendship and trust. Any western corporation that fails to recognize a Middle Kingdom mindset will have a rocky road. Any government, including our own, that assumes one can work with and in China solely from our own interest from an Enlightenment and Reformation mindset will learn what it means to be on the short end of the stick in the 21st century.

The religion issue, as our colleague here has mentioned, is very important. It cannot be separated and insulated away. In 1979, China recognized five religious entities—Buddhist, Taoists, Muslims, Protestants, and Catholics—granting freedom to assemble and worship. It did not include indigenous movements such as Watchman Nee's Little Flock, nor Seventh-Day Adventists, among others. Those were viewed as cults and therefore did not come under the policy of religious freedom.

Since 1979, we have witnessed increasing toleration of religious expression on the part of the Communist party's United Front Work Department. Leadership of the Three-Self Patriotic Movement and the China Christian Council has walked a fine line to meet the needs of churches and believers.

Because time is of essence, I hope the whole thing will be entered in the report, but let me just say over the last 20 years, the increasing openness to religious freedom—while there are policy guidelines—there is no governmental mandate that is forcing pastors and leaders to report, as long as they operate within the guidelines that are becoming increasingly more free.

With all of that to say that China is a very multi-complex reality, China as a nation is flexing its mind as well as its muscle and its heart. Everything is changing. I would not want to be the nation standing on the outside chunking rocks at this mammoth. Such action may prove to ourselves we're not afraid of the big bad wolf, but I believe it to be not self-serving, but self-defeating. In fact, as a non-economist, I wondered to myself if the term and notion of this MFN is not a vocabulary of the era of competing national economies, and does not serve us well in this new civilization aborning. After all, we are shaped by the words we use.

So I urge this committee, and the House as a whole, to be strongly supportive of MFN status for China. Then having done so, urge the State Department and any other governmental entity along with NGOs to choose very carefully persons designated to relate to the Chinese government and its people. This crucial intersection in which we find ourselves must not become the crossroads of partisan collisions that would keep us from influencing change in China by such influence perhaps undergo healing changes within our own body politic. Thank you very much.

[The prepared statement follows:]

TESTIMONY OF

WILLIAM R. O'BRIEN

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FOR THE HEARING OF THE TRADE SUBCOMMITTEE

OF THE

COMMITTEE ON WAYS & MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 17, 1998

INTRODUCTION

Mr. Chairman and members of the committee, thank you for the invitation to participate in the hearing today on China.

I am William R. O'Brien, Director of the Global Center at Samford University in Birmingham, Alabama. I have been in this position since March 1991. Prior to that I served in administrative positions from 1976 at the Foreign Mission Board, Southern Baptist Convention, in Richmond, Virginia, including the position of Executive Vice President from 1980-1989, and Director of Public Affairs and the Global Desk from 1989-1991. My family and I served as missionaries in Indonesia from 1963- 1971.

My wife, Dellanna, is Executive Director of Woman's Missionary Union, SBC. WMU is the largest women and girls organization in America with about 1 million members. The organization stays abreast of domestic and international realities in order to provide solid missions education for the local churches, and promotion of national offerings in support of Southern Baptist missions around the world. In its 110 year history, WMU has successfully raised about $2 billion for world missions.

In addition to almost twenty-seven years service through the Foreign Mission Board, I bring several years of international involvement through the Pacific Rim Think Tank of International Urban Associates, Plowshares Institute (a ministry wholly committed to conflict management and empowering for reconciliation with justice.), Evangelicals for Middle East Understanding, the Russian/American Logos Group (founding body of a Christian Music Conservatory and Cultural Center in Moscow), and co-chair of a task-force serving the Birmingham Civil Rights Institute.

CHINA

My youthful intrigue with China developed into more holistic concerns while living in Indonesia from 1963 - 1971. I followed with keen interest political developments, as well as nurturing a concern for Christ-followers in China and their churches.

I followed the Vietnam war from Indonesia. Listening to debates in the United States about the domino theory I scratched my head in wonderment. My family and I were in Hong Kong in January 1965 for a little rest and recreation. While there Indonesia pulled out of the United Nations and helped form the Conference of the New Emerging Forces. (CONEFO) The headquarters were to be built in Jakarta. The member bodies included North Vietnam, Cambodia, North Korea, and China. As the attempted coup in October 1965 unfolded it was apparent to those of us who lived inside Indonesia that we were watching the implementation of a vise theory, not domino. If the coup had been successful, conceivably the China-Indonesia vise grip would have been put on Singapore, thereby controlling the sea lanes between East Asia and the western routes. There probably would have been a different perspective on the ethnic Chinese minority in Indonesia. There certainly would have been a different story of Christians and churches in both places.

Meanwhile, history took a different turn politically and economically in China, to mention nothing

of the progressively freer opportunity for the expression of religion in China.

MIDDLE KINGDOM MINDSET

The spread between ancient capitals of the Middle kingdom (Bei/North; Nan/South; Xi/West and Eto/East which is Tokyo) reflects the vastness of territory considered to fall within the geographical and mental boundaries of what we now know as modern China and Japan. To become a part of an interdependent world, where, by the touch of computer keys over $1 trillion dollars is exchanged across borderless territories every twenty-four hours, is a formidable challenge for Middle Kingdom mindsets. For centuries of feudal cultures to be interrupted by a foreign political ideology such as Marxism ala Mao is quite a jar in itself. Then to be jolted once again with a reform perspective that exposes a mystique best served by secrecy represents a quantum leap. If Deng Siao-ping believed in the economic reform he initiated, he also obviously felt it could only be kept on track through the Middle Kingdom mindset that perceives the whole is more important than any single part. Therefore, reform must be guarded and guided in such a way so as not to see happen in China what was happening in Russia. The larger communal mindset takes precedence over individuals, and certainly individualism.

The reform continues to move in ways that cause many to see China as the world economic leader by the end of the first quarter of the twenty-first century. Peter Drucker affirms this with a caveat that it will not be China, but the Chinese who hold sway economically. (See March 10, 1997 issue of *Forbes*) Chinese multinational corporations are already owned by families and clans. The 50 million overseas Chinese have built vast networks of commerce well connected on the mainland. These corporations as most other Chinese relations work on the basis of friendship and trust. Any Western corporation that fails to recognize the Middle Kingdom mindset will have a rocky road. Any government, including our own, that assumes one can work with and in China solely from an Enlightenment and Reformation mindset will learn what it means to be on the short end of the stick in the 21st Century.

CHINA AND RELIGION

In 1979 China recognized five religious entities: Buddhists, Taoists, Muslims, Protestants and Catholics, granting freedom to assemble and worship. It did not include indigenous movements, such as Watchman Nee's Little Flock, nor Seventh-Day Adventists, among others. Since 1979 we have witnessed increasing toleration of religious expression on the part of the Communist Party's United Front Work Department. Leadership of the Three-Self Patriotic Movement and the China Christian Council has walked a fine line to meet the needs of churches and believers. Because of this unusual situation naysayers of the Council hold that the leaders are either Communists themselves, or at least collaborationists with the government. Charges that sermons of pastors in the registered churches are monitored and censored are common. Those who only support unregistered churches feel that the true believers are a part of these churches. Those who know China Chritian Council leadership and pastors of registered churches know these charges range from skewed perspectives to outright misrepresentation.

We do not know with certainty the number of unregistered house churches or the number of Christians in them. We do know there are 37,000 registered churches and meetings places with

12-15 million members. There are also unregistered but cooperating meeting places.

Since the mid-1980s the Amity Printing Press in Nanjing has printed and distributed 20 million Bibles. Copies of the Bible can even be bought in some Tass News Agency Bookstores. Pastors of unregistered churches come to the registered churches to get copies of the Bible and hymnbooks. Unregistered pastors do invite pastors of open churches to preach to their people. Registered church pastors will not attend worship in an unregistered church unless invited. To do so without invitation would bring the charge of being a spy by local members.

There is much misinformation about the "underground" churches. One pastor who boasts of having the largest "underground", or unregistered, church in all of China is in Guangzhou. His church meets in a building on the second floor over the police station. Everyone knows everything that is going on.

There is harassment, imprisonment, and persecution of some believers and pastors. My contention is that anything one reads about China is true; it is happening somewhere. But it does not necessarily represent a broad-sweeping general policy to be applied evenly across the board. Where some officials in one province, for whatever the reasons, are harassing believers, it may well be that a Christian revival is breaking out in a province somewhere else.

All of this to say that China is a multi-complex reality.

MOST FAVORED NATION STATUS

China is a nation that is flexing its mind as well as its muscle. In its own way in incremental developments, it is also flexing its heart. Knowing the Middle Kingdom mindset, and carefully peeling back the layers of culture and society, it is increasingly evident in an interdependent world that the United States should affirm its willingness to work inside the system. Everything is changing. I would not want to be the nation standing on the outside chunking rocks at this mammoth. Such action may prove to ourselves we are not afraid of the big bad wolf. But I believe it to be, not self-serving, but self-defeating. In fact, as a non-economist, I wonder to myself if the term and the notion of MFN is not a vocabulary of the era of competing national economies, and does not serve us well in this new civilization aborning. After all, we are shaped by the words we use.

I urge this committee and the House as a whole to be strongly supportive of MFN status for China. And then, having done so, urge the State Department and any other governmental entity along with NGOs to choose very carefully persons designated to relate to the Chinese government and its people. This crucial intersection in which we find ourselves must not become the crossroads of partisan collisions that would keep us from influencing change in China, and in so doing, perhaps undergo healing changes within our own body politic. Thank you.

Chairman CRANE. Thank you, Mr. O'Brien.

Mr. Dannenfelser.

**STATEMENT OF MARTIN J. DANNENFELSER, JR., DIRECTOR, GOVERNMENT AND MEDIA RELATIONS, FOR FAMILY RESEARCH COUNCIL**

Mr. DANNENFELSER. Thank you, Mr. Chairman. Mr. Chairman, members of the subcommittee, ladies and gentlemen, I appreciate the opportunity to testify today about the Family Research Council's policy priorities towards China. The subcommittee has asked me particularly to address the question of whether the U.S. should continue to renew most-favored nation status for China.

The Family Research Council President Gary Bower appeared before your subcommittee last year to testify against renewing MFN for China and I am here again before this body for the same reason—to urge Congress to revoke MFN status to China. I believe the reasons to do so have only increased in the past year. Denial of MFN for China will ultimately send a single to the rulers that we're serious and bring long-term improvement in the deplorable conditions suffered by the people of China.

Where have we come after another year of the same form of engagement with China? Arguably, we are in a less safe and more volatile world. Unlike what the gentleman said earlier that we don't have shooting wars anymore, the world is still a very dangerous place. We now have an estimated 13 Chinese long-range missiles pointed at American cities. Pakistan and India are on the brink of a nuclear arms race at least partially due to China selling nuclear weapons materials and missiles to Pakistan. There are also technology transfers to Iran and other countries.

Hong Kong is now being ruled by a public legislature controlled by Beijing. Our trade deficit with China has increased by about $15 billion. It was $50 billion in 1997, and many economics are projecting that it will grow to about $60 billion this year. Besides the highly publicized, but very limited symbols of releasing political dissidents Wei Jingsheng and Wan Dan, who were barred from returning to their home country, there has been no concrete evidence that conditions are getting any better for those in China who dare to disagree with their government.

Members of an underground church in China recently sent a letter to Freedom House telling of how the police threw out the church's members, beating some, and then raised the church. The fact that the Chinese regime would implement crackdowns such as this on the eve of the first visit by a U.S. president in nine years suggests that our current policy with China is not being the desired reforms we envision.

Last week, President Clinton presented his reasons for going to China. I believe he is setting up a false dichotomy by claiming that the debate is between a policy of engagement and a policy of isolationism. The debate is really about what type of engagement we are going to have. It is not isolationism to put American values at the forefront of our policy. Let me make it clear, I do not advocate an end to trade or diplomatic relations with China nor do I suggest that we impose an economic embargo on China. By revoking MFN, we're merely telling the Chinese rulers that there are certain mini-

mal standards a country must meet if it wishes to be fully welcomed into the family of civilized nations.

China is currently exporting to America four times than it imports from America. Depending on the American market for a large portion of its total exports—approximately 35 percent—China has far more to fear from its suspension of MFN than America has as in being China's own friendly public relations campaign in Washington today attests. America, in other words, stands before China in the summer of 1998 for the most part as customer. In most free economic relationships, it is the customer who has the power. Those who would argue that American values of equality and freedom for all will seep into Chinese culture as a result of increased trade forget that Chinese tyranny can also seep into ours.

The Chinese government generally places strict constraints on one of the best vehicles to the outside world—the Internet. Last year Prodigy agreed to block all of the Internet sites that the government requested in order to enter into a joint venture with the company controlled by China's military. You can visit a Free Tibet website in Washington. However, you cannot access the human rights in China website in Hong Kong. Chinese censors, with the aid of Prodigy, block that site.

There is evidence to suggest that if the U.S. were to redirect its trade policy toward China, more trade opportunities—not less—could result. It was in 1990 and 1991 when China was faced with a real prospect of losing MFN after the massacre of 700 to 2,000 students at Tiananmen Square that Beijing announced a large contract with Boeing. They were clearly afraid and responded accordingly—not only with the Boeing contract, but by: releasing some 800 political prisoners; promising to ban exports of goods produced by slave labor; ending illegal textile shipments; accelerating U.S. imports; closing down all illegal factories dealing in copyright and software theft; and opening a nuclear reactor that was building in Algeria to international inspection.

All this occurred only, when briefly in the summers of 1990 and 1991, it looked as if Congress might really act. China was faced not just with condemnation or bluster from Washington, but of a real prospect of losing its cherished MFN privileges with its greatest export market.

Our dealings with China have been highly one-sided. I believe they have been a bad deal for Americans, especially American workers and taxpayers. But I readily admit that I would not be appearing before this subcommittee today if this were only a matter of disadvantaged trade relationships. Facts continue to emerge indicating America's national security is seriously at risk.

U.S. high-tech trade with China is being conducted with a shortsightedness that exceeds any similar error we have made in the past. China is unquestionably engaging in the largest scale military buildup of any great power. Beijing uses much of the $40 billion in hard currency it nets from trade with the United States to finance its military buildup. Many of China's companies are virtually wholly-owned subsidiaries of the People's Liberation Army.

At a minimum, Congress should enact a ban on the importation of materials from companies controlled by the People's Liberation Army. The involvement of China's PLA-controlled firms in slave

labor, transfer of nuclear technology and chemical weapons to terrorist states, and the oppression of religious believers in China cannot be seriously denied. If we can't, at the very least, regulate our dealings with the oppressors army, how is anything we say going to be taken seriously in Beijing?

That same army is responsible for many of the atrocities committed against the people of China. China's human rights violations shock, or at least should shock, the conscience of the world. Our State Department continues to report that torture, extradition, judicial killings, arbitrary arrests and detention, forced abortion and sterilization, and brutal oppression of ethnic minorities and religions still exist in China.

The Beijing regime has also indicated that it used Christians as the enemy of totalitarian Communism. Its leadership, determined not to repeat the mistakes as they viewed them, of the Soviet empire speaks disparagingly of the "Polish disease." The religious resistance to Communism galvanized by Pope John Paul is very much on the minds of Chinese leaders.

Christians are not the only ones persecuted in Beijing. Buddhists, particularly those in Tibet and Muslims in the Northwest are experiencing a Chinese version of ethnic cleansing.

Despite the numerous examples of a consistently abusive and authoritarian regime, our country failed to initiate the rather mild gesture of condemning these abuses at the United Nations conference on human rights this past March. President Clinton, when he delinked trade from human rights in 1994 that that would be the vehicle for raising human rights concerns.

Mr. Chairman, the students who marched for freedom in Tiananmen Square carried copies of our Declaration of Independence—a document which speaks to a universal longing in the human soul for freedom and dignity. The United States of America should always ensure that the tyrants of this world will sleep uneasily in the knowledge that their people know the words of our Declaration of Independence. That they, and we still believe them. Thank you very much.

[The prepared statement follows:]

**Martin J. Dannenfelser, Jr.**
**Director of Media and Government Relations**
**Family Research Council**
**House Committee on Ways and Means**
**Subcommittee on Trade**
**June 17, 1998**

Mr. Chairman, members of the subcommittee, ladies and gentlemen; I appreciate the opportunity to testify today about our policies toward China. The subcommittee has asked me to particularly address the question of whether the U.S. should continue to renew Most Favored Nation (MFN) trade status for China.

I appeared before your subcommittee last year to testify *against* extending Most Favored Nation trade status to the People's Republic of China. I am here again before this body for the same reason: to urge the Congress to revoke MFN status for China. I believe the reasons to do so have only increased in the past year. Denial of MFN status to China's rulers will ultimately, I believe, bring improvement in the deplorable conditions suffered by the people of China.

Where have we come after another year of the same form of engagement with China? Arguably, we are in a less safe and more volatile world. We now have an estimated 13 Chinese long-range missiles pointed at American cities. Pakistan and India are on the brink of a nuclear arms race, at least partially due to China selling nuclear weapons materials and missiles to Pakistan. Hong Kong is now being ruled by a puppet legislature controlled by Beijing. Our trade deficit with China has increased by about $15 billion. It was $50 billion in 1997 and many economists are projecting that it will grow to about $60 billion this year.

Besides the highly publicized, but very limited symbols of releasing political dissidents Wei Jingsheng and Wang Dan (who are barred from returning to their country), there has been no concrete evidence that conditions are getting any better for those in China who dare to disagree with their government. Members of an underground church in China recently sent a letter to Freedom House, telling of how the police threw out the church's members, beating some, and then razed the church. The fact that the Chinese regime would implement crackdowns such as this on the eve of the first visit by a U.S. president in nine years suggests that our current policy with China is not bringing the desired reforms we envisioned.

Last week, President Clinton presented his reasons for going to China. I believe he is setting up a false dichotomy by claiming that the debate is between a policy of engagement

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and a policy of isolationism. The debate is really about what type of engagement we are going to have. It is not 'isolationism' to put American values at the forefront of our policy.

Let me be clear. I do *not* advocate an end to trade or diplomatic relations with China, nor do I suggest that we impose an economic embargo on China. By revoking MFN, we will merely be telling the Chinese rulers that they stand to face tariffs that are comparable to those that *Americans* currently face in seeking to enter China's markets. We will also be making it clear that there are certain minimal standards a country must meet if it wishes to be fully welcomed into the family of civilized nations.

China's markets have been largely closed to American goods. Despite the furious lobbying of Congress by various business interests, the highly touted Chinese market has proved to be a mirage -- steadily receding toward the horizon of a promise never quite fulfilled. Some economists may now be souring toward the potential of the China market. In this week's *Business Week*, Jeffrey Garten, the Undersecretary of Commerce for International Trade during the first term of the Clinton administration, writes that with "Beijing struggling to restructure an insolvent banking system, shut down thousands of bankrupt state companies, and cope with some 5 million newly unemployed workers...[China's] growth, its exports, and incoming foreign investment are rapidly losing steam."

However, China is *exporting* to America four times more than it imports from America. Depending on the American market for a large portion of its total exports, China has far more to fear from a suspension of MFN than America has -- as indeed China's own frenzied public relations campaign in Washington today attests. America, in other words, stands before China in the summer of 1998 for the most part as customer. In most free economic relationships, it is the customer who has the power.

Those who would argue that American values of equality and freedom for all will "seep" into Chinese culture as a result of increased trade forget that Chinese tyranny can also seep into ours. The Chinese government generally places strict constraints on one of the best vehicles to the outside world, the Internet. Last year, Prodigy agreed to block all of the Internet sites that the government requested in order to enter into a joint venture with a company controlled by China's military. You can visit a "Free Tibet" web site in *Washington*. However, you cannot access the Human Rights in China Web site in Hong Kong: Chinese censors, with the aid of Prodigy, block that site.

There is evidence to suggest that if the U.S. were to redirect its trade policy toward China, *more trade opportunities,* not less, could result. It was in 1990 and 1991, when China was faced with a loss of MFN after the massacre of 700 or more students at Tiananmen Square, that Beijing announced a large contract with Boeing.

Beijing was clearly afraid and responded accordingly: not only with the Boeing contract, but by releasing some 800 political prisoners, promising to ban exports of goods produced by slave labor, ending illegal textile shipments, accelerating U.S. imports, closing down all

illegal factories dealing in copyright and software theft, and opening a nuclear reactor that it was building in Algeria to international inspection.

All this occurred only when, briefly in the summers of 1990 and 1991, it looked as if Congress might really act. China was faced not just with condemnation or bluster from Washington, but with a real prospect of losing its cherished MFN privileges with its greatest export market.

Our dealings with China have been highly one-sided. I believe they have been a bad deal for Americans, especially American workers and taxpayers. But I readily admit that I would not be appearing before this subcommittee today if this were only a matter of a disadvantageous trade relationship.

Facts continue to emerge indicating America's national security is seriously at risk. U.S. high-tech trade with China is being conducted with a short-sightedness that exceeds any similar error we have made in the past. China is unquestionably engaging in the largest scale military buildup of any great power. Beijing uses much of the $40 billion in hard currency it nets from trade with the United States to finance its military buildup. Many of China's "businesses" are in fact wholly owned subsidiaries of the People's Liberation Army.

China continues to commit egregious violations of non-proliferation agreements without repercussion. Chinese rulers have treated pariah states like Iran and Iraq as *their* most favored nation trading partners. Their trade with these terrorist regimes has been in weapons of mass destruction, including poison gas and offensive missiles. Americans have been killed by these weapons.

Chinese rulers have demanded -- before doing business with certain corporations -- that U.S. manufacturers give them high-technology transfers, some of which are known to be diverted to weapons development. Most recently, the administration granted waivers to allow the companies Loral Space & Communications and Hughes Electronics to transfer vital rocket-launch technology to Beijing.

Perhaps the most immediate impact of these technology transfers has been the escalation of a nuclear arms race between India and Pakistan. Despite China's repeated promises to the contrary, they exported materials which enhanced Pakistan's nuclear capabilities. Indian government officials have testified to the fact that China's aggressive military buildup and its nuclear exports to Pakistan highly influenced India's decision to conduct nuclear tests.

At a minimum, Congress should enact a ban on the importation of materials from companies controlled by the People's Liberation Army (PLA). The involvement of China's PLA-controlled firms in slave labor, transfer of nuclear technology and chemical weapons to terrorist states, and the oppression of religious believers in China cannot be seriously denied. *If we can't, at the very least, regulate our dealings with the oppressor's army, how is anything we say going to be taken seriously in Beijing?*

That same army is responsible for many of the atrocities committed against the people of China. China's human rights violations shock -- or at least *should shock* -- the conscience of the world. Our State Department continues to report that torture, extra-judicial killings, arbitrary arrest and detention, forced abortion and sterilization, and brutal oppression of ethnic minorities and religions still exist in China.

Lest anyone doubt the reports of China's ruthless and coercive one-child policy, two Chinese women offered compelling testimony last week before the Subcommittee on International Operations and Human Rights. They told of routine population control practices in which women and their families are jailed until the women relent to being aborted or sterilized, and of unborn babies being killed in the ninth month of pregnancy. Ironically, one of the women to testify was formerly the head of a rural family planning clinic. She herself felt powerless to speak against the regime she represented.

The harassment and oppression of religious believers continues as well. Some 50 million Christians -- both Catholic and Protestant -- live in fear of government persecution. Many independent observers --like human rights lawyer Nina Shea and Canadian scholar Paul Marshall -- report that China's religious persecution has been *intensifying* since President Clinton delinked trade and human rights in 1994. Christian prayer services are routinely disrupted by the Chinese Public Security Bureau's baton-wielding police. Pastors and priests are imprisoned. Some clergy have not been heard from in months.

The Beijing regime clearly views Christians as *the enemy* of totalitarian communism. Its leadership, determined not to repeat the "mistakes" of the Soviet empire, speaks disparagingly of the "Polish disease." The religious resistance to communism galvanized by Pope John Paul II is very much on the minds of China's leaders. Paul Marshall, in *Their Blood Cries Out,* quotes China's state controlled press warning that, if China does not want to experience the same fate as the Soviet empire, it must "strangle the baby in the manger." In other words, they view Christianity as the greatest threat to their continued control over the Chinese people.

Christians are not the only ones persecuted in China. Buddhists, particularly those in Tibet, and Muslims in the Northwest are experiencing a Chinese version of "ethnic cleansing."

Despite the numerous examples of a consistently abusive and authoritarian regime, our country failed to initiate the rather mild gesture of condemning these abuses at the United Nations Conference on Human Rights in March. This is doubly disgraceful since the conference was supposedly the forum where human rights could be addressed. The Chinese regime, I'm sure, cheered: the "blunt instrument" of sanctions and the supposed fine-tooth comb of a simple human rights declaration were both discarded.

The students who marched for freedom in Tiananmen Square did not make *papier-mâché* models of Chairman Mao but of our Statue of Liberty. They didn't quote Marx but Jefferson. They carried copies of our Declaration of Independence, a document which speaks to a universal longing in the human soul for freedom and dignity. The United States

of America should always ensure that the tyrants of this world will sleep uneasily in the knowledge that their people know the words of our Declaration of Independence and that they, and we, still believe them.

Mr. Chairman, members of the subcommittee, I urge you to revoke China's MFN trade privileges. I do *not* believe we are the "moneybag democracy" Beijing has contemptuously called us. I believe we can act to defend our people, our honor, and our interests. I believe Americans who place a higher priority on human rights in China than on extending trade benefits want us to uphold a firmly rooted foreign policy. Ronald Reagan advocated a foreign policy "based upon our deep belief in the rights of man, the rule of law and guidance by the hand of God."

Some have argued that Ronald Reagan supported renewal of MFN for China during his presidency, therefore we should do the same today. Clearly, the circumstances surrounding our relationship with China are much different today than they were before 1989. One of the reasons that Richard Nixon created an opening to China was to draw them away from the nation that posed the greatest military threat to America at that time -- the Soviet Union. With the collapse of the Soviet empire and China's aggressive military buildup over the past decade, China has emerged as the greatest military threat to America. It is worth noting that President Reagan never granted MFN to the Soviet Union because of their failure to abide by certain human rights standards.

Prior to 1989, there were hints of political reform in China. However, the massacre in Tiananman Square marked a turning point for the Chinese leadership. They decided that openness to political dissent could ultimately jeopardize their hold on power. From their perspective, they did not want to make the same "mistakes" as the Soviet Union. As the State Department's human rights report has noted, every form of public dissent has been crushed in China since the crackdown at Tiananmen Square.

One of the clearest benefits of our post-Cold War world is foreign trade and the prosperity it offers; but one of the surest destroyers of peace is diplomacy for profit alone.

The Chinese people, like freedom-loving people everywhere, are looking to America for signs of hope. Let us send a clear message that we stand with those people and not their oppressors, that we support democracy in the world and will not underwrite tyranny. Far from ending all future dealings with China, the withdrawal of MFN could be one of the best investments America ever makes in China -- an investment in freedom.

Thank you.

Chairman CRANE. Thank you.
Mr. Craner.

**STATEMENT OF LORNE CRANER, PRESIDENT, INTERNATIONAL REPUBLICAN INSTITUTE**

Mr. LORNE CRANER. Mr. Chairman, Congressman Portman, thank you for the opportunity to testify today. I'm not going to add to the China policy prescriptions you'll be receiving on important issues such as proliferation, Taiwan, trade deficits, and campaign contributions. IRI is not a think tank, but we are a do tank, and we're helping to nurture democracy abroad.

So today, I want to give you IRI's perspective on some changes in China in which we became involved five years ago at the suggestion of both analysts and dissidents. I will address three questions: first, is China reforming its political system; second, do the reforms matter; and third, if they do matter, how can the U.S. help advance them?

First, is China reforming its political system? The answer is a qualified yes incrementally, but in three areas—electoral, legislative, and legal—that could have far-reaching consequences. For a decade, elections have been occurring in China's rural villages. They were, at first, of a very ragged quality. But with the passage of time, experience was gained and outside advice including IRI's was accepted.

Today, up to half of China's 1 million villages have elections that can be described as technically well-administered. The elections have enabled hundreds of millions to choose village councils responsible for local governance—from taxes to economic development. In the process, those elected—about 40 percent of whom are not Communist—are learning that they must serve the voters. As a result, responsive government—something that has never before existed—is coming to be expected by as many as 850 million rural Chinese.

In the meantime, elections are moving to a higher level to townships. The law governing village elections is expected to be debated, improved, and made permanent by China's National People's Congress. It may sound odd to talk about debate in China's National People's Congress, which has long been a classic Communist rubber stamp legislature whose members simply passed laws handed down by ministries. In the last five years, however, China's legislature has heavily amended draft bills and is expected this year to begin writing legislation. The NPC has also begun to exercise a greater degree of oversight authority. With these developments the NPC is moving away from being a rubber stamp for the rule of man and has begun to act as an institutional bulwark for the rule of law.

Legal reform is the final area in which IRI has worked, initially with judges charged with adjudicating new commercial laws, and more recently in helping to set up a new legal aid system for China's poor and indigent. This recent, but unprecedented development, should give ordinary Chinese a means of redress against entrenched economic and political interests.

The second question I posed at the beginning of my testimony is whether these reforms matter. I've already noted the unprecedented changes in political culture: rural voters expecting represen-

tation from those they elect; legislators exercising long dormant authority and ordinary citizens beginning to access a nascest legal system. These are the foundations of democracy and are therefore consequential for China itself. But the answer to whether these reforms matter for the U.S. lies in the very fears of those who seek China's isolation and containment. They believe that China's growing power will—within a decade or two—result in aggression against the U.S. But aggression requires both ability and intent. There are many powerful countries with the ability for aggressive action, but no intent to exercise it. The world would be well-served if early in the next century, China was similarly a powerful country lacking an aggressive intent.

A more democratic government responsive to a well-informed populace and restrained by a functioning legal system would likely be more interested in the welfare of those they serve in a foreign adventurism.

The last of the three questions I posed is how the U.S. can help advance these reforms. To answer that question, we need to know why they are occurring, and it is not because of the goodness in someone's heart. They are a direct result of economic change in China. Elections, for example, have occurred because the previous form of local government—communes—was dissolved in an attempt to raise crop yields. China's legislature is gaining more authority because of the need to reconcile free-market laws with varying regional stages of development. China's first recognizable legal system is taking shape to attract foreign investment and to resolve the tensions that result when ordinary citizens are hurt by economic change.

The economic motivation for these reforms should make one way the U.S. can help advance them obvious. Engagement has encouraged economic change and by extension helped initiate gradual political reform. As many have noted recently, however, there is a certain amount of faith in the belief that commercial transactions alone lead to rapid democratization. Critics of MFN call this the inevitability cop-out. There is some wisdom to their opposition to commercially-based engagement, especially given the short time until China can become a first-rate military power.

At IRI, we have pursued engagement with a purpose—organizing and catalyzing developments within China that are specifically in line with U.S. interests. It is important for the future of both countries that the U.S. make these developments a significant component of engagement and encourage support and assist them. I look forward to answering your questions.

[The prepared statement follows:]

Testimony of
Lorne W. Craner
President, International Republican Institute
Before the
Ways and Means Committee
Subcommittee on Trade
Wednesday, June 17, 1998

Mr. Chairman, I appreciate your kind invitation to appear before the Subcommittee on Trade to discuss the International Republican Institute's (IRI) programs in the People's Republic of China. While I understand that this hearing is on U.S.-China relations and the extension of most-favored-nation (MFN) trade status, I want to make clear that IRI is not in the policy-making business. Rather, I come before you today to highlight significant political reforms underway in China in which IRI has been involved through what I call meaningful engagement, or engagement with a purpose.

What do I suggest by 'meaningful engagement'? Simply, it is the targeting of programs that effect change in China in areas that are specifically in line with U.S. national interests.

When IRI sought advice from diplomats, policy analysts, and dissidents on how best to establish programs in China, nearly all encouraged meaningful engagement through technical assistance on village committee elections and legal and legislative support to the National People's Congress (NPC). We took their counsel, and today IRI has been witness to remarkable changes throughout China.

Before I describe some of those changes, let me draw the Subcommittee's attention to a June 14, 1998 article in the Washington Post, "A Quiet Bureaucrat, Promoting The Vote One Village at a Time." I am pleased to inform you that IRI has been working closely with Mr. Wang Zhenyao -- the chief architect of village elections -- since 1994. My staff and I know that his commitment to rural democracy in China borders on a crusade and we find him to be among the strongest and most capable voices of reform within the PRC.

**Electoral Reform**

In 1994, IRI became the first international organization to observe village committee elections when a small team of election observers traveled to Fujian province in southern China. That delegation, which consisted of both IRI and independent American election experts, evaluated village level elections using the same criteria that IRI uses to observe elections around the world. While errors and abuse of power were observed, on the whole, IRI concluded that the elections were of a minimally sound technical quality and that, if improved, they represented an unprecedented opportunity for Chinese citizens to select their local leaders in a direct, competitive process. Even more important than the quality of elections at that time was the willingness and desire that local and national officials expressed in working with IRI to make their elections more democratic.

Between 1994 and today, IRI has observed almost 50 elections in 10 of China's provinces. From the beginning, IRI assisted local officials to identify ways to improve the quality of village elections. IRI has been instrumental in advocating the use of secret ballot booths and election monitors, augmenting civic education efforts, and conducting training programs to stress the importance of open primaries and transparent vote tabulation.

In 1997, IRI returned to the counties in Fujian province where we had observed 1994 balloting to observe the next round of village elections. We were surprised to find that in three short years the use of secret ballot voting booths had become mandatory and candidate appointed monitors were present to check vote fraud and irregularity. In fact, of 40 recommendations made by the IRI delegation in 1994, 29 have been fully or partially implemented.

While there have been remarkable improvements in election administration, IRI maintains a healthy awareness of the reality of village elections. First, while over 800 million people are affected by village committee elections, only about a quarter have yet had elections with recognizable democratic practices. Second, no major changes to China's overall political structure have resulted. There are, for example, no truly independent political parties; China remains a one party state characterized by top-down management. This extends to village committees, which are not free to ignore unpopular central edicts, and must vie for power with local Communist Party branches.

But vie they do. As one non-Party member elected village committee chairman announced over loudspeakers throughout the village:

> I was elected by the whole village, the Party secretary was elected solely by Party members. From now on, I am the number one leader in the village. You should come to see me when you have problems.

Approximately two-fifths of those elected to village committees are non-communists. Village committees are beginning to wrest real power away from local Communist Party branches, which are viewed by many villagers as populated by out-of-touch cadres who care little about village concerns. This is beginning to result in a slow reform of the governance process, albeit at a local level, in a way that is unprecedented in modern China. Village committees are recognizing that democracy confers legitimacy and realizing that reelection is based on performance and they are responding to villagers' needs and concerns. Over the past few years, for example, IRI's staff has increasingly noticed that in villages where elections have occurred, transparency of village affairs has become a priority: village committees have started to post tax income and expenditures, while others are putting major policy decisions before their constituents for a vote.

Momentum is building behind efforts to apply the village election experience to the township and county level. President Jiang Zemin endorsed village committee elections during last September's Party plenum, and suggested: "The grassroots organs of power... in both urban and rural areas should establish a sound system of democratic elections." Similarly, Prime Minister

Zhu Rongji expressed support for local elections, though he deferred predictions on whether the president and prime minister of China may one day be democratically elected. In recent months, Chinese scholars and officials have renewed their calls for increased political reform, including extending open elections to higher office. By introducing hundreds of millions of Chinese villagers to an electoral process and by now extending that process vertically to higher levels of government, one can see a pathway on which democratic elections could travel.

The implementation of elections at the village level does not alone satisfy the demands for greater political reform in China. However, it has introduced important democratic concepts and generated momentum for increased reform. In the near future, a bill is expected to be discussed by the NPC that will amend the village election law to include articles that outline more transparent voting procedures, including transparent voter registration, open candidate selection, secret ballot, and immediate announcement of election results. The codification of these practices will have an impact at all levels in China as officials come to understand what democratic elections are and how they are implemented.

**Legislative Reform**

Just as signs of political reform have emerged at the grassroots level, national level bodies have started to emerge as institutions capable of promoting pluralism in the political process. The NPC, for decades rightfully derided as a rubber-stamp, has assumed a measure of control over the legislative process and started to debate and even disagree with central policies. Many in the press have reported the high percentages of negative votes cast during the legislature's annual meeting, registered as criticism of growing corruption and ineffectiveness. This year a new, anonymous voting system was installed in the legislative body, a step that may help to diminish Communist Party control over delegates.

IRI's own work with the NPC has focused on providing core assistance during the legislative drafting process. Almost a decade ago, a central document was issued that decreased the party's role in micro-managing the legislative process, opening the door for NPC Standing Committee delegates and their staff to take greater control over the drafting and amending of legislation. IRI began a program with an NPC severely hampered by a lack of resources, to provide technical and legal assistance on specific draft legislation. To date, IRI has worked with the Finance and Economic Committee on more than ten laws, including banking, bankruptcy, contract, futures, securities, partnership, sole proprietorship, real estate, anti-monopoly, trust, tax, and foreign currency management. As NPC delegates and staff increase their understanding of the substance of these subjects, they are able to participate more fully and effectively in the legislative process and to debate significant issues from a position of authority.

There is much evidence that China is becoming an increasingly pluralistic society. Economic development has lead to the stratification of Chinese society and the emergence of new and differing interest groups. Differences between rich and poor, coastal and interior, agrarian and industrial will only grow wider and the Chinese government will have to learn to address the

needs of new constituencies. In an increasingly complicated society, the NPC may be the only existing institution suited to represent growing interests and resolve tensions.

**Legal Reform**

Legal reform in China began in the 1980s, when China's leaders, wary of the excesses of the Cultural Revolution and anxious to promote investment and economic growth, reestablished administrative and organizational norms and passed commercial laws that could support the new market economy. For more than a decade now, legal reform efforts have centered on bolstering developments in these two areas. In recent years, greater attention has been paid to other areas of legal reform that have far reaching implications for the majority of China's citizens.

The promulgation of new laws is only one component of the development of the rule of law in China. Implementation of these laws and the administration of justice are arguably the most critical aspects of a sound legal system -- aspects which are deficient in China. In 1995, judges who attended a bankruptcy conference hosted by IRI and the NPC approached my staff to see if IRI would train judges on the enforcement of new laws. We immediately agreed, understanding that providing training to Chinese judges is an effective means of enabling them to preside over cases in accordance with the requisites of a rule of law system.

Since then, IRI has conducted judicial training seminars on futures law, securities law, guaranty law, and contract law. In addition to reviewing the details of each of these laws -- and studying and analyzing case studies -- IRI's pro bono, international legal experts have familiarized Chinese judges with Western judicial practices. In all of IRI's training seminars, Chinese judges have raised insightful questions about the adversarial process, the presumption of innocence, standards of proof, and the right to an appeal. IRI's judges training program, like all of the Institute's programs in China, deals with broader subjects of the rule of law and political reform by focusing on the technical aspects that make these concepts realities.

In 1996, China passed an amended criminal code, which among other things, gave defense counsel greater access to their clients, reduced the amount of time a suspect can be detained, and decreased the role courts plays in investigating the facts of the trial. While recognizing that there is often disparity between the law as it is written and the law as it is implemented, IRI sees the creation and establishment of legal aid centers throughout China as perhaps an indication that the criminal code may be taken seriously.

Growing income disparity, coupled with greater awareness of the legal system, has fueled the need for legal aid in China. In the first half of 1997, six provinces alone provided legal aid services, usually to the poor and indigent, in approximately 11,000 cases, mostly involving employment and family disputes and breach of contract issues. Those responsible for setting up the legal aid system are anxious to raise public awareness of the availability of legal aid, but they worry that lines will form around the block overnight.

In 1997, IRI became the first foreign organization to provide training for China's legal aid officials, including providers from the national legal aid center and from 17 provincial centers. Utilizing pro bono, international experts, IRI examined issues critical to the development of a sound legal aid system, including civil versus criminal legal aid, class action litigation, public outreach, and representation in death penalty cases.

While China is not yet a rule of law society, it is no longer a society where issues can be resolved definitively by work units and neighborhood committees. The law and the pursuit of legal action is becoming increasingly relevant, even for the poorest members of society who through legal aid are able to access the justice system in ways unprecedented in Chinese history.

**Conclusion**

Mr. Chairman, it would be a gross oversight to exclude from the MFN debate discussion of these significant reforms in China. They represent some of the best possibilities for change that dissidents and China scholars would like to see. Will they lead to a truly representative government and the rule of law in China? Possibly over time, but the reforms are certainly worthy of continued support from the U.S. Congress and business community.

Let me conclude by thanking the National Endowment for Democracy for its core support of IRI's activities in China. This Subcommittee should also recognize and praise the private support IRI has received for this program from Ameritech, Chubb, Federal Express, Ford Motor Company, Honeywell, Pfizer, and the William and Karen Tell Foundation.

Chairman CRANE. Thank you very much.

I have a quickie for you, Mr. Dannenfelser. It has to do with an article in today's New York Times—front page article. The article is about China's churches. They have some interesting observations in there that I wondered if you might have some information on. They say, according to a man named Reverend Don Angew—recent President of the National Association of Evangelicals in the U.S.—that China may experiencing the single—this is a direct quote—"single greatest revival in the history of christianity." Is that consistent with your evaluation?

Mr. DANNENFELSER. Well, as Paul Marshall, who's studied very widely on this subject, has said, China is a large enough country that everything is true somewhere within that country. So that's not to suggest that everywhere in China there's the same degree of oppression against religion. But there are some very basic things that can't be done still.

For instance, the Vatican cannot appoint bishops. The Chinese government won't recognize those bishops. You can't preach about the second coming of Christ, which is an essential tenet of christianity.

I think that they have certain information that comes from them from various sources. We have—but I don't believe that they really got out into the countryside unescorted by Chinese leaders. We have gotten people who have really—we've heard from people who have gone there and gone out and met with the underground church leaders. They've had to worship in the middle of the night. So they report a great deal of oppression and sent back messages of please continue to keep up the pressure back in the United States.

So I wouldn't suggest there is not—there is a great deal of, you know, belief and so on that is growing there. I think the people, you know, who have this faith will persevere in many cases despite the government, but they should not be subjected to abuse for practicing their beliefs.

Chairman CRANE. Well, another point in this article is in 1949—it says there were fewer than 1 million Protestants in China and 79 three years after the end of the cultural revolution when the Mao's mobs attacked churches and the homes of believers. Only three Protestant churches were open in all of China and today there are more than 12,000—up from 3,000 to more than 12,000 official Protestant churches that are open. That doesn't include the house churches.

We had Billy Graham's son, who's been doing missionary work over there for the last nine years. They have been distributing Bibles to a lot of those house church activities. I don't think they are supposed to be doing that sort of—I mean the house church thing, I don't think is wholeheartedly legal—do you know the answer to that, Mr. O'Brien?

Mr. O'BRIEN. There are 37,000 registered churches and meeting places. The terminology has shifted over this 20 years: registered church meaning they have openly agreed to work within the broad guidelines of freedom; registered meeting places that cooperate; unregistered cooperating meeting places that some call "house churches" or underground; and then unregistered non-cooperating. We

don't know how many unregistered non-cooperating there are, but we know there are 12,000 registered churches and another 25,000 unregistered but cooperating. They number 12 to 15 million. Now you'll hear 50 to 60 million total. But nobody knows because there's no way to count.

One, that culture doesn't put an emphasis on numbers, and we do. No. 2, they're just so proliferated, there's no way to get at it. There's 17 theological training centers and bible schools. As I indicated in my testimony, the Amity Press has printed and distributed 20 million Bibles within China itself. Interestingly, the pastors of unregistered churches come to the registered churches to get both their Bibles and their hymn books. They invite pastors of registered churches to preach in their pulpits. No registered pastor would go uninvited because it would cause the people in the unregistered churches to suspect they were spies or something. So there's a lot of misinformation, there's a lot of disinformation.

But as I pointed out, if you look over a 20-year period, the progressive development toward freedom and there is an impressive revival. As you pointed, something—anything you read is true; it's happening somewhere. You may have harassment in one area and a revival breaking out in the province next to it. You have some people who are arrested—not because they're Christians, but because they broke the law, just like in this country.

The issue of miracles in the cultic areas and those that did not fall in the original guidelines of freedom—there's a lot of heresy—the emphasis on miracles as a determinant of whether you're a believer or not. So they're desperately trying to produce new leadership that can combat heresy. So to me it's a very encouraging picture. I know personally these leaders.

Chairman CRANE. I have seen the figures and this article also documents that, that there are an estimated close to 40 million Christians in China——

Mr. O'BRIEN. It's an estimate.

Chairman CRANE [continuing]. Which is interesting because of the 1.2 billion Chinese only 40 million are Communists. I am now delegating my Chair responsibilities to Congressman Houghton. Rob Portman and I have to go—unless you want to ask a quickie before we run to catch this vote.

Mr. PORTMAN. Thank you, and I'm sorry that I can't stay with you to do our constitutional duty here. I have a number of questions.

Just to tell you where I'm coming from. Many of the concerns raised by Mr. Dannenfelser are ones that I know that I asked the other panel to share and some of you addressed some of them. I tried to list the ones I heard Mr. Dannenfelser mentioning and I know there are others about China selling missiles to Pakistan or nuclear materials to Pakistan; you mentioned Iran, as well, and we have some information on that; the poor conditions for political prisoners; you mentioned the churches being forced to be underground or being harassed; the Chinese markets not being open enough to U.S. products; the concerns, of course, with the People's Liberation Army; with of course, the one-child policy; and forced abortions which you spoke about.

You know, my question is a very simple one, and I will direct it to Mr. Dannenfelser, although all of you are free to chime in. I think I know most of your answers, but when I hear this litany, all of which concerns me a lot, and having been to China. In 1984, I spent 10 weeks on an unofficial trip. I went off the track a few times when I wasn't supposed to and survived it. You know, it is a huge, fascinating country but it has changed so much.

I just wonder how revoking MFN is going to help in any of these categories. Having again heard your arguments about all the problems, and so on, I don't see how disengaging in any respect—putting China in the category as the six countries that we don't offer normal trading relations to which is the Cubas and the North Koreas of the world—how that's going to help at all in terms of moving China toward a freer country, a country that does respect human rights. I just wondered if you could expand on that.

Mr. DANNENFELSER. Well, I think one point to keep in mind is that they are largest growing military power in the world; that representatives of their government have made it clear that they plan to reunify Taiwan by the year 2010——

Mr. PORTMAN. Again, I've got to run. I apologize.

Mr. DANNENFELSER. But I think that that's a distinction that they are really the only—well, not the only—they are the most significant military threat to us down the road.

Mr. PORTMAN. So you put them into another category than those other countries that aren't a threat?

Mr. DANNENFELSER. I think so. The other thing is that you deal with different countries based on the circumstances and levers, I guess, that you have. Trade is the best peaceful lever that we have for dealing with China. When you have a 35-to-2 situation—you know, 35 percent of their export market is the United States; they only represent 2 percent of ours, and that figure has stayed pretty flat for quite a number of years now despite the belief that it's just over the horizon. There's this great opportunity there that just has not materialized, except for maybe a number of large corporations.

So I think that, again, the fact that in the past—in the recent past—that they did take some tangible action only when they thought we were ready to act, I would believe that even now to the extent that conditions are not worse is that the Chinese leaders realized that, if they want to maintain the relationship they have now, that they need to place some limit on what they do because that threat is still there. So I think that's another factor to take into consideration.

Mr. PORTMAN. Thank you. I've got two minutes to literally run to vote. I apologize I can't stay, but Chairman Houghton will take over.

Mr. HOUGHTON [presiding]. All right. Good morning, gentlemen, thank you very much. I'm sorry I wasn't here for your testimony. Do you have anything else to add? I'd be delighted to hear it. If not, we'll move on to the next panel.

Mr. O'BRIEN. Just one interesting anecdote. This whole terminology on underground, clandestine church, everybody knows where all of the unregistered churches are. A Chinese pastor who boasts of having the largest unregistered church in China is in Guangzhou. His church meets on the second floor of a building,

right over the police station. And everybody knows everything that's going on. We really need to get past some myths. There's enough smoke to know there's fire in places; it's true in a lot of places. But I think it's in our best interest and theirs to get inside the Middle Kingdom mind set and be encouragers and affirmers where we can.

Mr. DANNENFELSER. If I could add from a Catholic perspective, my colleague here mentioned that the Holy Father is not permitted to appoint bishops in China with regard to the patriotic association, and that is true, but I think you need to understand the complexity of this. One prelate in China estimated that 70 percent of the patriotic association bishops have made private vows of obedience to the Holy Father, and this was evidenced recently when the Vatican invited two patriotic association bishops to attend the Asian Synod of Bishops that was held in Rome several weeks ago.

And the whole posture of the Vatican with regard to the patriotic association and the underground Catholic church is to encourage a reconciliation between the two, and not an isolation and a continuation of the breach.

Mr. HOUGHTON. That's very helpful, thank you. Anybody else?

Mr. DANNENFELSER. If I could add one or two quick things, following up on the question that Congressman Portman asked a few minutes ago. I think a real problem with our current policy is that we seem to have only additional incentives in our dealings with China. There is really no application of a disincentive. And even when they commit abuses, at least on the President's part, his answer seems to be, well let's give them new incentives to comply with the agreement that they just violated.

So it almost creates a situation where that benefits them to violate these agreements to get another incentive. And I think that that is really troublesome situation, and I think a balanced policy where they think that there is some penalty for egregious behavior, would, I think, give them some reason to pause when they contemplate doing some of the more undesirable things.

Mr. HOUGHTON. Have you got anything to add, Mr. Craner?

Mr. LORNE CRANER. I would add two things. No. 1, I don't disagree with the last statement by my colleague, but in addressing——

Mr. HOUGHTON. Which colleague?

Mr. LORNE CRANER. My colleague, Mr. Dannenfelser.

Mr. HOUGHTON. All right, I see. Thank you.

Mr. LORNE CRANER. But in addressing the issue of isolating China, I don't think we have to speculate about what it would do. We can look at some fairly recent history, and that is the period from 1949 to about 1969. China was largely isolated from the rest of the world. Internally, it stumbled from a communist revolution to the cannibalism of the Cultural Revolution, and in those twenty years we had to fight China twice, in Korea and then to a degree in Vietnam.

By contrast, we began to engage China in about 1969 to 1972. I think anybody who went there then, or even in the 1980s, as Congressman Portman did, would not recognize China today. So I think, we don't need to speculate on whether isolating China helps

it internally or makes it a greater enemy. I think we have history to show us the answer there.

Mr. HOUGHTON. Okay. Well, thank you very much. I appreciate your time, gentlemen, and your wisdom. Now we'll have another panel. And that panel will consist of, unless there are any changes, Mr. Hall, Mr. Holwill, Mr. Kapp, and Barbara Shailor.

Well, okay, I'm not going to apologize for the discrepancy of the number of bodies here and the in-and-out votes, because we always do this. It's always the pattern down here. But in any event, this is an important issue. We're delighted you're here. We're sorry you had to wait so long. But let's go right into this. Maybe we'll start with Mr. Hall.

**STATEMENT OF CHRISTOPHER HALL, DIRECTOR, INTERNATIONAL BUSINESS, CINCINNATI MILACRON, ON BEHALF OF THE SOCIETY OF THE PLASTICS INDUSTRY, INC.**

Mr. HALL. Thank you. Mr. Chairman, it is indeed a pleasure to speak to you today on behalf of the Society of the Plastics Industry, known as SPI, and Cincinnati Milacron in support of renewing most-favored-nation status for China. I appreciate this opportunity to present the views of SPI, and those of Milacron.

The Society of the Plastics Industry is a trade association of more than two thousand members, representing all segments of the plastics industry in the United States. SPI's business units and committees are composed of plastics processors, raw material suppliers, machinery manufacturers, mold makers, and other industry-related groups and individuals. U.S. manufacturers of plastics raw materials, products, machinery, and molds directly employ more than 1.3 million workers and ship more than 274 billion.

Plastics products rank fourth among the top manufacturing industry groups in shipments, only behind motor vehicles, petroleum refining, and electronics. Cincinnati Milacron is a global leader in plastics processing machinery, mold-making equipment, machine tools, and other industrial products, with 1997 sales of 1.9 billion. Based in Ohio, Milacron employs more than 13,000 in 30 plants in North America and Europe, with joint ventures and licensees for manufacturing and marketing in Asia and South America.

I have been with Cincinnati Milacron for more than 30 years, with direct responsibility for Milacron's international business and the company's China operations for several years. Growing and shaping a company's international business is certainly a challenge, but a necessary one in today's global marketplace.

International trade continues to play an increasingly important role, not only for Cincinnati Milacron but also for the entire plastics industry. As plastics industry exports continue to grow, so do the industries' export-related jobs. International trade accounted for more than 118,000 plastics industry jobs in the United States—plastics raw material, products, and machinery industries in 1996, a 22 percent increase in four years. More than 14 percent of overall plastics industry employment are directly related to the industry's exports.

International business for Cincinnati Milacron has also increased significantly in the past several years, accounting for 43 percent of

our business and creating thousands of jobs in Ohio, around the country and the world.

There is no doubt that China is an important market, both for my company and for the U.S. plastics industry. U.S. exports of plastics raw materials and products to China ranked seventh out of all U.S. exports in 1997, and have increased 94 percent in five years, to more than 432 million. U.S. exports of plastic resins, products, and machinery to China alone accounted for nearly 3,000 jobs in the U.S. in 1997.

Cincinnati Milacron's presence in China also has grown considerably in recent years with exports of machinery and tools to China, which is a significant part of our business. We have offices and employees in the cities in China of Beijing, Shanghai, and Guangzhou. We estimate that our China sales account for more than 100 jobs throughout the company. But this is only the tip of the iceberg. Milacron's many suppliers, most of which are small businesses and rely heavily on their Milacron business, benefit significantly from our business with China.

Fifty-five supplying companies provide more than 85 percent of Milacron's purchases, totaling more than 400 million annually. A business relationship with Cincinnati Milacron can represent 50 percent, or up to 10 million dollars of sales for these small to mid-size companies, the core of their business success. Supplying companies such as CastFab Technologies and Dayco are critical in meeting the needs of both our domestic and our Chinese customers.

Milacron also has a responsibility to service and respond to our U.S. customers already in China. Some of the Cincinnati Milacron plastics equipment currently in use in China are owned by U.S. companies such as Lear and Kodak. These companies need to know that their U.S. supplier can deliver top-quality service. This type of quality customer service requires that we have Cincinnati Milacron employees located in China, to make sure that our U.S. customers are——

Mr. HOUGHTON. Mr. Hall, could I just interrupt a minute? The red light is on. Now, if you want to continue, that's perfectly all right by me. We're going to try to keep it in reasonable segments here, but go right ahead.

Mr. HALL. Okay, just a couple more minutes, I think we can wrap up. Thank you, Mr. Chairman.

In addition to the suppliers located in the United States and the U.S.-based customers network in China, Milacron has developed relationships with Chinese-European joint ventures, providing the opportunity for our company to break into the often difficult-to-penetrate European market. Furthermore, our success and presence in China is related to our business interests in the entire Asian region. Milacron's presence in Japan, Singapore, and other Asian countries is linked to our business in China, the largest economy in the region. We want to, we need to continue our expansion into the Asian markets, and we need unencumbered access to the Chinese market to do that.

Cincinnati Milacron and the Society of the Plastics Industry strongly support renewing most favored nation status for China. I will be the first to admit that gaining access to the Chinese market and expanding there is not easy. A high value-added tax on plastics

machinery, excessive bureaucratic red tape, and intellectual property rights concerns can discourage companies from tackling the Chinese market.

While it may often be daunting, Cincinnati Milacron believes that China is critical for our continued growth, both domestically and internationally. If trade barriers are to be lowered, we must continue the dialogue between our two countries, to make sure that even more U.S. products reach Chinese customers. The Society of the Plastics Industry believes strongly, and so do we, that to promote an improvement in China's human rights practices, the United States should encourage an environment in which China accomplishes political reform on its own behalf.

I do know that in Milacron's 25 years in the China market, we have seen radical changes for the better. We have seen a dramatic increase in the standard of living of the Chinese consumer. We have witnessed a greater openness to our company and U.S. business in general. I firmly believe that if the United States cracks the MFN whip, we will pay through a loss of sales and jobs, and our competitors from Europe and other Asian countries will benefit as a result. The United States, no matter what it does, cannot stop China from growing, but we must choose whether we will be part of it or whether we will be watching from the sideline.

Cincinnati Milacron hopes to there playing, and leading, in the game to expand our China business and grow our U.S. job base as a result. We urge you and your colleagues to vote against House Joint Resolution 121, which would disapprove extending MFN treatment to China, and we urge you to support the United States' continuing a dialogue to improve the business ties between our two nations.

Thank you, Mr. Chairman, for allowing Cincinnati Milacron and the Society of Plastics Industry to express our views. I would be pleased to take any questions you have.

[The prepared statement follows:]

**Testimony of Christopher Hall,**

**Director, International Business,**

**Cincinnati Milacron,**

**Before the House Ways and Means Committee,**

**Subcommittee on Trade**

***On behalf of The Society of the Plastics Industry, Inc.***

**Wednesday, June 17, 1998**

Mr. Chairman, it is indeed a pleasure to speak to you today on behalf of The Society of the Plastics Industry, Inc. (SPI) and Cincinnati Milacron in support of renewing Most Favored Nation trading status for China. I appreciate this opportunity to present the views of SPI and those of Cincinnati Milacron.

The Society of the Plastics Industry, Inc. is a trade association of more than 2,000 members representing all segments of the plastics industry in the United States. SPI's business units and committees are composed of plastics processors, raw material suppliers, machinery manufacturers, moldmakers and other industry-related groups and individuals. U.S. manufacturers of plastics raw materials, products, machinery and molds directly employ more than 1.3 million workers and ship more than $274 billion. Plastics products rank fourth among the top manufacturing industry groups in shipments – only behind motor vehicles, refining and electronics.

Cincinnati Milacron is a global leader in plastics processing machinery, moldmaking equipment, machine tools and other industrial products, with 1997 sales of $1.9 billion. The

Ohio-based company employs more than 13,000 in 30 plants in North America and Europe, with joint ventures and licensees for manufacturing and marketing in Asia and South America.

I have been with Cincinnati Milacron for more than 30 years, with direct responsibility for Milacron's international business and the company's China operations for several years. Growing and shaping a company's international business is certainly a challenge but a necessary one in today's global marketplace.

International trade continues to play an increasingly important role not only for Cincinnati Milacron but also for the entire plastics industry. As plastics industry exports continue to grow, so do the industry's export-related jobs. International trade accounted for more than 118,000 plastics industry jobs in the U.S. plastics raw material, products and machinery industries in 1996, a 22 percent increase in four years. More than 14 percent of overall plastics industry employment are directly related to the industry's exports. International business for Cincinnati Milacron also has increased significantly in the past several years, accounting for 43 percent of our business and creating thousands of jobs in Ohio, around the country and the world.

There is no doubt that China is an important market both for my company and for the U.S. plastics industry. U.S. exports of plastics raw materials and products to China ranked seventh out of all U.S. exports in 1997 and have increased 94 percent in 5 years to more than $432 million. U.S. exports of plastics resins, products and machinery to China alone accounted for nearly 3,000 U.S. jobs in 1997.

Cincinnati Milacron's presence in China also has grown considerably in recent years, with exports of machinery and tools to China a significant part of our business. We estimate that our China sales account for more than 100 jobs throughout the company.

But this is only the tip of the iceberg. Milacron's many suppliers, most of which are small businesses and rely heavily on their Milacron business, benefit significantly from our business with China. Fifty-five supplying companies provide more than 85 percent of Milacron's purchases, totaling more than $400 million annually. A business relationship with Cincinnati Milacron can represent 50 percent or up to $10 million of sales for these small- to mid-sized companies, the core of their business success. Supplying companies such as CastFab Technologies, Vickers Electronic Systems and Dayco are critical in meeting the needs of both our domestic and our Chinese customers.

Milacron also has a responsibility to service and respond to our U.S. customers already in China. Some of the Cincinnati Milacron plastics equipment currently in use in China are owned by U.S. companies such as Lear, PepsiCo and Kodak. These companies need to know that their U.S. supplier can deliver top quality service. This type of quality customer service requires that we have Cincinnati Milacron employees located in China to make sure that our U.S. customers are up and running at all times.

In addition to the suppliers located in the United States and the U.S.-based customer network located in China, Milacron has developed relationships with Chinese/European joint ventures, providing the opportunity for our company to break into the often difficult-to-penetrate European market. Furthermore, our success and presence in China is related to our business interests in the entire the Asian region. Milacron's presence in Vietnam, Japan, Singapore and other Asian countries is linked to our business in China, the largest economy in the region. We want to – need to – continue our expansion into the Asian markets, and we need unencumbered access to the Chinese market to do that.

Cincinnati Milacron and The Society of the Plastics Industry strongly support renewing most-favored-nation status for China. I will be the first to admit that gaining access to the Chinese market and expanding there is not easy. A high value-added tax on plastics machinery, excessive bureaucratic red tape and intellectual property rights concerns can discourage companies from tackling the Chinese market. While it may often be daunting, Cincinnati Milacron believes strongly that China is critical for our continued growth, both domestically and internationally. If trade barriers are to be lowered we must continue the dialogue between our two countries to make sure that even more U.S. products reach Chinese consumers.

The Society of the Plastics Industry believes strongly – and so do we – that to promote an improvement in China's human rights practices, the United States should encourage an environment in which China accomplishes political reform on its own behalf. While conditioning the renewal of China's MFN trading status to human rights issues or others has laudable goals, we feel it would be counterproductive and harmful to both countries.

I do know that in Milacron's 25 years in the China market, we have seen radical changes for the better. We have seen a dramatic increase in the standard of living of the Chinese consumer. We have witnessed a greater openness to our company and U.S. business in general. I firmly believe that if the United States cracks the MFN whip, we will pay through a loss of sales and jobs and our competitors from Europe and other Asian countries will benefit as a result. The United States, no matter what it does, cannot stop China from growing, but we must chose whether we will be a part of it or will be watching from the sidelines.

Cincinnati Milacron hopes to be there playing – and leading – in the game to expand our China business and grow our U.S. job base as a result. We sincerely hope that the current politically charged environment surrounding MFN doesn't translate into a serious threat against

that. We urge you and your colleagues to vote against House Joint Resolution 121, which would disapprove extending MFN treatment to China and support the United States continuing a dialogue to improve the business ties between our two nations.

Thank you, Mr. Chairman, for allowing Cincinnati Milacron and The Society of the Plastics Industry to express our views on most-favored-nation trade status for China. I would be pleased to take any questions you may have.

Mr. HOUGHTON. Okay, well, thanks very much, Mr. Hall. I think we can wait until the end for the questions.

Now Mr. Holwill.

**STATEMENT OF RICHARD HOLWILL, DIRECTOR, INTERNATIONAL RELATIONS, AMWAY CORPORATION, AND CO-CHAIRMAN, ASIA TASK FORCE, U.S. CHAMBER OF COMMERCE, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE**

Mr. HOLWILL. Mr. Chairman, I am Richard Holwill, director of international affairs for the Amway Corporation, but I have the honor today of testifying on behalf of the U.S. Chamber of Commerce. I'm a member of the International Policy Committee and co-chairman of the Asia Task Force of the Chamber. I have submitted my testimony for the record. I have a summary here, but in the interest of time I'll attempt to summarize the summary for you.

We believe that expansion of U.S. trade is vital to America's economic future. The economy of China has experienced explosive growth in recent years, and it has tremendous potential for the future. The estimates of China's infrastructure requirements and the potential of its huge domestic market help to make China a top international priority for many U.S. companies during the 1980's and 1990's.

The members of the U.S. Chamber are eager to pursue these opportunities in the marketplace in China, particularly given the aggressive efforts of our European and Asian competitors there. Last year, the United States exported approximately 12.8 billion dollars in goods to China. These were, by and large, high-paying, that is, they supported hundreds of high-paying jobs in the United States, jobs that pay on average 10 to 15 percent more than domestic jobs. In 1997, China bought more than 1.6 billion in U.S. agricultural exports.

Withdrawing MFN is simply not a viable option. It would put these jobs at risk. Without MFN, tariffs on U.S. imports from China would dramatically increase, anywhere from 10 to 70 percent more. These tariff hikes would impose a tax of at least 300 dollars on the average American family. And if China were to lose MFN status, it would have a legal right and every reason to retaliate against U.S. exports, putting at risk billions of dollars of U.S. sales.

The recent economic growth in China has largely been fueled by this explosive surge of exports to the United States and other countries. Our bilateral trade deficit has grown steadily in the 1990's to a total of over 50 billion dollars last year. Expansion of our exports to China is the only viable way to reduce the trade deficit.

The actual challenge facing the United States is to move away from this ritualized debate over MFN, and to remove the barriers to trade. We believe that these annual debates on China's MFN status are counterproductive, because they distract from the more important issue of bringing China into the World Trade Organization. U.S. products face formidable market barriers in China. The present commercial environment is difficult for U.S. companies. It makes it hard for us to compete and to prosper. While MFN cannot address these issues, they are appropriate topics for consideration in the context of China's bid to join the WTO.

The challenges for the U.S. government are to bring China, one of the world's fastest growing trading nations, into the WTO, where it will be obliged to adhere to international standards and norms. WTO accession on commercially viable terms offers the best opportunity for securing vital access to this market.

Looking at our annual MFN exercise, China is rightly concerned that the U.S. Congress may not agree to permanent MFN, even in the context of a WTO accession agreement. Thus, Chinese negotiators appear cynical about the benefits to them of making concessions when it appears that the entire package might be rejected by this Congress. Therefore, we urge members of Congress to consider the vote on MFN in this context, and to send a strong signal that permanent MFN is a desirable option in the near future, particularly in context of measurable progress on WTO accession.

We further believe that expanding economic cooperation with China will have ancillary benefits in the area of human and worker rights. U.S. companies operating in China establish benchmarks for corporate practices in such critical areas as personnel management, corporate citizenship, fairness, and equal opportunity.

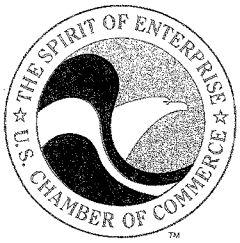
The recent experience of the Amway Corporation in China can serve as a case study of this phenomenon, and of the potential, the problems, and the manner in which progress can best be made in China. We opened there in 1995 and by 1997, our sales to China exceeded 178 million dollars. Our direct-selling system enabled Chinese citizens to establish their own businesses and control of their future in a way never before possible. In April of this year, the Chinese government imposed a ban on direct selling that was intended to eliminate fraud, but also threatened to put us and our Chinese citizen partners out of business.

I just returned from Beijing and can say that we've resolved most, but not all, of the outstanding issues there. We found officials open to reason and willing to work with us to resolve these difficult issues. We believe we will be able to reopen in the very near future. I would point out that we proposed to the Chinese government a series of international standards that would permit them to protect their citizens, while permitting us to offer that business opportunity. They were interested in these international standards far more than any solution that bore a made-in-the-USA label.

As a practical matter, we require a fair degree of goodwill to operate successfully in China. If Congress terminates MFN status for China, it will have effectively put us out of business. If, as we expect, we gain permission from the Chinese government to resume operations, it would be ironic, indeed tragic, if then the U.S. Congress killed our business.

Mr. Chairman, that concludes my remarks. I look forward to your questions.

[The prepared statement follows:]




# Statement of the U.S. Chamber of Commerce

**ON:** U.S.-CHINA TRADE RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS

**TO:** SUBCOMMITTEE ON TRADE OF THE HOUSE COMMITTEE ON WAYS AND MEANS

**DATE:** JUNE 17, 1998

**BY:** RICHARD HOLWILL

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 71 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- numbers more than 10,000 members. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 83 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. Currently, some 1,800 business people participate in this process.

**STATEMENT**
**on**
**U.S.-CHINA TRADE RELATIONS AND**
**RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS**
**before the**
**SUBCOMMITTEE ON TRADE**
**of the**
**HOUSE COMMITTEE**
**ON WAYS AND MEANS**
**by**
**Richard Holwill**
**June 17, 1998**

Thank you, Mr. Chairman, for allowing me to testify before this Subcommittee on Trade. I am Richard Holwill, Director of International Relations for Amway Corporation, a U.S. company well known to you all for its quality products and tradition of utilizing a direct selling system to encourage people in the United States and other countries to succeed by owning their own businesses. Amway has proudly maintained a partnership with its distributors for almost 40 years. This partnership has enabled the company to grow from operations in the basement of a home of one of the founders into a multinational enterprise with annual retail equivalent sales nearing $7 billion.

Today, I am appearing on behalf of the U.S. Chamber of Commerce. I am an active member of the U.S. Chamber's International Policy Committee and serve as Co-Chairman of its Asia Task Force. The U.S. Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. I appreciate this opportunity to present the U.S. Chamber's views on trade relations with China and the renewal of China's Most-Favored-Nation(MFN) trading status.

At the outset, Mr. Chairman, let me state that the U.S. Chamber is committed to building support for full normalization of the U.S.-China commercial relationship. The U.S. Chamber supports permanent and unconditional extension of MFN trading status for China, China's entry

into the World Trade Organization (WTO) under commercially viable terms, and the removal of unilateral economic sanctions on China. It is the U.S. Chamber's policy to build a solid commercial foundation for our relationship with China, which will encourage cooperation on the full range of issues in our bilateral relationship, from security and nonproliferation to human rights.

**Upcoming U.S.-China Summit**

While the bulk of my testimony is devoted to the question of China's MFN status, let me comment on the upcoming summit between President Clinton and President Jiang Zemin. President Clinton is preparing to make the first visit of a U.S. President to China in nearly a decade. The summit represents an opportunity to focus attention on the multifaceted relationship we have with China and the many areas on which we cooperate for mutual benefit. During the U.S.-China summit, our leaders will discuss security, trade, energy and the environment, human rights, and other issues that affect our ties with China. While we may not agree with all of China's policies, high-level engagement allows us to make progress on those areas where we cooperate with China and express our views on those areas where we disagree. We also believe that stronger high-level dialogue over the last several years may well have prevented some of the miscalculations and problems that have occurred.

Most recently, these problems include allegations of improper technology transfers and fundraising improprieties. These are serious questions that deserve answers. National security is a matter of paramount importance. While we support a full investigation into these matters, we hope Congress will not take steps to damage our overarching strategic relationship with China as the investigation proceeds. We were encouraged by the letter that Speaker Gingrich, Chairman Archer, and the distinguished Chairman of this Subcommittee, Mr. Crane, sent to President Clinton, indicating their belief that while investigation of alleged improprieties is important, termination of China's MFN status would be a far too draconian and detrimental a response.

**Overview of U.S.-China Commercial Ties**

Expansion of U.S.-China trade is vital to America's economic future. The economy of China has experienced explosive growth in recent years, and its potential is impressive. The estimates of China's infrastructure requirements and the potential of its huge domestic market helped to make China the top international priority for many U.S. companies during the 1980s and early 1990s. Member companies of the U.S. Chamber are eager to pursue opportunities in the Chinese market, particularly given the very aggressive efforts of our European and other Asian competitors. By implication, these companies' vendors and suppliers have vested interests in the Chinese market as well.

The U.S. Chamber has worked to facilitate business development through dialogue with policymakers in China, through events at the U.S. Chamber, and through business-to-business conferences. For example, the Chamber recently partnered with the State Chamber in Oklahoma to organize a conference on business opportunities in China. The conference was held in Oklahoma City, not the first place you think of when you think of U.S.-China trade. Yet judging by the level of participation—over 300 attendees including senior corporate executives, Chinese and U.S. government officials—the event was a huge success.

The Oklahoma conference was just one of the Chamber's efforts to increase public understanding of the commercial opportunities in China. In January 1997, the U.S. Chamber launched a multi-year education campaign to build domestic support for international trade. Armed with its extensive grassroots network, the Chamber is drawing on its state and local chamber of commerce affiliates as well as small and medium-sized member companies to strengthen public understanding of the importance of the U.S.-China commercial relationship.

This effort has helped to underscore that it is not only large U.S. companies like Amway that will benefit from a more stable U.S.-China relationship. When the U.S. Chamber testified before this subcommittee last June, it released the results of a nationwide survey of small business trade and investment with China. That survey showed that small business has a major stake in

U.S.-China trade, and that trade with China is not the exclusive province of large multinational companies. Currently, U.S. companies of all sizes struggle in China with inconsistent rules and regulations, a lack of transparency, unclear divisions of authority among national, provincial, and local officials, and difficulties in local contacts. But it is worth noting that the state of U.S.-China relations was cited as a key factor in the confidence of these companies to do business in China.

**Renewal of Most-Favored-NationStatus for China**

On June 3, 1998, President Clinton decided to request a renewal of MFN for China without conditions. In taking this action, the President appropriately recognized that the United States should pursue a policy of "engagement" with China that advances long-term U.S. commercial, strategic, and national security interests.

The U.S. Chamber strongly supports permanent and unconditional extension of China's MFN status. While the title implies a favored status, MFN is not a special privilege. MFN is in fact the routine, nondiscriminatory tariff treatment enjoyed by all but six countries in the world. The United States should not use China's MFN status as a means to "send a message" on Taiwan, human rights, market access concerns, arms proliferation or other issues. Instead, the United States should continue the policy of comprehensive engagement with China which recognizes our vital interest in maintaining regional stability, preventing weapons proliferation, fostering democratic ideas and working towards fair and free trade.

It is clear that expanding U.S.-China trade is in America's economic interest. Last year, the United States exported approximately $12.8 billion in goods and services to China. These exports support hundreds of thousands of high-wage American jobs. And these are jobs that pay on average 10% to 15% higher than domestic jobs. U.S.-China trade also supports tens of thousands of jobs at ports, retail establishments, and consumer good companies. China is a crucial market for American farmers. In 1997, China bought about $1.6 billion in U.S. agricultural products, making China the sixth largest export market in the world for American farmers. Moreover, according to World Bank estimates, China must invest around $750 billion in infrastructure development over

the next decade. As China embarks on its massive infrastructure program, it will spend billions of dollars in sectors in which U.S. firms are very competitive. Over the next decade, China will be an important market for members of the U.S. Chamber that export high technology equipment, aerospace, telecommunications, petroleum technology, agricultural products and consumer goods.

American consumers and small shop owners also benefit from trade with China. Without MFN, tariffs on U.S. imports from China would dramatically increase by 30-50% or more. These tariff hikes would impose **a tax increase of at least $300 on the average American family**, which would fall hardest on low-income and working households who would pay more for high-quality consumer goods such as apparel, footwear, and toys. Small and medium-sized American companies selling these goods would also be hard hit.

Withdrawing MFN is simply not a viable option. It would put American trade and jobs at risk. If China were to lose MFN status, China would have a reason to retaliate against U.S exports, putting at risk billions of dollars of U.S. sales and thousands of American jobs. Even limited sanctions linked to matters that are not trade-related place U.S. companies at a competitive disadvantage, since none of China's other major trading partners imposes such conditions on trade.

We further believe that expanding economic cooperation with China is in our broader national interest. It has fostered and accelerated dramatic economic reforms, which are in turn generating internal political reforms in China. U.S. Chamber members help to promote fundamental rights wherever they operate by establishing benchmarks for corporate practice in such critical areas as personnel management, corporate citizenship, fairness and equal opportunity. Many U.S. Chamber members have also made their commitments explicit through a corporate statement of principles. U.S. Chamber members have been, and will continue to be, forces for positive change in China.

Some critics argue that by renewing China's MFN status, the United States ignores China's human rights record. We strongly disagree. Removing MFN will not lead to progress on human rights. It would erode our economic relationship, harm those forces in China which are most

sympathetic to political reform, and isolate those Chinese officials who argue for an improved relationship with the United States. The end result would be to increase the power of hard-liners who favor stronger government control. The U.S. Chamber and all others who support human rights should recognize that the best way for the United States to see a prosperous, free China is for U.S. companies to stay commercially engaged. Commercial engagement is not a panacea that will solve all the problems of the world, but the human impact of engagement is clearly positive.

Allow me to tell the Subcommittee about Amway's recent experience in China. The company has been involved in China since 1995. In 1997, our last complete fiscal year, Amway sales in China exceeded $178 million. Please note that these are sales within China and included a very substantial quantity of exports from the United States. Until recently, we used the same direct selling system in China that we use in the rest of the world. Through it we offered business opportunities to average citizens who had little or no other prospect of economic betterment. However, in April of this year, the Chinese government imposed a ban on all direct selling. That ban, which was imposed to crack down on fraud, also threatened to put legitimate companies like us and our Chinese citizen distributor partners out of business.

Since the imposition of the ban, Amway has been working with the Chinese government to find a solution that protected their citizens from fraud while permitting Amway and other direct selling companies to continue to provide opportunity to Chinese citizens. I want to stress that we in Amway had great support in this effort from the Administration, the U.S. Embassy in Beijing and, in particular, U.S. Trade Representative Charlene Barshefsky and her excellent team.

I just returned from Beijing and can say that we have resolved most but not all of the outstanding issues. We found officials there open to reason and willing to work with us to resolve difficult issues. At this point, I do not know if these efforts will succeed or fail, but I can tell you without equivocation that we strongly support MFN for China.

As a practical matter, we require a fair degree of good will to operate successfully. If Congress terminates MFN status, it will have effectively put us out of business in China. If, as we

expect, we gain permission from the Chinese government to continue operating, it would be ironic-indeed tragic—if the U.S. Congress then killed our business.

**China's Accession to the World Trade Organization**

We believe the annual debate on China's MFN status is counterproductive because it distracts us from the more important issue of negotiations to bring China into the World Trade Organization (WTO). China's growing trade surplus with the U.S. is a matter of serious concern. U.S. products face formidable market barriers in China and the present commercial environment in China makes it difficult for U.S. companies to compete and prosper. The recent experience with the ban on direct selling, for example, highlights the need to strengthen the rule of law and to provide for transparent rulemaking procedures that include consultation with industry before and not after an edict is issued. China has taken some positive steps to open up its market but it needs to do more. It has reduced tariffs but should lower them further. It has strengthened trading rights and provided intellectual property rights protection but it must institutionalize a mechanism of judicial review.

While MFN cannot address these issues, they are appropriate topics for consideration in the context of China's bid to join the WTO. The challenge the U.S. government faces is to secure strong multilateral discipline on one of the world's fastest growing trading nations. The commitments made by China in the WTO accession negotiations offer a genuine opportunity to secure access to China's markets.

The Chamber hopes to see China become a member of the WTO, but only on terms that offer U.S. firms commercially viable access to that market. Before the U.S. Chamber can support China's accession into the WTO, China must:

- bring its trade regime into conformance with WTO Agreements and Disciplines;

- extend national treatment on all goods and services to foreign companies that want

to invest in China;

• sign the WTO Government Procurement Code;

• provide market access for textiles and agricultural products (where China uses standards and certification requirements as barriers to trade);

• reduce export subsidies;

• ensure protection and market access for U.S. intellectual property goods and services;

• liberalize access to its foreign exchange system for foreign exporters and investors;

• apply the provisions of the WTO uniformly throughout China;

• eliminate restrictions on who may import or export products or services to and from China; and

• expand distribution rights of U.S. exporters and investors in China.

China may deserve some latitude in making the transition to a market economy. But the U.S. Chamber supports the Administration in insisting that China adhere to basic WTO obligations, take "significant" steps forward on market access for goods, services, and agriculture, and agree to apply international trade rules and disciplines. We are concerned that China has a long way to go on such fundamental issues as the rule of law, transparency of its regime, uniform application of trade rules and distribution rights. We strongly believe that until the Chinese make concrete commitments that will allow U.S. companies a stronger foothold in that market, the U.S. Chamber cannot support China's membership in the WTO.

China has earned international praise for the responsible role it has played to date in addressing the Asian financial crisis. By maintaining its currency at a stable value, China has helped to avert another round of competitive currency devaluations. It is worth noting that China has done this at great expense to its own exports. China can earn additional praise by committing to international norms of fair trade. Looking at our annual MFN exercise, China is concerned that the U.S. Congress may not agree to permanent MFN even in the context of a WTO accession agreement. Thus Chinese negotiators appear cynical about the benefits to them for making concessions that might be rejected by Congress. We urge Members of Congress to consider the vote on MFN in this context and to send a strong signal that permanent MFN is a desirable option in the very near future, particularly in the context of measurable progress on WTO accession.

Mr. Chairman, the integrity of the WTO system is at stake in China's WTO negotiations. Final accession terms will doubtless be used as a benchmark for accession negotiations for Russia, Ukraine, Vietnam and other economies that are still in the early stages of a difficult transition from a centrally planned to a market economy. Each of these countries, including China, will be tempted to reverse market reforms in the face of political or economic uncertainties that are virtually certain to occur in the process of market transition. China, in particular, is in the midst of a wholesale revamping of its state owned enterprise system. As a consequence, we believe that the terms of WTO accession should be defined carefully to ensure that reforms in international trade policies are secure from threats to the reform process.

**Conclusion**

The U.S. Chamber strongly supports permanent extension of MFN status to China. Extending permanent MFN status to China would strengthen U.S.-China commercial ties to the benefit of American business and workers. It would also provide a positive basis for U.S.-China dialogue on human rights, weapons proliferation and security matters, and strengthen cross-cultural ties and awareness of American cultural and political values.

The U.S. Chamber believes that a great deal hangs on the multilateral negotiations with

China. China is one of the largest countries in the world and the terms of China's accession must expand market access for U.S. companies; strengthen China's commitment to the rule of law; and reflect a commitment to apply market rules and fair competition in accordance with the WTO and its economic stature.

Mr. Chairman, this concludes my formal presentation. Thank you. I would be happy to respond to any questions.

Mr. HOUGHTON. Thank you, Mr. Holwill. Again, we're going to wait for the end to have questions.

Mr. Kapp.

**STATEMENT OF ROBERT A. KAPP, PRESIDENT, UNITED STATES-CHINA BUSINESS COUNCIL**

Mr. KAPP. Mr. Chairman, thank you. I will be very brief. Knowing that I might be coming to this hearing near the end of the day, I decided that I wouldn't try to repeat verities that others had said before. I've associated myself and the U.S.-China Business Council with many of the very constructive remarks that have been offered by other participants in the hearing today.

I have chosen instead in this material to try to get us down to the inescapable reality that it's time to get rid of annual MFN. We are now in the ninth year, I think it is, of this exercise. We went through 10 years in which Congress said nothing about MFN annually, between 1980 and 1989, but for the last nine years we've been going through an exercise which is essentially doomed to perpetual fruitlessness, because it is misdirected.

It stems, as you know, Mr. Chairman, from the making of an act by the Congress in 1974 that was aimed to force the Soviet Union to permit the emigration of Soviet Jews. Emigration is not an issue with China. The Soviet Union is gone. The world has changed. Only the annual MFN exercise with China remains. It's time to finish it up.

MFN, as we all know, is not "Most Favored" anything. There are three or four of what I, perhaps a little bit too colorfully, call trade midgets around the world, with whom the United States does not maintain MFN relations. But for the rest, of course, the United States has MFN trade with one and all.

I have struggled to come up with something new to say to break through some of this thick and seemingly perpetual fog, and this year I've decided to come up with the analogy of the pit stop.

We are engaged in a long and complex challenge in managing and accommodating ourselves to the arrival of China for the first time in our history as a major player in the world of global economics and global power. It is a long and difficult struggle with a nation that has not played that role before in the modern era. There are, as Mr. Holwill and everyone else experienced with China will attest, many difficulties and many areas of conflict and friction.

In a situation like that, whose rhythms are not governed by the annual calendar of Jackson-Vanik, it seems to me that if we have to deal with MFN at all, it should be as a necessary but routine maintenance stop, and nothing more. You cannot compete in the entire race, you cannot win the race, if you don't change the wheels, fill the tank, and top off the radiator along the way.

Let's not load MFN down with the intellectual and moral baggage, and the strategic baggage, that we go through every year in these discussions. This is a humble, unglamourous trade matter. It is obsolete to begin with, but as long as we're stuck with it should be treated as a humble and unglamourous trade matter and nothing more.

I would just paraphrase by saying that MFN is about maintaining the most basic, lowest common denominator standard of civility

in the economic and non-economic relations of two great nations, each a major trade and economic partner of the other, and each possessed of the power to shape world events. That humble fact is the reason that Congress should sustain MFN and free itself from this annual burden at the earliest moment.

I did want to take a minute to thank your chairman, Chairman Crane, and his committee chairman, Chairman Archer, and of course the speaker, Speaker Gingrich, for their very constructive statement on MFN issued almost immediately after President Clinton announced his intention to renew MFN for the coming year. Permit me also to call your attention, and the attention of interested members, to the letter which Representative Curt Weldon, a member of the House National Security Committee, has circulated, first to fellow members of his committee and I think then to the House as a whole, making a very important distinction and maintaining the separateness—the clear separateness—of the MFN issue from the issues now under investigation regarding alleged breaches of United States military security that are being handled separately in the Congress. I think that's an important point.

To conclude, as I put it a little bit colorfully, the annual MFN debate sustains a cottage industry of publicists, advocates, political strategists, journalists, pundits, spinmeisters, and instant interpreters, all of whom should be given a chance to earn their living in other ways.

Thank you very much.

[The prepared statement follows:]

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**Testimony of Robert A. Kapp**
**President, United States - China Business Council**

**Trade Subcommittee, Committee on Ways and Means**
**U.S. House of Representatives**
**June 17, 1998**

**Introduction**

Mr. Chairman, members of the Subcommittee, thank you for inviting me to participate in this important hearing on the renewal of normal trade relations between the United States and China.

I am Robert Kapp, president of the US-China Business Council. Established in 1973, the Council is a private, nonprofit and nonpartisan association of nearly three hundred member US companies. Our main function is direct business advisory services to companies seeking to build their business relations with China. We publish The China Business Review, leading periodical on US-China business and economic affairs, as well as other papers. Our meetings and programs for member companies frequently include guests from the Congress, and our ongoing "China on the Hill" series offers opportunities for Members and staffers of single state delegations to the Congress to discuss the on-the-ground experiences of companies from that particular state who are active in China. I might thank both Committee Chairman Archer and Subcommittee Chairman Crane for working with the Council to hold "China on the Hill" sessions with Members and staffers from their respective states, and I would like urge other Members of this Subcommittee to consult with me on the possibility of similar sessions with them and their colleagues from their state's delegation to the Congress.

The US-China Business Council regularly analyses the US-China trade relationship and the Chinese business and investment climate. Rather than dwell on facts and figures in the body of this testimony, I append several Council documents that may help Members to review the growth and current dimensions of our trade and economic engagement with China.

**A Recent Council Commitment**

The Council has just celebrated its twenty-fifth anniversary, and on that occasion, June 2, we announced the establishment of the US-China Legal Cooperation Fund.

Member companies in our Council have pooled their voluntary financial pledges to form this Fund, whose purpose is to bring needed private sector support to programs now being developed in furtherance of the October 1997 commitments by President Clinton and President Jiang Zemin to enhance US-China cooperation in key building-block areas of the so-called "Rule of Law."

American business knows from experience at home and abroad that economic and social progress in any society depends heavily on the creation and application of a comprehensive, transparently arrived-at, impartially applied, and universally implemented system of laws and regulations.

We hope that our gesture of support for what we believe to be an important US-China cooperative program will encourage others, very importantly including the US Congress, to make available the resources necessary to carry out America's side of a growing list of US-China cooperative endeavors, of which long-term collaboration in the area of legal development is surely one of the most important.

**A Word About American Business's Role in China**

More generally, permit me to observe that US business represents America well in China. Having entered China with the opening of China's door by China's own government after 1978, American businesses in China now, in the course of conducting their operations and facing the challenges of the Chinese environment, are an intrinsic part of the historic transformation of China into a more outward-looking, globally engaged and more prosperous society capable of meeting the world on the world's terms. Over and beyond the well documented charitable and humanitarian commitments that many US companies have made and continue to make in China, the conduct of their operations according to their corporate worldwide standards of integrity and social responsibility deserve recognition by this body.

US companies do not engage with China for the purpose of transforming Chinese society or, for that matter, remaking Chinese politics in the image of any other country. Nor is the presence of US business in China a freestanding solution to the concerns that some Americans have over various aspects of China's internal affairs.

But it is not coincidental that the rapid growth of American business activity in China has corresponded with the rapid growth of China's modern economy, China's plunge into the mainstreams of global commerce and ideas, and the spectacular economic advances that have brought massive benefit to hundreds of millions of Chinese citizens. America's commercial engagement with China is a significant contributor, just as it is a beneficiary, of these changes, and the further growth of this commercial engagement should be viewed in the most positive light.

With that glowing affirmation out of the way, let me now turn to the less elevated issue of MFN.

**MFN Annual Renewal -- Again**

Mr. Chairman, I come before this Subcommittee for my fifth testimony on MFN. Again, controversy rages over US policy toward China. Again, Members are being asked to support a negative measure that would, if it became law, dismantle an entire carefully erected edifice of commercial, economic, and other relationships between the U.S. and China.

We urge the House to do as it has done year after year since the early 1990s: vote down the Resolution of Disapproval, and sustain the baseline trade relationship so vital to the achievement of US goals with China.

We are well aware that, for some Members, the annual debate over MFN renewal is more important than its outcome; that the annual debate provides the opportunity for lusty condemnation of Chinese behavior that some Members find unacceptable; that the annual debate offers an opportunity to "send China a message," that the annual MFN debate is a device for the working out of legislative-branch exasperation with the executive branch, whether over China or other matters; that the annual China go-round has implications in domestic and international policy circles far removed from US-China relations themselves.

Let me urge Members today to face instead the essential facts on the MFN exercise, and to sustain normal trade with China -- not as a grandiose gesture with profound philosophical overtones, not to "send a message" about something else -- but simply as a modest reaffirmation of an unspectacular, normal condition among two mature trading partners.

Here are the core considerations:

1. **The MFN debate over China gets nowhere year after year because it is misdirected**. The Trade Act of 1974 that requires annual renewal of MFN for non-market economies was designed specifically to force the now-defunct Soviet Union to permit Jewish emigration. Its key substantive concern is that the country in question permit emigration.

The Soviet Union is gone; emigration is not an issue with China. The Congress is left trapped in a box, if not of its own making, then at least forced upon it by the enormous historical changes of the past quarter of a century. The legislative basis for MFN is rooted in realities of another time and another world, and this annual bitter but unproductive exercise is the result.

In fact, the Congress for its own sake should face the facts of its dilemma and turn to the real common-sense task of moving out from behind the annual MFN 8-ball altogether.

We can go on like this indefinitely, if we have to, returning each spring, making familiar arguments or responding to new and ingenious charges. But surely this is not the best way to spend Congress's time.

2. **MFN is not "most favored" anything.** The term, like the Jackson-Vanik Amendment to the 1974 Trade Act, is a relic of another world. The term first came into the US-China relationship in the 1840s when, after the British won the Opium War against China and extracted a series of trade and other concessions from the Manchu dynasty in the ensuing peace treaty, the Americans steamed into the harbor and demanded the same concessions from China that had been given to the British -- i.e., treatment as favorable as that provided to the "most favored" nation trading with China!

Then, as now, "MFN" doesn't mean special treatment, or one-of-a-kind largess; it is instead the standard tariff treatment that a country applies to the incoming products of all other countries except those to whom it does not accord such standard treatment. For the U.S., the list of trade partners not receiving normal tariff treatment is minuscule, and consists of a few trade midgets worldwide. MFN with China simply means that China is not specially discriminated against in the application of US tariffs.

3. **As long as Congress does have to continue to take it up, annual MFN renewal ought to be seen as a pit stop -- nothing more -- in a long and grueling race.**

Keeping US-China trade and economic relations on an even keel by preventing their massive disruption through the canceling of MFN is like changing the tires, filling the tank, and topping up the radiator on a race car; doing it does not guarantee victory, but failing to do it virtually guarantees failure.

The real US challenge with China is much, much larger and longer-term, and it is not measured by the calendar of Jackson-Vanik deadlines. It is the challenge of responding to China's emergence as a major player on the world stage, and of maximizing American interests with China through the continued successful integration of a positive and influential China into the main currents of world affairs -- commercial and non-commercial. This historic challenge requires -- of us, of the Chinese, and of the world -- endurance, knowledge, strategic thinking, tactical flexibility, concentration, and a critical sense of change over time. All too often, US approaches to China demonstrate the opposite characteristics.

Toward all of this -- the real game in town -- the annual MFN imbroglio is simply misdirected. Particularly in the form it takes -- i.e., a vote to dismantle and destroy, which by definition offers its proponents the chance to encourage "Yes" votes with the darkest and most apocalyptic rhetoric -- the annual MFN exercise is profoundly inconsistent with a far-sighted and productive American approach to its real challenges with China.

4. **This recurrent MFN debate, framed this year by the outbreak of sensational and as-yet unproven allegations in other areas of US-China contact and by the imminence of the first trip by the first presidential visit to the world's most populous nation in almost a decade, may center around specific trade concerns in this Trade Subcommittee of the House Ways & Means Committee, but in the Congress as a whole it is only tangentially about trade.**

Instead, each year this debate becomes intertwined with broader and highly-charged issues, most of them not trade-focused at all: fidelity to American values, as defined by their various advocates; fidelity to

ethical or religious convictions intrinsically interwoven with controversial American social issues; even ownership of the prevailing diagnosis of the American condition and America's place in the world.

Once again, this is overloading a humble, even technical matter, which happens to be subject to annual Congressional review because of the 1974 Jackson-Vanik language, with baggage it cannot usefully carry. The question of normal tariffs on incoming Chinese goods is not about Good and Evil; it is not about rewarding the vicious and betraying the virtuous (nor, I might say, about rewarding the Good and harming the Bad).

MFN renewal is about maintaining the most basic, lowest-common-denominator standard of civility in the economic and non-economic relations of two great nations, each a major trade and economic partner of the other, and each possessed of the power to shape world events. That unglamorous fact is the reason that Congress should sustain MFN this year, and free itself from this annual burden at the earliest moment.

**5. In this regard, our Council was delighted that, within hours of the president's announcement that he would renew normal tariffs on Chinese imports, the chairman of this Subcommittee and the chairman of the full Ways & Means Committee joined with the Speaker of the House in assuring the president of their cooperation in support of continued standard tariffs.**

We have also been deeply impressed to note the message that Representative Curt Weldon, a member of the House National Security Committee, has circulated among his fellow Committee members for subsequent dispatch to all Members of the House, supporting MFN renewal on the grounds that a) MFN is a completely separate issue from the questions of military security that have recently received heavy House attention, and b) the security of the United States would not be well served by the undoing of the enormous economic relationship between the US and China that today brings so much benefit to both countries.

These are important statements, both as to the distinctiveness of the MFN issue amid other controversies, and as to the essential role that normal trade relations play in the working out of the larger US-China agenda. We congratulate these Members for their forthright comments, and hope that other Members throughout the House will associate themselves with these statements.

**Conclusion**

Mr. Chairman, let me sum up my testimony by saying this: the annual China MFN debate sustains a cottage industry of publicists, advocates, political strategists, journalists, pundits, spinmeisters, and instant interpreters, all of whom should be given a chance to earn their livings in other ways.

MFN renewal, a necessary but unromantic "pit stop" in the long-term effort to maximize America's interests with a huge and rapidly maturing China, is today overloaded with cosmic baggage.

This relic of the confrontation with the Soviet Union, having lain dormant and utterly without congressional interest for the entire decade of the 1980s, now lives on year after year after year because no one seems able to give it a decent burial.

The advent of the MFN season each spring has historically provided the occasion for a new round of sensational allegations and political responses which, in turn, make it "politically infeasible" for yet another year to put the whole process out of its misery.

Since crippling an $80 billion trade relationship that generates hundreds of thousands of U.S. jobs, and undercutting the viability of $25 billion in U.S. investment in China, is an act of such magnitude and hostility that, in the end, judicious members of the Congress in both parties will always think twice before taking the fateful step, I urge this Subcommittee and its parent Committee to take the lead in breaking the

MFN logjam once and for all. In addition to renewing normal tariffs on Chinese imports to the United States for the next twelve months, I hope that we will see the distinguished and conscientious members of this Subcommittee and its parent Committee, charged with so much of the House's responsibility for wise legislation in the trade arena, lead the way toward the permanence of normal trade relations with our nation's fourth-ranked trade partner in the very near future.

I welcome the opportunity to respond to specific questions or comments from the Subcommittee.

Thank you.

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**Investment Update**
**June 1998**

*FDI rises in first quarter, but slowdowns predicted*

China registered stronger-than-expected foreign direct investment (FDI) inflows in the first quarter of 1998. Contracted investment jumped 10 percent, and utilized investment rose 9.7 percent, compared to figures for the first quarter of 1997. But Ministry of Foreign Trade and Economic Cooperation (MOFTEC) economists expect these numbers to drop and caution that the figures may be misleading, in part because the sharp fall in contracted investment in 1997 created a low base of comparison. Several uncharacteristically large deals with Western companies, including a multi-year $1 billion deal with Eastman Kodak Co. and a $4.2 billion deal with the Royal Dutch/Shell Group, also may have skewed the figures.

The origin of new investment entering China is changing, with contracted investment from Asian economies down to roughly 55 percent of the PRC's first-quarter total, compared with 62 percent for the same period last year (*see Table 1, p.2*). Utilized investment from Asia rose about 2 percent, due primarily to a 51 percent increase in investment from Singapore and a 13 percent increase in investment from Hong Kong. Contracted investment from the United States and the European Union (EU) was down 4.3 percent and 8.3 percent, respectively. Utilized investment, however, jumped sharply, with US investment up 28.4 percent and EU investment up 75.4 percent. The most dramatic increase (114 percent) came from the tax-haven Virgin Islands, which was the source of contracts worth over $1.6 billion, second only to Hong Kong. Utilized investment from the islands also increased more than 100 percent to $411 million.

*1997 year-end investment review*

But China's restrictive investment environment continued to hamper the country's overall FDI receipts in 1997 (*see Table 2, p.2*). Contracted investment plummeted to $52 billion, down 29 percent over the 1996 level. Contracted investment growth rates also have declined since peaking in 1993. In fact, the number of contracts approved in 1997 fell 14 percent to 21,046, the lowest annual number of approved contracts since 1992. But utilized FDI in 1997 increased by roughly 8 percent to reach $45 billion, reflecting the realization of commitments finalized in recent years. Most experts agree that the previous rapid growth rates cannot be sustained over the long term and point out that China has built up a large base of FDI. China was, for the third year in a row, the recipient of the second-largest amount of FDI in 1997, behind the United States.

Perhaps reflecting the caution that has gripped the investment community, the average contract size in 1997 fell to $2.5 million, an almost 18 percent decrease over 1996. Wholly foreign-owned enterprises (WFOEs) had an average contract size of $1.8 million (a 38 percent drop), and equity joint ventures (EJVs) averaged a contract size of $2.4 million (down 6 percent). Foreign investors increasingly choose to go it alone: 46 percent of all signed contracts in 1997 took the form of WFOEs, compared to 43 percent for EJVs and 11 percent for contractual joint ventures.

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All indicators of US direct investment in China fell in 1997. Contracted investment dropped 29 percent to $4.9 billion, its lowest level in five years, and utilized investment was down 6 percent to $3.2 billion. The number of contracts signed fell 13 percent over the 1996 level to 2,188. And the average contract size, at $2.3 million, was well below the international average and 18 percent smaller than the average US contract size in 1996.

According to contracted FDI figures, Hong Kong, as in recent years, was the PRC's largest investor in 1997, with the United States and Japan a distant second and third, respectively. Though Hong Kong also remains the top source of China's utilized FDI, the order of other top contributors has shifted. Japan, Taiwan, and the United States round out the second, third, and fourth positions, respectively.

The decreasing rates of investment have appeared to catch Beijing's attention. The government reinstated the capital equipment import duty exemptions that it had revoked beginning in 1996, though the exemptions do not apply to all projects (*see February CMI, p.4*). Beijing also reportedly is considering allowing foreign investment in small- and medium-sized State-owned enterprises (SOEs) as a potentially effective means of shedding some of the burden of the SOE albatross. Ongoing negotiations for China's accession to the World Trade Organization (WTO), meanwhile, also may sway policymakers toward improving the investment environment in such key areas such as market access and policy transparency.

**Table 1: FDI in China by Country, First Quarter, 1998**

| | Number of Contracts | | | Contracted FDI ($ million) | | | Utilized FDI ($ million) | | |
|---|---|---|---|---|---|---|---|---|---|
| Country | 1998 (Q1) | 1997 (Q1) | % Change | 1998 (Q1) | 1997 (Q1) | % Change | 1998 (Q1) | 1997 (Q1) | % Change |
| World | 3,971 | 4,181 | -5.0% | 8,720.0 | 10,811.4 | 9.7% | 8,590.0 | 5,484.6 | 10.0% |
| Hong Kong | 1,659 | 1,720 | -3.6% | 2,954.0 | 3,071.3 | -3.8% | 4,088.1 | 3,593.4 | 13.8% |
| Taiwan | 540 | 594 | -9.1% | 466.0 | 602.2 | -22.6% | 686.6 | 641.7 | 7.0% |
| Japan | 229 | 323 | -29.1% | 599.9 | 602.4 | -0.4% | 505.0 | 783.4 | -35.5% |
| Singapore | 121 | 156 | -22.4% | 570.0 | 483.6 | 17.8% | 360.1 | 237.8 | 51.4% |
| South Korea | 220 | 344 | -36.0% | 163.3 | 262.3 | -37.8% | 199.5 | 451.5 | -55.8% |
| EU (total) | 193 | 183 | 5.5% | 783.6 | 854.6 | -8.3% | 963.4 | 549.2 | 75.4% |
| Germany | 50 | 30 | 66.7% | 272.8 | 115.2 | 136.7% | 149.7 | 209.3 | -49.3% |
| *Grt. Britain* | 38 | 75 | -49.3% | 128.1 | 372.0 | -65.6% | 259.7 | 173.4 | 49.8% |
| United States | 444 | 426 | 4.2% | 643.0 | 674.4 | -4.6% | 776.5 | 604.8 | 28.4% |
| Virgin Isl. | 105 | 56 | 87.5% | 1,622.0 | 757.2 | 114.2% | 411.5 | 177.5 | 131.7% |

**Source:** MOFTEC

**Table2: FDI in China 1979-1997**

| ($ million) | 1979-89 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | % Change | Total 1979-97 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total Foreign Direct Investment** | | | | | | | | | | | |
| No. of Contracts | 21,776 | 7,273 | 12,978 | 48,764 | 83,437 | 47,549 | 37,011 | 24,556 | 21,046 | -14% | 304,390 |
| Amt. Contracted (US$ mn) | 32,360 | 6,596 | 11,980 | 58,122 | 111,436 | 82,680 | 91,282 | 73,276 | 51,780 | -29% | 519,512 |
| Amt. Utilized (US$ mn)* | 18,468 | 3,410 | 4,366 | 11,008 | 27,515 | 33,767 | 37,521 | 41,726 | 45,280 | 9% | 223,061 |
| **US Direct Investment** | | | | | | | | | | | |
| No. of Contracts | 959 | 357 | 694 | 3,265 | 6,750 | 4,223 | 3,474 | 2,517 | 2,188 | -13% | 24,427 |
| Amt. Contracted (US$ mn) | 3,948 | 358 | 548 | 3,121 | 6,813 | 6,010 | 7,471 | 6,920 | 4,940 | -29% | 40,129 |
| Amt. Utilized (US$ mn)* | 1,729 | 456 | 323 | 511 | 2,063 | 2,491 | 3,083 | 3,440 | 3,240 | -6% | 17,336 |
| **US Share of Contracted Investment** | 12.2% | 5.4% | 4.6% | 5.4% | 6.1% | 7.3% | 8.2% | 9.4% | 9.5% | -- | |

**Source:** MOFTEC for 1979 to 1996 data, State Statistical Bureau for 1997 data

**Note: For more statistics and investment information, please see the Council Webpage (http://www.uschina.org).**

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**Trade Update**
**June 1998**

Though many of Asia's regional economies have been suffering from the effects of the Asia crisis for quite some time, its impact on PRC trade is only now beginning to show and is expected to worsen, according to China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC).

PRC Customs statistics comparing January-April 1998 to the same period in 1997 reveal that China's total trade expanded just 8.0 percent, down 4 percentage points from 1997 growth levels, to reach $97.5 billion (*see table*). Exports rose 11.7 percent, down more than 15 percentage points from 1997 levels, to measure $56.2 billion; imports totaled $41.3 billion, up just 3.2 percent. China's trade surplus thus equaled $14.9 billion, a 44.7 percent increase.

Though modest in growth, China's imports in the first four months of this year were spurred by the January 1998 reinstatement of the duty-free import policy for capital equipment. However, we will likely see further growth in imports once the full effect of the policy reinstatement becomes apparent over the next few months. The current rise in imports can be attributed in large part to the relatively large-scale price decreases of Asian exports to China. Because prices on such goods have fallen substantially, imports from many Southeast Asian countries for January-April 1998 are up over the same period in 1997. China's imports from the Philippines skyrocketed 64.6 percent, while those from Thailand jumped 32.8 percent, and those from Malaysia were up 18.5 percent.

For the same reasons, China's exports to other Asian countries during the first four months of this year fell sharply, and an end to this trend is not in sight. In particular, exports of iron and steel, mineral fuels, and cotton were down, while chemical exports were up only slightly. New orders for Chinese goods, particularly from South Korea and Japan, have dropped. PRC exports to South Korea shrank nearly 25 percent to $1.9 billion, while those to Japan fell 3.1 percent to $9.2 billion. At the same time, exports to many of the Association of Southeast Asian Nations (ASEAN) member economies decreased quite substantially. For example, exports to Thailand were down 23 percent to $367 million, exports to Indonesia were down 33.5 percent to $314 million, and exports to Malaysia were down 16.5 percent to $440 million. Much of China's overall export growth came from strong exports to the United States, up 21 percent, and the European Union, also up more than 20 percent. However, exports to Latin America and Africa also rose substantially and helped support China's overall trade surplus.

In addition to strong contributions from China's processing industries and State-owned enterprises (SOEs), the recent easing of interest rates, the current effort to improve the distribution of value-added tax (VAT) refunds, and the increase in VAT refunds on textile exports helped China maintain its export growth. The government reportedly is reviewing a proposal to raise the 9 percent VAT rebate to 11 percent for machinery and electronics, and to 14 percent for large, technology-intensive equipment such as ship generators. A revised list of VAT rebates is expected to be announced soon.

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*US-China trade*

The US-China trade relationship has been plagued in recent years by growing concern over the US trade deficit with China. The deficit has been the focus of many rounds of discussions at the highest levels of both governments, and it is expected to be on the agenda of the upcoming presidential summit. According to DOC statistics for January-March 1998, China is America's sixth-largest trading partner and fourth-largest supplier of imports, and China ranks thirteenth among the top destinations for US exports.

In the first three months of 1998, total US-China trade measured $18.1 billion, an 18.3 percent increase over the 1997 period (*see table*). US exports to China climbed 17.9 percent to $3.3 billion, while imports grew 18.4 percent to $14.8 billion. Thus, the US trade deficit with China, second only to the US trade deficit with Japan, expanded 18.6 percent, reaching $11.5 billion. The US trade deficit has been fueled by consistently strong US imports of toys, footwear, small electronic items, and apparel (*see table).*

*China posts healthy year-end 1997 trade figures*

The mixed figures thus far in 1998 contrast with China's impressive merchandise trade performance in 1997. Last year, total cumulative trade reached an all-time high of $325.1 billion, with imports totaling $142.4 billion (up 2.5 percent over 1996) and exports climbing to $182.7 billion (up 21 percent). China's 1997 trade surplus--the largest ever--surpassed $40 billion, up 230 percent over 1996.

China's strong trade position in 1997 was bolstered by strong exports in key sectors such as electronics, footwear, textiles, and toys. Further support came from the decrease in imports: power generation equipment (-17.7 percent), fertilizer (-16 percent), iron and steel (-8.3 percent), and chemicals (-1 percent). Lackluster import performance was partly the result of the removal of tax- and duty-free treatment for capital imports in 1996, China's relatively high tariff rates (which average 17 percent), and tight credit policies.

US-China merchandise trade in 1997 also reached an all-time high, topping $75.4 billion. DOC statistics reveal that imports (at $62.6 billion, up 21.6 percent over 1996) far exceeded exports (at $12.8 billion, up 2.4 percent), resulting in a US bilateral trade deficit of $49.8 billion, a 26 percent rise over 1996. PRC Customs statistics, meanwhile, report only a $16.4 billion bilateral US trade deficit. Differences in the way both countries calculate goods that are re-exported through Hong Kong account for much of the discrepancy.

*Outlook for remainder of 1998*

Despite the evidence of weakening trade, MOFTEC officials hope to maintain trade growth this year by raising imports as well as exports. For example, total PRC exports are targeted to reach $200 billion. In order to accomplish the necessary trade growth, some experts have speculated that more firms--foreign, joint-venture, and domestic--may be granted trading privileges, and imports may be encouraged by lifting import controls such as quotas, reducing the VAT on imports, or further lowering tariffs.

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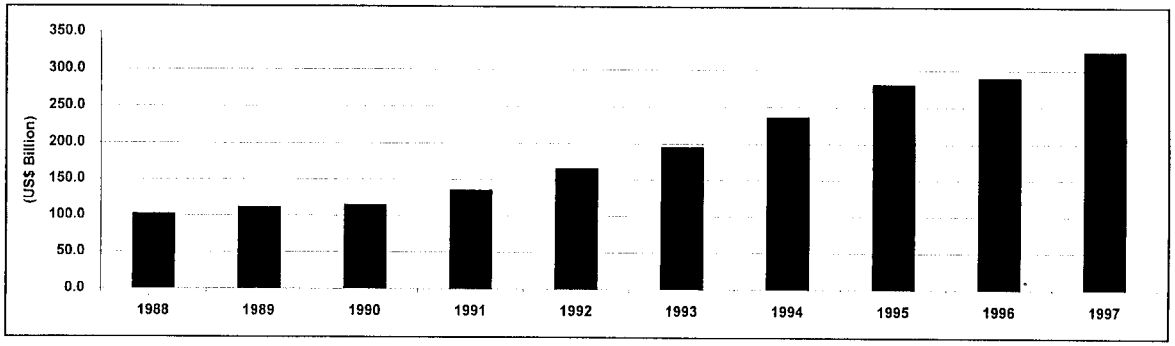
## China's Trade with the World (US$ billion)




| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | Jan-Apr 1997 | Jan-Apr 1998 | % Change Jan-Apr '98 vs. Jan-Apr '97 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Exports** | 47.5 | 52.5 | 62.1 | 71.9 | 84.9 | 91.7 | 121.0 | 148.8 | 151.1 | 182.7 | 50.3 | 56.2 | 11.7% |
| **Imports** | 55.3 | 59.1 | 53.3 | 63.8 | 80.6 | 104.0 | 115.6 | 132.1 | 138.8 | 142.4 | 40.0 | 41.3 | 3.2% |
| **Total** | 102.8 | 111.7 | 115.4 | 135.7 | 165.5 | 195.7 | 236.6 | 280.9 | 289.9 | 325.1 | 90.3 | 97.5 | 8.0% |
| **Balance** | -7.8 | -6.6 | 8.7 | 8.1 | 4.4 | -12.2 | 5.4 | 16.7 | 12.2 | 40.3 | 10.3 | 14.9 | 44.7% |

SOURCES: PRC General Administration of Customs, *China's Customs Statistics Monthly, Hong Kong Standard*
NOTE: According to China's official statistics, exports are reported on an F.O.B. basis and imports on a C.I.F. basis.

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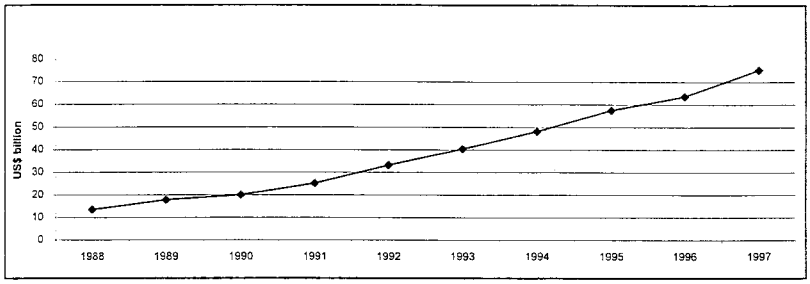
## US Total Trade with China (US$ billion)




| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | Jan-Mar 1997 | Jan-Mar 1998 | % Change '98 vs. '97 |
|---|---|---|---|---|---|---|---|---|---|---|
| **US Exports (F.A.S.)** | 6.2 | 7.5 | 8.8 | 9.3 | 11.8 | 12.0 | 12.8 | 2.8 | 3.3 | 17.9% |
| **US Imports (C.I.F.)** | 19.0 | 25.7 | 31.5 | 38.8 | 45.6 | 51.5 | 62.6 | 12.5 | 14.8 | 18.4% |
| **Total Trade** | 25.2 | 33.1 | 40.3 | 48.1 | 57.4 | 63.5 | 75.4 | 15.3 | 18.1 | 18.3% |
| **US Trade Balance with China** | (12.8) | (18.2) | (22.8) | (29.5) | (33.8) | (39.5) | (49.8) | (9.7) | (11.5) | 18.6% |

SOURCE: US Department of Commerce

## Top US Imports from China (US$ million)

| Harmonized Tariff Schedule Category | 1996 | 1997 | % Change | Jan-Mar '97 | Jan-Mar '98 | % Change |
|---|---|---|---|---|---|---|
| 85 Electrical Machinery & Equipment | 8,900.6 | 10,553.9 | 18.6% | 1,815.9 | 2,426.8 | 33.6% |
| 95 Toys | 7,504.4 | 9,364.7 | 24.8% | 1,356.4 | 1,839.8 | 35.6% |
| 64 Footwear | 6,391.6 | 7,414.9 | 16.0% | 1,756.0 | 1,941.6 | 10.6% |
| 61,62 Apparel | 5,025.6 | 5,998.0 | 19.3% | 1,281.1 | 1,226.7 | -4.2% |
| 84 Power Generation Equipment | 4,475.8 | 5,983.5 | 33.7% | 1,372.3 | 1,769.2 | 28.9% |

SOURCE: US Department of Commerce

## Top US Exports to China (US$ million)

| Harmonized Tariff Schedule Category | 1996 | 1997 | % Change | Jan-Mar '97 | Jan-Mar '98 | % Change |
|---|---|---|---|---|---|---|
| 84 Power Generation Equipment | 2,303.8 | 2,477.0 | 7.5% | 476.1 | 563.1 | 18.3% |
| 88 Air & Spacecraft | 1,708.4 | 2,122.6 | 24.2% | 358.4 | 812.7 | 126.6% |
| 85 Electrical Machinery | 1,433.2 | 1,520.1 | 6.1% | 311.9 | 346.1 | 11.0% |
| 31 Fertilizer | 891.1 | 1,049.8 | 17.8% | 307.0 | 180.8 | -41.1% |
| 90 Medical Instruments | 487.6 | 627.4 | 28.7% | 133.6 | 145.9 | 9.2% |

SOURCE: US Department of Commerce

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Mr. HOUGHTON. Well, thanks very much Mr. Kapp.
Ms. Shailor.

**STATEMENT OF BARBARA SHAILOR, DIRECTOR, INTERNATIONAL AFFAIRS, AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS**

Ms. SHAILOR. Thank you, Mr. Chairman, and thank you for this opportunity to present the views of the AFL–CIO, as we have for the last eight years on the extension of most-favored nation trading status to China.

The AFL–CIO opposes granting MFN to China. We believe that China's egregious and flagrant violations of human and worker rights, its flaunting of international agreements on arms sales, market access, intellectual property rights, forced labor, and the environment, and its non-reciprocal and discriminatory trade and investment policies are not improving under the current policy.

Only the threat of withdrawing trade preferences will cause the Chinese government to address these very serious concerns. Our choice, we believe, with respect to China is not between isolationism and engagement, as some would argue. Rather, it is between continuing the status quo and using the leverage of our marketplace to affect necessary and positive change.

The key issue that Congress and the country face is whether or not our current policy is working. At the AFL–CIO we believe that on every dimension—human rights, worker rights, and trade—we are seeing a deterioration or failure to make significant progress.

The human rights situation in China continues to be an international disgrace. The State Department's 1997 human rights report asserts the Chinese government continues to commit widespread and well-documented human rights abuses, including torture and mistreatment of prisoners, forced confessions, arbitrary arrests, and lengthy incommunicado detention. The government continues tight restrictions on freedom of speech, the press, assembly, association, religion, privacy, and worker rights. Human rights abuses in minority areas, including Tibet and Chianxing, continue in some cases in fact to intensify.

The AFL–CIO welcomes the release of political prisoners this year, particularly Wei Jeishing, who eloquently addressed the Executive Council of the AFL–CIO this January. But releasing political prisoners forced into exile is not the same as allowing them to speak freely and work towards democratic change in their own homeland.

The worker rights situation in China remains particularly bleak. The single official recognized labor organization, the All China Federation of Trade Unions, is controlled by the Communist Party. Its main tasks are to improve labor discipline, mobilize workers to achieve party and government objectives, and dispense social welfare funds.

The State Department reports that there were more efforts last year to form or register independent unions in 1997 but that none of them were successful. The official labor unions in China represent the interests of both management and the government, but certainly not the interests of working people.

Workers attempting to organize independent unions or carry out strikes in response to truly dreadful working conditions are fired, imprisoned, beaten, and tortured. Working conditions in industries such as toys, apparel, and electronics, in which there is significant foreign investment, are deplorable. Excessive hours, violation of minimum wage laws, poor health and safety conditions, and physical abuse by managers is commonplace.

A recent report by the National Labor Committee, based on extensive investigations carried out in China, reveals that workers producing goods for the American consumer market may work from 60 to 98 hours a week, 28 days a month, for as little as 13 cents an hour. The workers are often housed in dormitories 16 to a room.

Companies that produce in China to sell to American consumers reap enormous windfall profits, by taking advantage of these shamefully low wages and poor working conditions, while charging premium prices for their products. Nike's advertising budget alone for one year is 650 million dollars. That would pay the entire wage bill for all 50,000 workers at the Yuyong factory in China for 19 years. These workers produce Nike sneakers 12 hours a day, 7 days a week for 16 cents an hour.

What is the point at which the United States Government will set limits on its trade with China? Will we draw the line at trading with and boosting the earnings of companies that are owned by military organizations responsible for carrying out the Chinese government's policy of repressing students, workers, and religious and ethnic minority activists?

The AFL–CIO calls on President Clinton to immediately revoke the visas of all representatives of the PLA and the PAP doing business in the U.S.; on Congress to enact legislation to ban trade and investment with these companies; on corporations to pledge to refuse to do business with these organizations; and on the American consumers not to buy products produced by the Chinese military.

China's policy of extorting technology transfers in investment from American companies interested in selling in China is costing the United States good jobs—good jobs in aircraft and automotive sectors, to name two. More serious transferring technology, much of which has been subsidized by American taxpayers, will create in China the capacity to challenge American competitiveness in industries that we now take for granted. While it may serve the interests of individual companies to trade away technological advantage for short-term market access, this certainly does not serve the national interest.

The AFL–CIO supports trade expansion, international engagement, and equitable development. But the Chinese government is not engaging in free trade, and we will neither help the Chinese people in their aspirations, nor our own work force by ignoring this basic fact.

Thank you, Mr. Chairman. I'm glad to answer any questions.

[The prepared statement follows:]

98-11

**Testimony of Barbara Shailor, Director**
**Department of International Affairs**
**American Federation of Labor and**
**Congress of Industrial Organizations**
**Before the House Committee on Ways and Means**
**Subcommittee on Trade on the**
**Extension of Most Favored Nation Trading Status to China**

June 17, 1998

Thank you, Mr. Chairman and members of the Committee, for this opportunity to present the views of the AFL-CIO on the extension of most favored nation (MFN) trading status to China. The AFL-CIO opposes granting MFN status to China. We believe that China's egregious and flagrant violations of human and worker rights; its flaunting of international agreements on arms sales, market access, intellectual property rights, forced labor, and the environment; and its non-reciprocal and discriminatory trade and investment policies are not improving under the current policy. Only the threat of withdrawing trade preferences will cause the Chinese government to address these very serious concerns.

Our choice with respect to China is not between isolation and engagement, as some would argue. Rather, it is between continuing the status quo and using the leverage of our marketplace to effect necessary and positive change.

The key issue the Congress and the country face is whether or not our current policy is working. The AFL-CIO believes that, on every dimension--human rights, worker rights, and trade-- we are seeing deterioration or failure to make significant progress.

The human rights situation in China continues to be an international disgrace. The State Department's 1997 Human Rights report asserts that the Chinese government "continued to commit widespread and well-documented human rights abuses," including "torture and mistreatment of prisoners, forced confessions, and arbitrary arrest and lengthy incommunicado detention. . . . The Government continued tight restrictions on freedom of speech, the press, assembly, association, religion, privacy, and worker rights." Human rights abuses in minority areas, including Tibet and Xinjiang "continued and, in some cases, intensified" (p. 2).

While the State Department report finds that there were "positive steps in human rights" (p. 2), these were minimal. The AFL-CIO welcomes the release of political prisoners this year, particularly Wei Jingsheng, who eloquently addressed the AFL-CIO Executive Council meeting in January of this year. But releasing political prisoners into forced exile is not the same as allowing them to speak freely and work toward change at home. We applaud China's signing of the United Nations Covenant on Economic, Social, and Cultural Rights and call on the Chinese government to honor this commitment in spirit and letter.

The worker rights situation in China remains bleak. The single officially recognized labor organization, the All China Federation of Trade Unions (ACFTU), is controlled by the Communist Party. Its main tasks, according to the State Department, are to "improve labor discipline, mobilize workers to achieve party and government objectives, and to dispense social welfare funds." The State Department reports that there were more efforts to form or register independent unions in 1997, but that "none was successful" (p. 31). The official labor unions in China represent the interests of both management and the government, but not those of working people.

Workers attempting to organize independent unions or to carry out strikes in response to dreadful working conditions are fired, imprisoned, beaten, and tortured. The right to strike was removed from the Chinese constitution in 1982 on the grounds that the political system had "eradicated problems between the proletariat and enterprise owners."

Working conditions in industries such as toys, apparel, and electronics, in which there is significant foreign investment, are unacceptable and, in many cases, illegal: excessive hours worked, violation of minimum wage laws, poor health and safety conditions, physical abuse by managers, and illegal levies and deductions. Deplorable working conditions and phony unions may, in the end, undermine the very stability U.S. multinational corporations have sought to foster in China.

A recent report by the National Labor Committee,[1] based on extensive investigations carried out in China, reveals that workers producing goods for the American consumer market may work from 60 to 98 hours a week, 28 days a month, for as little as $.13 an hour. The workers are often housed in dormitories and fed a meager diet of rice gruel and vegetables.

Companies that produce or purchase goods in China to sell to American consumers reap a windfall profit by taking advantage of these shamefully low wages and poor working conditions, while charging premium prices for their products.

Nike's advertising budget for one year, $650 million, would pay the entire wage bill for all 50,000 of Nike's workers at the Yue Yuen factory in China for 19 years! These workers produce Nike sneakers 12 hours a day, 7 days a week, for 16 cents an hour.

What is the point at which the United States government will set limits on its trade with China? Will we draw the line at trading with and boosting the earnings of companies owned by the military organization responsible for carrying out the Chinese government's policy of repressing students, workers, and religious and ethnic minority activists?

Companies owned by the Chinese People's Liberation Army (PLA) and the People's Armed

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[1] Charles Kernaghan, "Made in China: Behind the Label," a special report prepared for the National Labor Committee, New York City, March 1998.

Police (PAP) continue to sell their goods in American stores. Harry Wu, the Chinese human rights activist, revealed last year that K-Mart purchased 73 tons of men's rainwear and ponchos in 1996 from China Tiancheng, a company the U.S. Defense Intelligence Agency confirms is owned by the People's Liberation Army General Political Department. Research by the Food and Allied Services Trades Department of the AFL-CIO revealed that 25 PLA trading companies shipped products into the United States in 1996.[2]

The AFL-CIO calls on President Clinton to immediately revoke the visas of all representatives of the PLA and the PAP in the U.S.; on Congress to enact legislation to ban trade and investment with the U.S. by PLA and PAP companies; on corporations to sign a pledge to refuse to do business with the PLA and the PAP; and on American consumers not to buy PLA and PAP products.

The skewed U.S.-China trade relationship continues to worsen. Last year, the United States racked up a merchandise trade deficit with China of $50 billion, up from $40 billion in 1996 and balance in 1980 (see figure 1). The United States imported $62.6 billion worth of goods from China in 1997, while exporting only $12.8 billion worth, a ratio of almost 5 to 1, by far our most asymmetrical trade relationship.

In the 1990s, U.S. worldwide imports (excluding China) have grown by 57 percent, while U.S. imports from China have grown 315 percent. In 1997, 34 percent of Chinese exports were sent to the U.S., while only 1.8 percent of U.S. exports went to China. This ought to give the United States a great deal of leverage when negotiating market access agreements.

In 1992, the U.S. and China signed a Memorandum of Understanding (MOU) on market access. This agreement committed China to implement changes in its import regime over a five-year period. As has been the case with all agreements signed by China since 1980, China has not fully implemented these commitments, particularly with regard to uniform application of trade rules, import substitution policies, and the use of standards as a barrier to trade. While some import quotas were eliminated, these were simply replaced by new non-tariff measures. China promulgated a series of measures which impede market access for many products covered under the MOU, including registration requirements, the auto industrial policy and restrictions on imports of medical equipment.

The use of non-transparent and discriminatory standards and or licensing requirements is also common. In October 1997, China reduced its overall tariff level to around 17 percent; however, some tariffs on priority products remain high or were actually raised.

For all the attention given to Japan's trade barriers, Japan's market looks open in comparison to

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[2]FAST, "China's People's Liberation Army": Where to Find PLA Companies in America, What Products the PLA Sells in America, and Who Are the PLA's Customers?" June 23, 1997.

China's. For all the hoopla about the size of the Chinese market, the United States sold more last year to Belgium, Singapore, and the Netherlands. And for all the talk about the jobs supported by U.S. exports to China, nine out of the top ten trade surplus categories last year were raw materials and intermediate goods: fertilizers, cotton, oil seeds, rawhides, etc. The top ten deficit categories, in contrast, were all manufactured goods (see Table 1).

China's policy of extorting technology transfers and investment from American companies interested in selling in China is costing the United States good jobs in the aircraft and automotive sectors today. More serious, transferring technology--much of which has been subsidized by American taxpayers--will create in China the capacity to challenge American competitiveness in industries we now take for granted. While it may serve the interest of individual companies to trade away technological advantage for short-term market access, this does not serve the national interest.

In other words, the dream of a massive consumer market in China that is served by American-made goods remains just that. U.S. access to the Chinese market is severely limited today, and the Chinese government is continuing to strategize toward limiting that access in the future. Revoking MFN might impose some short-term costs on American businesses, consumers, and workers. In the long run, however, encouraging China to develop down a democratic, egalitarian, and sustainable path will be infinitely more in the interest of both countries than our present set of policies, which have utterly failed to bring about necessary and long-overdue change.

The AFL-CIO supports trade expansion, international engagement, and equitable development. But the Chinese government is not engaging in free trade, and we help neither the Chinese people in their aspirations nor our own work force by ignoring this basic fact.

Mr. Chairman, members of the Committee, thank you for your time and attention.

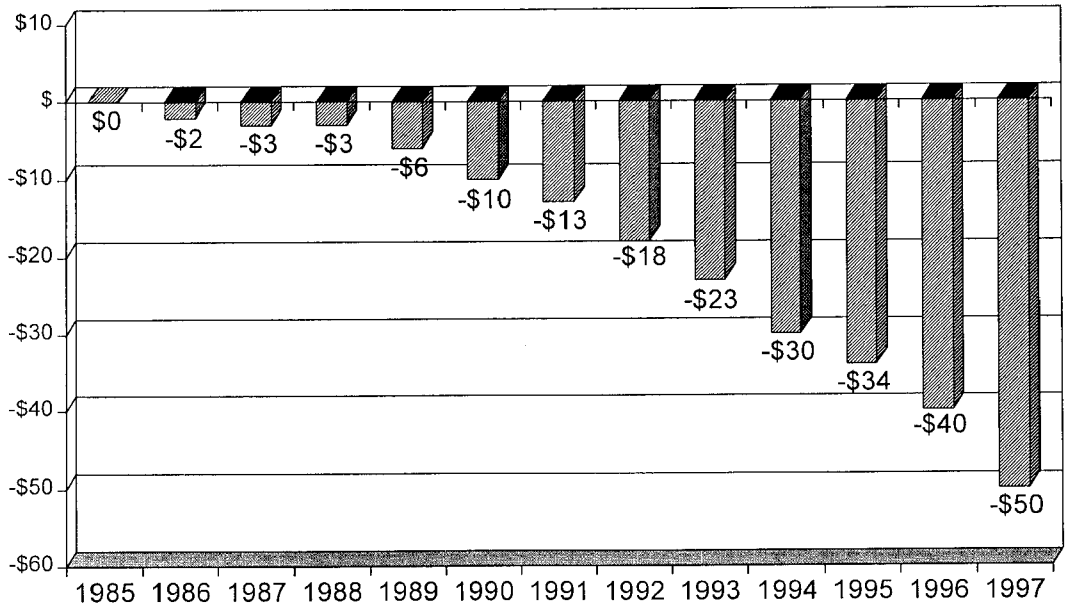
TABLE 1
U.S.-CHINA TRADE BALANCE: TOP TEN ITEMS, 1997
(billions of dollars)

| U.S. SURPLUS | | U.S. DEFICIT | |
|---|---|---|---|
| Aircraft | 2.087 | Toys & games | 9.250 |
| Fertilizers | 1.049 | Electrical machinery | 9.041 |
| Cotton | .418 | Footwear | 7.393 |
| Oil seeds | .355 | Apparel | 5.990 |
| Animal &veg. oils | .160 | Machinery | 3.516 |
| Wood pulp | .148 | Furniture & bedding | 2.966 |
| Rawhides | .134 | Leather articles | 2.956 |
| Aluminum & articles thereof | .104 | Plastics & articles thereof | 1.551 |
| Residues & waste from food industry | .103 | Optical & photographic | 1.348 |
| Meat & meat offal | .062 | Articles of iron & steel | .800 |

Source: U.S. Department of Commerce, National Trade Data Bank

Figure 1

U.S. Merchandise Trade Balance
With China 1985-1997
(billions of dollars)



Mr. HOUGHTON. Well, thank you very much, Ms. Shailor. You know, I could ask each of you individual questions, but maybe it will be a good idea if I just threw out a couple of questions and then we could sort of chew on them together, to sort of get an idea.

I think one question, is in terms of the businesses involved, and I think particularly of the Amway and Cincinnati Milacron. But what really is the balance of trade? Is there something going back and forth which is fair? That's one issue.

Another issue is in terms of the Asian financial crisis. What impact is that having?

Another issue is really this concept, as you bring up, Ms. Shailor, of the extorting technology transfers and investments. I'd be really interested in answers to those or anything else you might bring up. So let's open it up. And cut in at any time.

Ms. SHAILOR. Let me address the technology transfer issues for a moment.

Mr. HOUGHTON. All right.

Ms. SHAILOR. We represent many members, obviously, at Boeing, at McDonnell-Douglas, at a number of the large aerospace companies, and in separate testimony before Congress and in many other forums, we have been indicating for several years our severe concern about the extortion of technology. In particular, for access in the aircraft market. And at Boeing and McDonnell-Douglas and, I might add, I assume Cincinnati Milachron as well, you will see the transfer of technology which is dual-use equipment that is sitting in military facilities in China where the nuclear-strike bombers are produced.

I think, when we look at China's accession to the WTO, one of the most significant issues is going to be the market-access question and the technology-transfer question, and I think, certainly under the current circumstances, the technology questions need to be looked at very carefully. They are not in our national interest and they are creating a key industry for the Chinese that we have no way at this hearing or in the coming years to determine will eventually come back in ways that we seriously regret.

Mr. HOUGHTON. True. Well, on this—yes, go ahead.

Mr. KAPP. I just would urge that we be very, very specific in our depictions of realities here. The term, "nuclear-strike bomber," is a classic example of the kind of easy-to-say term that gets launched into the public dialogue with precious little detail behind it. I think that it is very important that if we're going to cast blanket condemnations across the transfer of industrial technology and know-how, and managerial know-how, from American corporations to their customers in other countries around the world, including China, we be very specific as to the nature of the technology——

Mr. HOUGHTON. Sure.

Mr. KAPP. And the nature of the——

Mr. HOUGHTON. No, I understand that, but——

Ms. SHAILOR. I can be very specific.

Mr. HOUGHTON. But let's just, for example, for Cincinnati Milacron, suppose you were exporting plastics, or your customers were exporting plastics to China. And, I don't know if this it could happen or not, and China would say, we want to make them ourself. And furthermore, if you do not put up a plant here, and if you

do not give us our technology, despite the fact that you cannot make any money on that, the return on investment would be bad, but you felt that was the only way to access the Chinese market, what would you do? You don't have to answer that, but, I mean, it's a very practical question, and I'm sure it's been posed to many industries.

Mr. HOLWILL. Mr. Chairman, our company does not make or use sensitive technologies. We sell soap and personal-care items, but I would like to point out that we are among that do export to China. We want to export more to China, and we see the focus on MFN as inhibiting the negotiations on WTO, and I would suggest to my friend from the AFL-CIO that emphasis on worker rights can best be carried out in the context of the WTO session agreement. And we would urge them to join us in pushing this Congress and this Administration to accelerate that in the best, and the most aggressive way possible, and to include such standards in the agreement, if possible.

Ms. SHAILOR. And I might add on the question of specificity. I think this is a problem for multinationals throughout the world. It's not unique to American companies. And I think there is no question that addressing it multilaterally and within the context of the WTO on commercially acceptable grounds and in ways that impact on all companies would move us forward.

But you have a situation where companies are in fact being held up on their technology transfers. And so, for example, you'll see Cincinnati Milacron five—access milling equipment in facilities where there is also military production going on in China. And it is a concern for Boeing, for McDonnell-Douglas, for all of the aircraft industry when the Chinese can simply say, if you don't transfer this technology, we'll buy Airbus equipment instead. So we are sympathetic to the pressures that our companies are under, and we would like it addressed in a multilateral way, but it still gets to the issue of the extortion by the Chinese government.

Mr. HOUGHTON. Well, now do you have—if I could just interrupt a minute—you have page 3 of your testimony. You talk about the People's Armed Police and the People's Liberation Army, and you suggest that Congress enact legislation to ban trade and investment and so on and so on. Why don't you boycott them yourselves? Why doesn't the labor union, why doesn't the AFL–CIO boycott them, whether the Congress does or whether business does?

Ms. SHAILOR. Well, boycott is a——

Mr. HOUGHTON. No, seriously. Why aren't their flyers in your communities, where you have organized plants, and they're all over the country, why don't you do this yourself?

Ms. SHAILOR. We are urging our members, and we have through many different ways indicated that we would very much hope that we would be able to identify products that were coming in from the PLA and urge them not to buy those products. That is a common process that we go through in the labor movement, as we have done in many situations in many countries where workers are being repressed and abused. As we did in Poland, as we did in South Africa, as we continue to do in many regions of the world.

You have a situation where Chinese workers are suffering terribly as well. They've lived through a very difficult history and——

Mr. HOUGHTON. You know what I mean. You know what I mean on this. Now, maybe I could just move along to Mr. Kapp. You talk about this unromantic pit stop.

Mr. KAPP. Mr. Chairman, could I interrupt for just a second? I think our friend from Cincinnati Milacron had a comment on the previous discussion.

Mr. HOUGHTON. Okay.

Mr. HALL. Just quickly, before we do run out of time, I would like to submit to the record, in regard to these comments about Milacron machines involved in military, if I could at some later time in detail.

Mr. HOUGHTON. You're going to put it in the record?

Mr. HALL. I would like to prepare something.

Mr. HOUGHTON. You would like to make a comment? Go ahead, make a comment.

Mr. HALL. At this time, I'm not prepared to, but I would like to at a later time.

Mr. HOUGHTON. All right. Good. We'll make it at the end of this or submit it for the record. That would be great.

Mr. HALL. Thank you.

[The following was subsequently received:]

**ADDITIONAL COMMENTS FOR THE RECORD**
**TESTIMONY OF JUNE 17, 1998**
**U.S. HOUSE OF REPRESENTATIVES**
**WAYS AND MEANS COMMITTEE**
**IN THE MATTER OF EXTENDING MFN TO CHINA**

**Submitted by: Chris Hall, Cincinnati Milacron, Inc.**

Mr. Chairman, I want to thank you for the opportunity to respond for the record to a statement made during the questioning period by a representative of the AFL-CIO, Ms. Barbara Shailor.

During Ms. Shailor's remarks she intimated that Cincinnati Milacron 5-axis machine tools were used in the production of bombers capable of delivering a nuclear payload. Let me assure you and other members of the Trade Subcommittee that as recently as February 17th of this year, Milacron representatives visited the factory in question and at no time observed any military parts being manufactured then or during any other visit since the machine's installation.

I should also note for the record that full time Boeing employees have been located at this factory continuously for at least the past five years. With significant set-up times required to produce precise military aircraft components, it is virtually impossible to shift from commercial to military and back again to commercial aircraft parts without the knowledge of those Americans located on the premises of the manufacturing facility.

Again, Mr. Chairman, thank you for the opportunity to amplify our response to Ms. Shailor's erroneous implications.

Mr. HOUGHTON. Now, Mr. Kapp, this unromantic pit stop, could you break that down a little bit?

Mr. KAPP. Yes. What I'm trying to get at there, Mr. Chairman, is the fact that, as this panel and all the other panels today have once again revealed, and as the comments, I believe, of Representative Jefferson, who was speaking when I first entered the room, brought us back to the MFN process is a creation of an American law which singles out for annual MFN renewal so-called non-market economies. And the criterion on which the President is to recertify is the question of immigration, the permission of the country in question that its citizens can emigrate.

What has happened over the years since the tragedy at Tiananmen is that the MFN decision has been decked out, Christmas-tree style, with every other imaginable objection that Americans of good conscience, and Americans with strong political feelings, and others might raise to aspects of China's behavior, domestic or international.

My point is that we've lost track of what the MFN renewal actually is. To me at least, and I would hope to the members of Congress, it is a simple procedural question. Do they permit the emigration, or don't they? The emigration is not an issue, and therefore I would like to think, (a) that we can put this whole dinosaur into the ground once and for all, and (b), until we can do that, we should try to get back to the fact that this is a routine maintenance stop every year in a much larger challenge, that the United States must face. That challenge is to come to terms with the emerging, powerful, and significant China on the world scene. This MFN exercise is, in fact, as Richard Holwill and others had said, a debilitating distraction from what we really should be doing.

Mr. HOUGHTON. Well, anyway, as I listen to you, the basic thrust is China is big; China is important; China's a great market; we've got to keep it open. We ought to get rid of any of the impediments, such as an annual review of the MFN. And they're very important to us; they're very important to employment, so on and so forth. And I agree with all that. I mean, I am basically down there.

However, you know, Mrs. Shailor is saying something important. Is there a quid pro quo? I mean, would we deal with England the same way we are dealing with China? And if not, why?

Mr. HOLWILL. Mr. Chairman, the point of my remarks was simply that there are legitimate criticisms. She has raised several; other speakers here today have raised others. But MFN is a unilateral move in which we attempt to arrogate to ourselves the right to dictate policies within China. China does respond well when there are clear international standards that it's expected to meet. If we move away from MFN and toward a multilateral regime with international standards, such as WTO, we will advance those goals far more effectively than if we continue to do so in a bilateral manner that engenders only hostility and resentment from the Chinese.

Mr. HOUGHTON. Okay, so what you do is you disagree with Mrs. Shailor. I'm going to cite a particular sentence in the first paragraph of her testimony. I don't think you have it. Let me read it to you.

"Only the threat of withdrawing trade preferences will cause the Chinese government to address these very serious concerns?"

You don't agree with that?

Mr. HOLWILL. I don't, sir. I believe—

Mr. HOUGHTON. Well, help me on that. Or anybody help me on that.

Mr. HOLWILL. I do not, and I believe there have been several references here today that the Chinese have maintained a stable currency through the Asian economic crisis; if we shut the door on $68 million in Chinese exports to the United States, they will be obliged to find other markets, and the primary mechanism which we'll have to do that will be to devalue the one currency that is maintaining some stability in Asia.

Mr. HOUGHTON. I agree with you, but you're talking in economic terms, and those are real terms, and they're important terms, and they're probably the most critical terms. But what about the other issues we're trying to get at? It's always this balancing between the human and the right versus the economic. How do we handle this other area?

Mr. KAPP. Sir, at the risk of spilling the beans on my Senate testimony tomorrow, which I haven't quite finished yet——

Mr. HOUGHTON. I won't tell a soul. [Laughter.]

Mr. KAPP [continuing]. And I know it will be held completely within these round walls. Let me read you a little bit of Jasper Becker's description of the famine that engulfed China between 1958 and 1961, a famine caused by the obsessive dreams of the deified ruler of China and enforced across the whole face of the land.

"Fear and terror explain the behavior of the cadres who did nothing in the face of this catastrophic economic collapse. A cadre who questioned orders faced death. The anti-Right opportunists campaign had clearly demonstrated this fact, but it also showed that opposition not only endangered the official, but also his family, his relatives, and his friends. As the famine worsened and the peasants lost hope, the cadres also found that they could only order by creating more and more terror. All judgments and beliefs were suspended. No one dared move or act according to what he knew to be true. Instead, even the highest-ranking officials moved in a secretive society, paralyzed by an all-pervasive network of informers and spies. In a world of distorted mirrors, it became hard to grasp that such senseless cruelty could really be taking place. Who could believe that party officials would plaster and paint trees, stripped of their bark by starving peasants, to hide a famine from the country's president, Yo Tzou Chi Zhou, who was on a visit?"

Now, Mr. Chairman, if we look at the society that China was thirty years ago, the China that adults of China today lived in and lived through, we come to understand how far China has in fact traveled in the last 20 years. The great leader is gone. No more semi-divine leader. No more doctrinal fanaticism. No more Marxism-Leninism-Mao Zedong thought in command of everything. No more isolation from the world—it is not, in fact, a small coincidence these things go together. And, of course, spectacularly raised living standards for large numbers of people.

In other words, as we consider legislative policy toward China, we somehow have to understand that the China of today, for all of the objectionable features that all of us might discover somewhere, is still much more advanced and improved over the China of a gen-

eration ago. We need to bear that in mind as we go about determining American policy for a China that is still moving forward today and tomorrow.

Mr. HOUGHTON. Yes, but if we eliminate—yes, go ahead, please. Yes.

Ms. SHAILOR. A comment on the transition, the political transition, that's going on in China. And I think that was an excellent recent history. So we've gone then from the Long March to the Great Leap Forward to the Cultural Revolution to Socialism with Chinese characteristics and I think this period could be called capitalism with a Fascist face.

Mr. KAPP. Well, again, that might be a good sound bite, but I think that this issue actually bears a more serious analysis at much greater length than such a phase implies.

Mr. HOLWILL. Mr. Chairman.

Mr. HOUGHTON. Yes.

Mr. HOLWILL. I would like to add one personal observation here and that is, having just completed a round of negotiations on a very difficult, technical issue, what I have learned in dealing—in looking at this issue is that the Chinese themselves are looking to the world to see how to reorder and to restructure their society. They themselves are struggling with many of these issues.

And I believe that the best way to achieve the goals, which I believe is your primary question, is MFN or the threat of denial of MFN going to achieve those goals? I believe the best way to do it is to offer to them cooperation in finding the appropriate international standards for dealing with issues that trouble them. Their workers are demanding better standards and those who advocate the improvement of labor—of the status of labor in China would be well-advised, I believe, to move away from threats and move toward areas of cooperation where they can see the benefits of a dynamic and democratic labor movement within the country.

Mr. HOUGHTON. Sure. I just want another crack at this. I mean, you know, we're living in an extraordinary time. I've been around the business world since the early 1950's and I've never seen anything like this. But, you know, we'll go south at some time. We always have; we always will. And the thing that I worry about is that we go south in a way which then forces us to get our balance of trade back into power and into balance and then, also, be very careful that the United States keeps its status as the country with a reserve currency, rather than going to the Euro or something like that. If that goes, then we've got a double-barreled hit.

So I guess the thing that I'm concerned about is that if we end up in a situation—we're not there yet—where we have a $200 billion-a-year annual trade, not current account, but trade deficit with China and we see our currency destabilizing and we see—or having to put ourselves back in control—it's good to trade with China and it's important to do it, but what sort of monitoring mechanism do we have as we go along, if we take away this annual review of the MFN?

Mr. KAPP. Congressman, monitoring mechanism as to what?

Mr. HOUGHTON. Monitoring—what?

Mr. KAPP. Monitoring mechanism as to what?

Mr. HOUGHTON. Monitoring mechanism in terms of our trade imbalance.

Mr. KAPP. Oh, I see.

Mr. HOLWILL. Mr. Chairman, I would submit to you that the accession of China to the WTO should be the higher priority and there will be, through that mechanism, both an opportunity to provide oversight to the terms of accession and oversight by this committee to the action of WTO in pursuing the cases that are brought before it that relate to whatever dispute may be at hand, whether it is an investment dispute, a business condition—a dispute relating to market access, or a dispute relating to the fact that some industries may be operating with subsidized or slave labor.

There are—there will be, through that mechanism, a role for this committee that will be vital and it will be a far more effective role, I submit, than the one that you now are offered through MFN, which is a once-a-year ritual over an all-or-nothing option for dealing with the problems in China.

Mr. HOUGHTON. Well, I think you're right. But, at the same time, you say on page eight, you know, you say things which are great. I mean, they make a lot of sense. They would be nice if they were enacted. Provide market access for Texas and agricultural products, reduce export subsidy, trim protection of market access, liberalize access to foreign exchange, provide the provisions of WTO uniformly through China. That's not going to happen. I mean, it may ultimately, but in the meantime, we've got to live and we've got to be able to keep this thing in balance and have them understand the importance of our economy as well as theirs. That's what I'm saying about some sort of monitoring device.

Mr. HOLWILL. Thank you, Mr. Chairman.

Mr. HOUGHTON. Well, look, you're nice to come. Mr. Hall, have you got something which you'd like to enter here? Or would you just like to just enter it in the record?

Mr. HALL. I'd just like to enter it in the record. Thank you.

Mr. HOUGHTON. Okay, fine.

Well, listen, I really appreciate this. It's been very, very helpful and, without any other comment, session adjourned.

[Whereupon, at 5:45 p.m., the hearing was adjourned subject to the call of the Chair.]

[Submissions for the record follow:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Trade, Committee on Ways and Means, House of Representatives

For Release on Delivery
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# CHINA TRADE

# WTO Membership and Most-Favored-Nation Status

Statement for the Record by JayEtta Z. Hecker, Associate Director, International Relations and Trade Issues, National Security and International Affairs Division

GAO/T-NSIAD-98-209

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to provide this statement for the record for your hearing on June 17, 1998. I would like to offer some observations on the People's Republic of China's negotiations to join (accede to) the World Trade Organization (WTO). Today's hearing is about the President's recent decision to extend China's waiver and continue to grant most-favored-nation (MFN)[1] status to China. You requested that we explain the relationship between China's MFN status and WTO membership. My statement will explain (1) the WTO accession process and (2) the legal framework affecting China's MFN status, its implications for WTO membership, and the role Congress plays in the process.

My observations are based on our past and ongoing work;[2] our review of WTO and executive branch documents; U.S. law; and related literature; the economic literature; and our discussions with U.S. government, WTO, and foreign government officials. Before getting into the specifics of these topics, let me provide a brief summary of my statement.

SUMMARY

China has the largest economy worldwide that is not covered by the WTO. The WTO seeks to promote open and fair international trade through increased transparency (public openness), rules, and commitments to reduce barriers on foreign goods and services, and provide a binding system for resolving disputes. China would like to join the WTO and is currently in the negotiation phase, which is the second of the four-stage process for becoming a member. Joining the WTO will require China to make substantial changes to its economy. Although Congress does not vote on China's WTO membership, the United States Trade Representative (USTR) is required to consult with Congress before a WTO vote is taken. The Administration plans to ask Congress to enact legislation to resolve a potential conflict between the conditional MFN afforded China under U.S. legislation and the unconditional MFN provided by the WTO Agreements. If China becomes a member and Congress has not enacted this legislation, the Administration intends to invoke a WTO provision that would permit the United States not to apply the WTO Agreements to China. An important consequence of taking this exception is that China and the United States would not be obligated to provide each other all the WTO trade commitments that they would give to other WTO member states. In such a situation, U.S. business may not

[1]Most-favored-nation treatment generally refers to the practice of extending to a country the best trade privileges granted to any other nation. For example, imports from countries receiving MFN treatment are provided the lowest tariff rates and other charges imposed on imported products.

[2]See attached list of some related GAO products.

be able to benefit fully from the commitments China will make to open its markets to other WTO members.

BACKGROUND

Since the late 1970s, China has introduced a variety of market reforms to liberalize its centrally planned economy. Today China is much more developed, open, and market oriented, such that now almost all sectors of its economy have elements of both free markets and state planning. However, China still lacks considerable transparency in its trade regime and intervenes in its economy in ways that can distort trade. For example, China restricts its imports by applying high tariffs to specific sectors, using import quotas, requiring import licenses, imposing other import barriers, and promoting and supporting its exports. In combination with macroeconomic forces, these trade practices have fostered a Chinese balance of trade surplus with the world and a rapid buildup in foreign reserves.

In addition to these factors, the U.S. trade deficit with China has recently grown because U.S. demand for goods from China has grown more rapidly than Chinese demand for U.S. goods. Over the past 4 years this bilateral U.S. trade deficit has risen from $30 billion to $50 billion.[3] Top U.S. exports to China tend to consist of high-technology goods, such as aircraft, while the top U.S. imports from China include many low-technology products such as toys and apparel. U.S. imports from China also include products such as electrical machinery. The United States has negotiated with China to open its markets through numerous bilateral trade agreements, including a 1979 agreement that approved reciprocal MFN status between the two countries[4] (for more information on U.S.-China bilateral trade agreements, see app. I).

Since 1986, China has been negotiating to join the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT). China will have to make significant changes to its economy to be able to meet WTO commitments (for a brief discussion of China's

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[3]There is sometimes a discrepancy between the trade statistics of the United States and China, mainly because of the differences in how they calculate bilateral trade through Hong Kong.

[4]The Agreement on Trade Relations was signed on July 7, 1979, under section 405 of the Trade Act of 1974, as amended. Section 405 authorizes the United States to enter into bilateral commercial agreements that provide MFN status to other countries if the President determines that such agreements promote the purposes of the act and are in the national interest. The agreement is subject to renewal at 3-year periods, but all or part of the agreement may be suspended if a party lacks the domestic legal authority to implement it. The agreement was recently renewed on February 1, 1998.

economy, see app. II). Existing WTO members and countries that agree to join the WTO[5] must abide by a set of rules and obligations that promote trade and increase transparency and fairness in the world trading system. Nondiscrimination toward other WTO members is a fundamental principle in the WTO agreements[6] and is embodied in the granting of MFN status and providing national treatment. Generally WTO members are obligated under the MFN principle to grant each other trade privileges as favorable as they give to any other foreign country. National treatment requires that they treat other member's products no less favorably than they treat their own, once foreign goods have crossed their borders.

China, like other WTO members, will also have to commit to reduce tariffs for industrial and agricultural products and to follow rules designed to limit the use of trade-distorting nontariff barriers (such as subsidies and import licensing requirements). Additional WTO rules cover financial and other services, trade-related investment measures, market access, and trade-related intellectual property rights. WTO members have access to dispute settlement procedures designed to help them more quickly address other members' trade practices that appear to violate WTO rules.[7]

China has sought to join the WTO as a developing country, which would allow it to benefit from longer transition periods given these countries to implement WTO obligations. However, the United States and other countries have maintained that China should be treated as a developed country because of its size and status as a major world exporter. While there is debate about the true size and growth rate of China's economy, there is no doubt that it is very large and has grown rapidly. The Organization for Economic Cooperation and Development (OECD) estimates that China's gross domestic product (GDP) was the second largest in the world in 1997. Despite its size, however, China's economy still is considered "developing" by World Bank estimates. According to U.S. and foreign government officials, negotiations on transition periods and other special treatment for China will be considered on a case-by-case basis since China does not fit neatly into either of these categories of development.

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[5]There are currently 132 WTO members, and an additional 31 have applied for membership. Another 32 countries worldwide are not members of the WTO nor have they applied to join, according to our analysis.

[6]As used in this testimony, the WTO agreements refer to the agreement establishing the WTO and the binding Multilateral Trade Agreements set forth in annexes 1, 2, and 3 of that agreement, as well as subsequent revisions and additions to those agreements. This includes the Dispute Settlement Understanding.

[7]Various WTO agreements establish a national security exception to otherwise agreed to commitments. Under this exception, WTO members can take certain generally described actions they consider necessary for protection of their essential security interests.

Overall, a major objective of the Administration has been to negotiate a WTO accession agreement that is "commercially meaningful to U.S. business."[8]

WTO'S ACCESSION PROCESS

China is currently negotiating with WTO members, including the United States, to join, that is, to "accede" to, the WTO. After joining, China will be bound by the commitments it makes both in the accession negotiations and in the underlying WTO agreements. A successful accession requires the applicant to make the necessary concessions to meet the commercial and trade requirements of the WTO agreements. Thus, the outcome of this process is, to some degree, already determined by the existing agreements, in contrast to traditional trade negotiations; the primary issue for debate is agreeing to what measures a country like China needs to take to assure WTO members that it can meet the requirements. Also, the applicant must negotiate the levels at which it will bind its tariffs[9] with WTO members. Any special provisions granted to the applicant are counterbalanced by greater obligations that the applicant must fulfill. For instance, although members might allow the applicant time to phase in tariff reductions, the applicant might be required to meet additional reporting and transparency commitments during the phase-in process.

The accession process begins when the applicant submits a letter of application to the WTO Director-General. China began this process in 1986 when it applied to the GATT, and renewed its application in 1995 upon the creation of the WTO. This process, diagrammed in figure 1, is comprised of four phases:[10] (1) fact-finding, (2) negotiation, (3) WTO decision, and (4) implementation. China is currently in the negotiation phase of the accession process.

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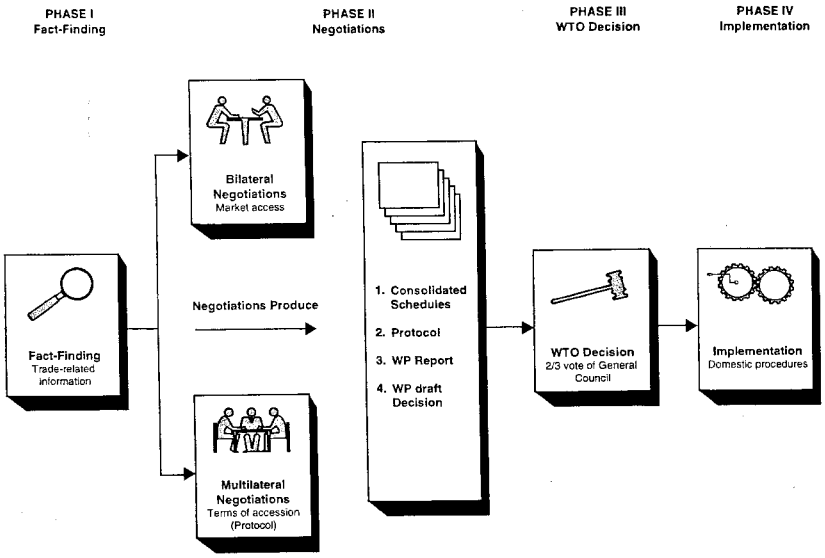
[8]USTR 1998 Trade Policy Agenda and 1997 Annual Report, p. 11.

[9]In international trade, the concept of "binding" is defined as a legal obligation not to raise tariffs on particular products above the rate specified in a country's schedule of concessions. Binding tariffs provide greater commercial certainty by creating a ceiling on tariffs that can be applied by a country.

[10]The first two phases often overlap at times, as parties request more information from the applicant before proceeding with the negotiations.

Figure 1: WTO Accession Process




Legend
WP = Working Party
Source: GAO analysis, based on WTO document, "Accession to the World Trade Organization: Procedures for Negotiations under Article XII."

- Fact-finding: As figure 1 illustrates, in the first phase of fact-finding the WTO working party,[11] assisted by the Secretariat,[12] collects and synthesizes information on the applicant's trade regime. The applicant submits a detailed outline of its trade policies and practices and answers questions until the working party has sufficient information to begin negotiations.

- Negotiation: Figure 1 shows that the second phase of the process follows a two-track approach, involving both bilateral and multilateral negotiations. On a bilateral basis, each working party member negotiates with the applicant on its specific commitments on goods and services under the WTO agreements. The applicant submits an overall market access offer as the starting point for the negotiations, detailing how the country will lower barriers to trade. Although these negotiations are conducted bilaterally, any agreement reached between two countries will apply to all WTO members, as the principle of MFN requires. In the multilateral negotiations, the working party and the applicant negotiate terms for how the applicant will adhere to WTO's principles and technical guidelines, so that the applicant will meet the normal obligations and responsibilities of membership. For example, a country might be asked where and when it would publish new laws, in order to comply with a WTO transparency requirement.

  The negotiation phase results in four documents, which detail the results of the negotiations and make up the applicant's final accession package:

  (1) The Consolidated Schedules: These detail the applicant's specific market access commitments under various WTO agreements, primarily covering individual tariff lines for goods and services. They are annexed to the protocol as an integral part of the agreement.

  (2) The Protocol: This is usually a brief document[13] containing the terms of accession and affirming the applicant's adherence to WTO guidelines and principles.

  (3) The Working Party Report: This provides a narrative on the results of the negotiations. Frequently, the report includes specific commitments made by the applicant regarding how it will meet WTO requirements.

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[11]The working party is created to oversee the negotiations and is open to all interested members of the WTO.

[12]The WTO Secretariat provides administrative and technical support. For example, the Secretariat ensures that parties meet documentation requirements.

[13]China's draft protocol and supporting documents are much more lengthy and detailed than those of most WTO applicants.

Commitments detailed in either the report or the protocol carry the same legal weight for the applicant, according to WTO and USTR officials.

(4) The Draft Decision: Written by the working party, this document affirms the working party's consensus decision on the applicant's bid for accession.

After the working party members conclude all the negotiations and reach consensus on language detailing the terms and conditions for the applicant's membership, they will forward the package to the General Council.

- WTO Decision: The third phase in figure 1 is the formal decision process, in which the General Council (comprised of all WTO members)[14] approves (or rejects) the terms and conditions of the applicant's package. Traditionally, the General Council reaches decisions by consensus. However, if consensus cannot be reached, the draft decision can be approved by a two-thirds majority. Any country that decides to forgo normal WTO obligations and benefits ("non-application"), including MFN, must notify the Council before the Council approves the accession package.

- Implementation: Finally, the last phase in figure 1 is implementation of the applicant's WTO commitments. The applicant's WTO obligations enter into force 30 days after the General Council's approval and the applicant subsequently files its acceptance of membership. The accession package is part of the applicant's WTO agreement, and the acceding country is equally bound by the provisions of the WTO agreements and the commitments in the accession package. In some cases, the applicant's parliament or other legislative body must pass legislation to allow for accession before the applicant submits its acceptance. Applicants must also make the necessary internal adjustments as required by the accession package before the 30-day period begins. The General Council approves the draft decision, and then the applicant becomes a member. The most recent countries to join--Ecuador, Mongolia, Bulgaria, and Panama--were required to eliminate or begin to phase out most trade practices incompatible with WTO rules immediately upon accession.

LEGAL FRAMEWORK AFFECTING CHINA'S WTO ACCESSION

At this point, my statement will discuss (1) USTR's requirement to consult with Congress before a U.S. vote on China's WTO membership, (2) presidential determinations on

[14]The General Council has the authority to carry out the responsibilities of the Ministerial Conference, which must approve membership, so in this sense they are one and the same (and are often used interchangeably).

China's state trading enterprises, (3) provisions in U.S. law affecting China's MFN status, (4) the potential use of WTO's non-application provision if China joins the WTO, and (5) implications for the United States if non-application is invoked.

Consultation Requirement

Under U.S. law, USTR is required to report to and consult with appropriate Congressional committees before any WTO General Council vote on an applicant's membership when a vote would either substantially affect U.S. rights or obligations under the WTO agreement or potentially entail a change in federal law.[15] In view of China's importance to U.S. foreign trade and the MFN issue described in our later comments, it is clear that this consultation requirement would apply to a vote on China's membership in the WTO.

Presidential Determinations on State Trading Enterprises

Before China joins the WTO, another United States law[16] requires the President to make certain determinations about China's state trading enterprises.[17] Specifically, the President must decide (1) whether China's state trading enterprises account for a significant share either of China's exports, or China's goods that are subject to competition from goods imported into China; and (2) whether these enterprises adversely affect U.S. foreign trade or the U.S. economy. If both determinations are affirmative, the WTO agreement cannot apply between the United States and China until either China enters into an agreement that addresses the operations of state trading enterprises, or legislation is enacted approving application of the WTO agreements to China.

China and U.S. MFN Law

A key legislative action Congress will face before China becomes a WTO member is whether to remove China from coverage under title IV of the Trade Act of 1974. Specifically, Section 401 generally requires the President to deny MFN to products from a

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[15]The Uruguay Round Agreements Act (P.L. 103-465, 108 Stat. 4828, codified at 19 U.S.C. §§ 3531-32). The term "appropriate congressional committees" means the House Committee on Ways and Means, the Senate Committee on Finance, and any other congressional Committees that have jurisdiction over the matter with respect to which consultations are to be held.

[16]The Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418, 102 Stat. 1133, codified at 19 U.S.C. 2905).

[17]For purposes of this provision, state trading enterprises are defined as government entities or businesses that are owned, controlled, or supported by the government and that purchase goods or services in international trade for purposes other than government use.

number of countries, including China.[18] Section 402, better known as the "Jackson-Vanik Amendment,"[19] permits a 1-year exception when the President determines that a country, such as China, substantially complies with certain freedom of emigration objectives.[20] The President can recommend renewal of these waivers for successive 12-month periods if he determines that further extensions will substantially promote these objectives. These recommendations must be made 30 days before the end of the previous year's waiver period, that is, by June 3. Congress has up to 60 days from the end of the waiver period to pass a joint resolution disapproving the waiver. If necessary, Congress has an additional 15 days to override any presidential veto of such a resolution. China first received a waiver in 1980, and U.S. presidents have renewed the waiver from 1981 to most recently, on June 3, 1998.

Since the Jackson-Vanik amendment provision only allows a 1-year waiver of title IV restrictions and Congress can disapprove the waiver, the Administration plans to ask Congress to enact legislation that would remove China from title IV's coverage. The Administration believes that temporary, that is, conditional MFN under Jackson-Vanik conflicts with the WTO obligation to provide unconditional MFN to WTO members.

In the past, Congress has passed legislation removing certain WTO/GATT members from title IV's coverage and granting them permanent MFN. For example, in 1996 the Congress enacted legislation[21] providing the President with discretionary authority to grant permanent MFN to Bulgaria, which the President did on September 27, 1996.[22] This approach appears to increase the administration's leverage to obtain final commitments. At least one bill, S. 737, currently pending in Congress takes the same approach for China. Other pending bills, S. 1303 and H. R. 1712, for example, do not provide the President this

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[18]Like China, Albania, Armenia, Belarus, Georgia, Kazakhstan, Kyrgystan, Laos, Moldova, Russia, Ukraine, Uzbekistan, and Vietnam, which also wish to join the WTO, receive conditional MFN from the United States. Estonia, Latvia, Lithuania, and Cambodia have also applied for WTO membership and have been provided permanent MFN under U.S. law.

[19]Section 409 of title IV, which deals with certain other sanctions against countries with emigration restrictions, is also part of the Jackson-Vanik amendment.

[20]The country cannot deny its citizens the right or opportunity to emigrate; impose more than a nominal tax on emigration or on documents required for emigration; or impose more than a nominal tax, fee, or any other charge on any citizen because of his or her desire to emigrate to any country.

[21]Public Law 104-162, sec. 2.

[22]Proclamation 6922, 61 Fed. Reg. 51205 (Sept. 27, 1996).

kind of discretionary authority. Instead, they provide that on the day China becomes a WTO member title IV shall no longer apply, and China's products shall receive MFN.

Non-application Clause

If China becomes a WTO member and Congress has not passed legislation removing China from title IV's coverage, the Administration plans to invoke the "non-application clause" of article XIII of the WTO agreement. The "non-application clause" permits either a WTO member or an incoming member to refuse to apply WTO commitments to each other. In the past, the United States has invoked non-application when countries have joined the WTO (or GATT) and Congress had not repealed title IV of the Trade Act for the incoming member. Table 1 lists these instances.

Table 1: Countries Lacking Unconditional MFN Status Upon Joining WTO/GATT

| Country | Accession date to WTO/GATT | Date unconditional MFN granted by United States |
|---|---|---|
| Romania | Nov. 14, 1971 | Nov. 7, 1996 |
| Hungary | Sept. 9, 1973 | April 10, 1992 |
| Mongolia | Jan. 29, 1997 | Pending[a] |

Legend
NA = not Applicable

[a]There is pending legislation before Congress that would grant Mongolia this status.

I would like to point out four important characteristics of the WTO non-application clause. A member (and, when appropriate, an incoming member):

(1) must notify the WTO of its intent to invoke non-application before the new member's terms of accession are approved by the General Council;

(2) may invoke non-application and still vote to have the new member admitted to the WTO; the United States did this for Mongolia's accession in 1997;

(3) cannot invoke non-application selectively, because the clause covers all WTO obligations. For example, the United States cannot choose to withhold its WTO MFN obligation and then apply other WTO provisions to China such as dispute settlement procedures; and

(4) may later rescind non-application, resulting in both parties applying all WTO rights and obligations to each other. For example, the United States did this for Romania and Hungary.

Implications of Non-application for the United States

If China joins the WTO and the United States invokes non-application, any MFN rights between the United States and China will come from the 1979 U.S.-China Bilateral Agreement on Trade Relations. Although neither we nor USTR have compared in detail the scope of MFN under the 1979 agreement and that provided in the WTO agreements, the coverage under the former does not appear to be as comprehensive. For example, the 1979 agreement does not establish clear MFN obligations for services and service suppliers,[23] nor does it provide for compulsory dispute settlement procedures. For instance, if the United States believes that China has violated its WTO commitments, the United States would be unable to bring China to WTO's dispute settlement body.

An important consequence of the United States invoking WTO non-application is that if China becomes a member, it does not have to grant the United States all the trade commitments it makes to other WTO members, both in the negotiated accession package or in the underlying WTO agreements. Because U.S. businesses compete with business from other WTO members for China's markets, this could potentially put U.S. business interests at a considerable competitive disadvantage. For example, the United States may not benefit from Chinese concessions regarding services, such as the right to establish distribution channels in China. While the United States would continue to benefit from Chinese commitments made in bilateral agreements concluded with the United States, the commitments are not as extensive as those in the WTO agreements.[24]

In summary, the size of the Chinese economy and the extent of its reform efforts create challenges for negotiators and policymakers trying to integrate China into the WTO. As part of any congressional deliberation to remove China from coverage of title IV of the Trade Act, it will be important to evaluate China's accession package, and the advantages and disadvantages of providing China permanent MFN. This would include determining if the accession package has met the Administration's objective of producing a

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[23]When the United States invoked non-application for Romania and Hungary, trade relations with those countries were established through bilateral agreements, which were fairly extensive in comparison to GATT/WTO commitments, according to an International Trade Commission official.

[24]Nevertheless, the United States might still benefit indirectly from China's WTO commitments for increased transparency and certain changes in standards and regulations.

"commercially meaningful" agreement. Congress will be evaluating an agreement that covers a wider array of issues than those of other new WTO members with MFN restrictions. As requested, we will be working with your staff to help evaluate this agreement when it is finalized.

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This concludes my statement for the record. Thank you for permitting me to provide you with this information.

## U.S.-CHINA BILATERAL TRADE AGREEMENTS[1]

The framework for current U.S. trade relations with China is based upon the Agreement on Trade Relations that was signed on July 7, 1979. The agreement established reciprocal Most-Favored-Nation (MFN) status between the two countries and committed both parties to protect intellectual property. Since then, the United States has attempted to increase market access and reduce trade barriers and other trade distorting policies and practices by entering into numerous bilateral trade agreements with China (see table I.1). Nevertheless, China's implementation of these agreements has been uneven, according to the U.S. Trade Representative (USTR). China still restricts imports, subsidizes Chinese exports, and maintains significant barriers to foreign business penetration, according to USTR.

For example, the United States has entered into a series of agreements with China regarding China's protection of intellectual property rights (IPR). Under the Memorandum of Understanding on the Protection of Intellectual Property Rights signed in 1992, China amended its patent law, issued copyright regulations, joined international copyright conventions, and enacted protection for trade secrets. However, U.S. officials subsequently determined that China did not establish an adequate and effective mechanism for IPR enforcement. As a result of a Special 301[2] investigation, the two parties signed an additional IPR agreement in 1995 in which China committed to (1) provide improved protection for copyrights, (2) strengthen border controls, (3) institute trademark law modernization, and (4) intensify a "Special Enforcement Period" aimed at cracking down on piracy. However, China's continued insufficient implementation of the 1995 IPR agreement led the United States to threaten to impose sanctions in May 1996; the two parties avoided sanctions with the signing of an agreement in June 1996, which confirmed China's most recent attempts to enforce the 1995 agreement.

In addition, the United States and China have signed a series of bilateral trade agreements to improve the regulation and pricing of satellite launch services. In 1995 the United

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[1]The information contained in this appendix is drawn from USTR and International Trade Commission documents.

[2]Under "Special 301" of the 1974 Trade Act, as amended, USTR performs an annual review to identify countries that do not provide adequate or effective protection for U.S. intellectual property rights. If a country is designated a "priority foreign country," USTR must decide within 30 days whether to initiate a Special 301 investigation into the country's IPR practices. 19 U.S.C. §§ 2242, 2412.

States and China renewed the Bilateral Agreement on International Trade in Commercial Space Launch Services for the period between 1995 and 2001. To further clarify the Agreement's provisions on low earth orbit satellites (LEO), the two countries signed an annex containing specific LEO pricing guidelines in 1997.

Table I.1: U.S.-Chinese Bilateral Trade Agreements, 1984-1997

| Agreement | Date signed | Issue |
|---|---|---|
| Accord on Industrial and Technological Cooperation | 1/12/84 | Committed the United States and China to promote and facilitate technology transfer and trade in technology products |
| Memorandum of Understanding on the Protection of Intellectual Property Rights | 1/17/92 | Committed China to provide significantly improved protection for U.S. inventions and copyrighted works |
| Memorandum of Understanding on Prohibiting Import and Export in Prison Labor Products | 6/18/92 | Permitted U.S. embassy officials to visit Chinese prisons suspected of producing goods for export to the United States |
| Memorandum of Understanding Concerning Market Access | 10/10/92 | Committed China to changes in its import regime, including gradual elimination of most nontariff barriers such as quotas and licenses, elimination of import substitution policies, publication of all trade laws and regulations and ban on the use of sanitary and phytosanitary standards as trade barriers |
| Memorandum of Agreement to Renew the Bilateral Agreement on International Trade in Commercial Space Launch Services | 3/13/95 | Specified limits on China's geosynchronous earth orbit (GEO) launches and improved GEO pricing practices |
| Agreement on Providing Intellectual Property Rights Protection | 2/26/95 | Committed China to take specific actions to provide protection of IPR for U.S. companies and provide market access for U.S. intellectual property-based products |
| Agreement on Intellectual Property Rights | 6/17/96 | Outlined the steps China took to implement the 1995 IPR agreement and provided more detailed market access guidelines concerning IPR |
| Agreement on Trade in Textiles and Textile Products | 2/1/97[a] | Opened the Chinese market to textile and apparel exports from the United States by reducing tariffs and binding tariffs at applied rates |
| Interim Agreement on Market Access for Foreign Financial Information Companies | 10/24/97 | Secured market access terms for foreign financial information companies operating in China |
| Agreement to Strengthen Space Launch Trade Terms | 10/27/97 | Placed guidelines on the Chinese pricing of LEO launches |

[a]Final exchange of diplomatic notes has not yet occurred. The agreement is being applied provisionally in the interim.

Sources: USTR 1998 Trade Policy Agenda and 1997 Annual Report; United States International Trade Commission (USITC) The Year in Trade (1992, 1995, 1996); Statement of Ambassador Michael H.Moskow, Deputy USTR, on the Preservation of MFN Status for China, Before the Subcommittee on Trade, House Ways and Means Committee (June 29, 1992); 1998 National Trade Estimate Report on Foreign Trade Barriers.

## OVERVIEW OF CHINA'S ECONOMY

China is undergoing a historic transformation, as market reforms and integration with the world economy create growth and increased trade and investment. In 1997, China's second largest export market after Hong Kong was the United States; China's bilateral trade surplus with the United States has more than doubled since 1993 to about $50 billion in 1997. However, substantial trade and investment impediments remain. According to U.S. government and foreign officials, the size of the Chinese economy and the extent of its reform efforts create challenges to negotiators and policymakers trying to integrate China into the WTO. At the end of this appendix, we provide a table with some statistics on the Chinese economy.

### CHINA'S ECONOMY

According to our review of the economic literature, China, for almost 30 years prior to 1979, had a rural, developing economy with relatively few connections to the rest of the world. The Chinese communists ruled over a centrally planned economy in which prices were set by the state. In late 1978, China's leaders introduced market reforms into the agricultural sector, where 71 percent of China's labor force worked. As agriculture yield increased, market reforms were introduced into other specific sectors and locales and then gradually expanded to other regions and sectors of the economy. Today, almost all sectors of the economy are a mix of market-oriented reforms and state planning. Experts generally credit these reforms and China's high rates of investment and saving as principal reasons for China's high growth rates during the last 20 years. They also credit these reforms for making China's economy much more developed, open to international trade and investment, and market-oriented.

China's economy appears to be very large and growing quite quickly, although not as fast as indicated by the widely publicized Chinese official figures. According to official Chinese figures, in 1997 GDP was $900 billion, per capita gross domestic product (GDP) was $724, and growth since 1986 averaged almost 10 percent per year.[1] The most recent data from the Organization for Economic Cooperation and Development (OECD) suggest that China is the second-largest economy worldwide.

In 1997, China was the world's 10th largest exporter, 12th largest importer, and the largest trading nation that is not a WTO member. According to the economic literature, China has become increasingly open to international trade and investment since 1978, although it retains significant trade and investment barriers.

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[1]All dollar data are current/nominal dollars.

SUBSTANTIAL CHINESE TRADE AND INVESTMENT IMPEDIMENTS REMAIN

China has been negotiating to join the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT), since 1986. Despite substantial reforms, China will have to make significant changes to its economy to meet WTO rules and obligations.

Today, China still restricts imports, promotes and supports Chinese exports, and maintains significant barriers to foreign business penetration, according to U.S. Trade Representative (USTR) and Commerce Department reports. They report that China's import restrictions include high tariffs for specific sectors and other taxes on imports; nontariff barriers such as import licenses, import quotas, limitations on which enterprises can import, and limitations on access to foreign exchange. They also report that China promotes exports by providing exporters with access to funds, freight services, and inputs on noncommercial terms. China also provides exporters with income tax reductions and imposes foreign exchange earning and export requirements on foreign corporations in China.

According to these reports, significant barriers or impediments to foreign business operating in China include guiding foreign investment to certain sectors; protecting state-owned enterprises from competition by law, regulation, and/or custom; restricting the opening of branches of foreign banks, insurance companies, accounting, and law firms to selected companies and particular locales; and prohibiting representative offices of foreign firms from signing sales contracts or billing customers. They also report on problems from excessive bureaucracy and corruption in China, especially regarding government procurement practices. The corruption problem is confirmed by private studies; one ranked China as the fifth most corrupt among 54 countries surveyed in 1996.

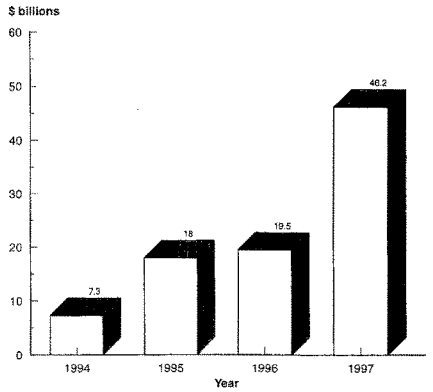
Balance of Payments Accounts

From 1980 until 1994, China's trade and current account balance (its goods, services, income, and current transfers) were more often in deficit than surplus. Current account deficits generally were financed by capital inflows, particularly foreign direct investment, which grew relatively slowly until 1992, and by borrowing from the World Bank. The Chinese government's holding of foreign exchange, the main component of its international reserves, fluctuated moderately.

Beginning in 1993, China has had large capital inflows, due to substantial and growing levels of foreign direct investment. China's goods surplus grew to $7.3 billion in 1994 from a $10.7 billion deficit in 1993. It then grew to $18 billion in 1995, and then jumped to $46.2 billion in 1997. Goods exports rose steadily from $102.6 billion in 1994 to $182.7 billion in 1997. China's goods imports increased more slowly from $95.3 billion in 1994 to

$136.5 billion in 1997. China's goods and services balance grew steadily from $7.6 billion in 1994 to $17.6 billion in 1996, then rose to $40.5 billion in 1997 (see fig. II.1).

Figure II.1: China's Surplus in Goods Trade with the World




Source: International Monetary Fund International Financial Statistics; China's State Statistical Bureau; U.S. Commerce Dept.

At the beginning of 1994, China devalued its official exchange rate to that on the private market, and then rapidly gained foreign exchange under a managed float system at the rate of $22-$35 billion per year. At the end of 1997, China's foreign currency reserves were second only to Japan's, at $139.9 billion.

CHINA'S BILATERAL TRADE WITH THE UNITED STATES

China's surplus in goods trade with the United States has continued to increase for more than a decade. The bilateral surplus rose from $2.8 billion in 1987, to $29.5 billion in 1994

(the year China last devalued its currency), to $49.8 billion in 1997, according to U.S. Commerce Department figures. U.S. goods imports from China have rapidly grown from $6.3 billion in 1987, to $38.8 billion in 1994, to $62.6 billion in 1997. U.S. goods exports to China grew more slowly from $3.5 billion in 1987, to $9.3 billion in 1994, to $12.8 billion in 1997. By 1997, the U.S. goods deficit with China was second to that of Japan for the third straight year. In 1997, goods imports from China were 7.2 percent of all U.S. goods imports, with leading imports of electrical machinery and equipment; toys, games, and sports equipment; footwear; boilers and machinery; and clothing accessories and apparel, much of which tend to be labor-intensive. In 1997, U.S. goods exports to China were 1.9 percent of all U.S. goods exports, with leading U.S. exports to China consisting of Customs categories of nuclear reactors, boilers, and machinery; aircraft and spacecraft; electrical machinery and equipment; and fertilizers. In 1997, the United States was China's second-largest goods export market after Hong Kong, and third-largest source of goods imports after Japan and Taiwan.

Table II.1: Economic Data of China: 1987-97

Billions of current U.S. dollars, unless otherwise noted

| | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Goods trade balance | $(1.7) | $(5.3) | $(5.6) | $9.2 | $8.7 | $5.2 | $(10.7) | $7.3 | $18.0 | $19.5 | $46.2 |
| exports | 34.7 | 41.1 | 43.2 | 51.5 | 58.9 | 69.6 | 75.7 | 102.6 | 128.1 | 151.1 | 182.7 |
| imports | (36.4) | (46.4) | (48.8) | (42.4) | (50.2) | (64.4) | (86.3) | (95.3) | (110.1) | (131.5) | (136.5) |
| Goods and services balance | 0.3 | (4.1) | (4.0) | 10.7 | 11.6 | 6.0 | (11.5) | 7.6 | 12.0 | 17.6 | 40.5 |
| exports | 39.2 | 45.9 | 47.8 | 57.4 | 65.9 | 78.8 | 86.9 | 119.2 | 147.2 | 171.7 | 207.2 |
| imports | (38.9) | (50.0) | (52.8) | (46.7) | (54.3) | (73.8) | (98.3) | (111.6) | (135.3) | (154.1) | (166.8) |
| Current account balance | 0.3 | (3.8) | (4.3) | 12.0 | 13.3 | 6.4 | (11.6) | 5.9 | 1.6 | 7.2 | 30.0 |
| Financial account balance | 6.0 | 7.1 | 3.7 | 3.3 | 8.0 | (9.2) | 23.5 | 32.6 | 38.7 | 40.0 | 23.0 |
| inward foreign direct invest. | 2.3 | 3.2 | 3.4 | 3.5 | 4.4 | 11.2 | 27.5 | 33.8 | 35.8 | 40.2 | 44.2 |
| Overall balance of payments | 4.8 | 2.4 | (0.5) | 12.0 | 14.5 | (2.1) | 1.8 | 30.5 | 22.5 | 31.7 | 35.7 |
| Foreign exchange (yr. end) | 15.2 | 17.5 | 17.0 | 28.6 | 42.7 | 19.4 | 21.2 | 51.6 | 73.6 | 105.0 | 139.9 |
| | | | | | | | | | | | |
| Yuan/U.S. dollar (yr. end) | 3.722 | 3.722 | 3.972 | 4.847 | 5.347 | 5.545 | 5.767 | 8.584 | 8.341 | 8.314 | 8.288 |
| Yuan/U.S. dollar (avg.) | 3.722 | 3.722 | 3.765 | 4.783 | 5.325 | 5.515 | 5.762 | 8.619 | 8.351 | 8.314 | 8.290 |
| | | | | | | | | | | | |
| China's trade balance, with U.S. | $2.6 | $3.5 | $6.2 | $10.4 | $12.7 | $18.2 | $22.8 | $29.5 | $33.9 | $39.5 | $49.8 |
| exports | 6.3 | 8.5 | 12.0 | 15.2 | 19.0 | 25.7 | 31.5 | 38.8 | 46.6 | 51.6 | 62.6 |
| imports (F.A.S.) | (3.5) | (5.0) | (5.8) | (4.8) | (6.3) | (7.5) | (8.8) | (9.3) | (11.7) | (12.0) | (12.8) |
| GDP official | 321 | 401 | 449 | 388 | 405 | 483 | 601 | 543 | 698 | 825 | 902 |

Legend

F.A.S. = free-alongside-ship (a method of export and import valuation whereby the seller's price includes charges for delivery of goods up to the port of departure).

Note: Items in parenthesis indicate a deficit.

Source: International Monetary Fund; International Financial Statistics; China's State Statistical Bureau; U.S. Commerce Dept.

RELATED GAO PRODUCTS

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**Statement of**

**THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS (AAEI)**

***UNITED STATES-CHINA TRADE RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS***

**Prepared for**

**SUBCOMMITTEE ON TRADE**

**COMMITTEE ON WAYS AND MEANS**

**JUNE 17, 1998**

**Introduction and Background**

The American Association of Exporters and Importers (AAEI) is a national organization, comprised of approximately 1,000 U.S. company-members that export, import, distribute and manufacture a complete spectrum of products, including chemicals, electronics, machinery, automobiles/parts, household consumer goods, footwear, food, toys, specialty items, textiles and apparel. Members also include firms and companies which serve the international trade community, such as customs brokers, freight forwarders, banks, attorneys, insurance firms and carriers. Many of AAEI's member firms and companies have or are considering investment in China.

U.S. businesses in these areas of international trade will benefit, either directly or indirectly, from a decision to extend Most-Favored-Nation (MFN) status for China beyond July of 1998. A substantial number of AAEI exporters and importers are currently engaged in direct trade with China, with many AAEI retailer members sourcing as much as 30% - 40% of imports from China. Overall, more than one-half of AAEI's membership is involved in trade with China in some capacity. Considering the importance of continued China MFN for U.S. industry, including AAEI's members, we urge the Administration and Congress to revamp U.S. policy in an effort to avoid the annual MFN debate. To this end, AAEI supports President Clinton's 1994 decision to de-link human rights concerns from MFN consideration and urges serious exploration of long-term or permanent renewal of China's MFN status.

U.S.-China trade and investment has grown tremendously in volume and complexity since the U.S. first accorded China MFN status. Total trade has more than tripled since 1981 and nearly doubled since 1990. Total cumulative U.S. investment in China is rapidly increasing, and China is one of our fastest growing export markets, purchasing an estimated $15.9 billion in U.S. goods and services last year. Beyond China, Asia accounts for over 37% of U.S. trade (compared to 22% for Europe); supports over 3 million export-related American jobs; and represents a major customer for U.S. farm products, including grains, meat, lumber, fish, tobacco, fruits and cotton.

MFN status is the cornerstone of normal commercial trading relationships with countries worldwide, including China, and is a key aspect of the bilateral trade agreement with China negotiated in 1979. The term "most-favored-nation" is a misnomer, suggesting some sort of privileged trading relationship. In fact, we grant most of the world's nations MFN status, which merely entitles a U.S. trading partner to the standard tariff rates available to other trading partners in good standing. The U.S., like most other countries, maintains two complete tariff schedules -- one set of standard rates for MFN countries, and a second set of often prohibitive rates for non-MFN countries. The tariff differential between these rate schedules generally ranges from 10% to 50%, and can be as high as 100% or more for some products, so that the loss of MFN status can effectively price a country's exports to the U.S. out of the market. Currently, these "column 2" rates are only imposed on Afghanistan, Cuba, North Korea and Vietnam. The additional cost associated with denying MFN status would be paid for by U.S. companies and will reek havoc on capital and currency markets, jeopardizing overall economic and political stability in Asia.

**AAEI Supports Unconditional MFN Renewal**

AAEI strongly supports the President's 1994 decision to de-link human rights issues from the annual renewal of China's MFN status. As we testified in previous years, we believe that the threat of terminating China's MFN status is neither an appropriate nor effective tool for addressing human rights concerns. We urge the members of the Trade Subcommittee to take a strong stand in ensuring that human rights issues are kept separate from U.S. trade relations with China, as all of our other trading partners/competitors do.

The Chinese market is already the world's third largest, according to an International Monetary Fund (IMF) study, and until quite recently has experienced an annual growth rate of more than 10%. This market is simply too important to our future international competitiveness and to the battle against inflation in the U.S. to ignore or to jeopardize through an unstable trading relationship. As President Clinton has recognized, MFN is the essential cornerstone for a long-term, stable bilateral relationship with China in both the economic and foreign policy realms. Any annual review process introduces uncertainty, weakening the ability of U.S. traders and investors to make long run plans, and saddles U.S./China trade and investment with a risk factor cost not faced by our international competitors.

AAEI members agree that human rights issues warrant our attention and further bilateral negotiations between the U.S. and China. However, the Association does not believe that the threat of terminating MFN is an appropriate or constructive tool for pursuing this important U.S. foreign policy objective. History suggests that despite China's strong interest in trade with the U.S., efforts to impose our will on the Chinese government through a series of public demands will prove to be counterproductive. MFN is the foundation on which the U.S. bilateral relationship with China rests.

Terminating MFN for China would not simply result in higher tariff rates for some imported goods, it would sever the basic economic, financial-- and, consequently, geopolitical -- relationship between the two countries and all of Asia. It would also strengthen those in China who desire to see the People's Republic turn inward again, away from ideologically threatening capitalist influences, and would weaken those liberalizing forces that we seek to encourage.

**China's Post-June MFN Status Should Be Renewed**

AAEI supports the President's human rights objectives. For reasons noted above, we do not believe that the unilateral threat to eliminate MFN -- and the uncertainty associated with annual MFN debates -- furthers either U.S. foreign policy or trade objectives. As an association of companies engaged in trade with China, the balance of our comments will focus on the trade and economic aspects of the debate. This, however, should not in any way be construed to suggest any lesser interest in the successful resolution of U.S. human rights concerns in China.

China has made some good faith efforts to respond to U.S. market-opening initiatives. Among important developments, China has agreed to remove high tariffs on hundreds of U.S. imports, increase transparency with regard to its trade operations and move towards currency convertibility. Recently, China has exercised great restraint by refraining from devaluing the yuan. This is despite the great pressures on its economy due to the extreme weakening of the Japanese yen, which is making Chinese exports far more expensive in Japan, Asia and the rest of the world.

There are a many other reasons for supporting the continuation of MFN treatment for China. Trade with China must be kept open to maintain benefits to U.S. industry of a bilateral economic relationship with China. Failure to renew MFN would threaten the jobs of thousands of U.S. workers producing goods for export to China and would harm American businesses relying on Chinese imports for their livelihood. Tariffs, which are at an average 4% - 5%, would skyrocket to as high as 110% in some cases, increasing costs to American consumers by billions of dollars. In many cases, this increased cost would be inflationary and fall most heavily on those Americans least able to bear the burden.

The loss of China's MFN status would also have both immediate and long-term consequences for AAEI members and the entire importing community. In the short-term, they would incur significant losses on merchandise already contracted for sale at a specific price, but not yet delivered. Payment for these orders are often guaranteed by irrevocable letters of credit. If duty rates increased from Column 1 to Column 2 levels before Customs clearance, these companies would be required to absorb the increases or pass them on to American consumers. American companies and American consumers, not Chinese, are harmed by increasing duty rates for merchandise which was previously ordered.

**An MFN Cut-Off Would Have A Deleterious Impact on Global Markets**

Over the longer term, revocation of MFN could force China to devalue the yuan. With the devaluation, there would be a ripple effect - shaking currency markets to creating political and social unrest throughout the Asian region. The culmination would be global deflation which would result in severe consequences for U.S. exporters.

China represents a significant, and very promising, market for U.S. exports, with approximately $15.9 billion worth of American goods purchased by the Chinese last year. The Department of Commerce estimates the value of U.S.-China trade and investments will be $600 billion in the next five to seven years. Historically, China has been quick to retaliate against foreign countries perceived as interfering with domestic issues. It would not be surprising for China to withdraw MFN for American goods and services and to limit U.S. investment and government procurement opportunities in response to elimination of MFN for Chinese goods. Important U.S. industry sectors such as agriculture and aircraft have recently been hit by Chinese willingness to turn to our competitors when its exports are threatened. It would be truly ironic if the net result of the last few year's hard-won Chinese market opening commitments expanded business for European and Japanese competitors because U.S. companies are effectively excluded from the market by a U.S. -China breakdown.

China's economy has grown rapidly in recent years and is poised for major expansion over the next decade as China rationalizes its economy. According to an IMF study, China's economy is now the world's third largest. U.S. companies have established a major presence in China, providing an ideal foundation for future expansion. A trade breach would threaten this foundation. It would also provide U.S. competitors in Asia and Europe with a major advantage.

**MFN Trade Sanctions Would Be Counterproductive**

Unilateral trade sanctions imposed for foreign policy purposes have a very poor history of effectiveness. They serve mainly as symbolic gestures, often at great expense to U.S. economic interests, U.S. exports and foreign market share, and consumer prices.

Elimination of China MFN, and the resulting withdrawal of U.S. business from China, would decrease Chinese exposure to Western values and free market ideas which have clearly played a part in China's move toward trade liberalization and a market economy. Liberalized market-oriented sectors, such as those in South China, would be the first to be injured or even shut down if MFN were withdrawn, and Chinese authorities would direct business back to state-owned enterprises. Terminating MFN would merely enable Chinese authorities to blame the U.S. government for its current domestic economic problems, further strengthening hard-line, anti-Western elements in the government. AAEI reminds Congress that this is a precarious time for the overall economic and political stability of the entire Asian region.

**The U.S. Should Support China's Admission To The WTO**

China's accession to the World Trade Organization (WTO) under commercially acceptable terms will open markets for U.S. goods and services, assure market-oriented economic reforms, and subject China to the rules and disciplines of the global trading system. This is the United States' strongest opportunity to get China to commit to central WTO principles, including national treatment, non-discrimination, reciprocal market access, transparency, protection of intellectual property rights (IPR), binding dispute settlement, trading rights, judicial review, uniform application of laws, and adherence to state-trading subsidy programs. Once a member of the WTO, China will be subject to the force and scrutiny of the global trade community as opposed to the U.S. acting alone.

In order to effectively secure the full benefits of China's market-opening commitments, the U.S. must extend "permanent MFN." The WTO's "unconditional MFN" clause, set forth in GATT Article I, requires all members to provide unconditional MFN to every other member. If the U.S. continues to "condition" China's MFN status on annual reviews, China would have the legal right, under WTO, to withhold the full benefits of the agreement.

We support the role of Congress in consulting on the terms on any WTO accession protocol. However, we oppose new legislation that would require Congress to formally ratify China's accession and add new statutory pre-conditions. This invites camouflaged projectionist measures.

For over two decades, U.S.-China commercial relations have been defined by the Jackson-Vanik Amendment to the Trade Act of 1974, which is an outdated provision, implemented during Cold War conditions. By law, Jackson-Vanik relegates the U.S. to a second-class commercial relationship with China. The U.S. stands alone in this policy. All other major exporting nations grant China permanent, unconditional MFN. The U.S. restrictive policy only serves to isolate U.S. companies, workers and farmers in the Chinese marketplace. Jackson-Vanik is a constant cloud of uncertainty over the entire U.S.-China relationship, driving Chinese purchasers to source from their more reliable European, Japanese, Canadian or Australian counterparts.

**Conclusion**

AAEI strongly supports renewal of MFN for China for another year. As stated, AAEI supports the President's 1994 decision to de-link human rights issues from the annual renewal of China's MFN status. Although we recognize the importance of focusing attention on human rights concerns in China, we do not believe that terminating China's MFN status will contribute to this worthy objective. We urge members of the Subcommittee to take a strong stand to ensure that human rights issues are kept separate from U.S. trade relations with China, as is the case with almost all of our other trading partners.

China is facing great pressure to devalue the yuan. Revocation of MFN might be the inciting incident causing it to abandon its current self-restraint. A devaluation of the yuan would have severe economic, political and social consequences for Asia and the rest of the world. Ultimately, U.S. exporters would pay a heavy price.

AAEI supports initiatives by the Administration and Congress to grant China MFN status on a permanent basis and urges serious consideration of a revision of the Jackson-Vanik Amendment toward this aim. A revision of Jackson-Vanik does not require a revision of U.S. human rights objectives in China. AAEI supports those human rights objectives. AAEI believes that President Clinton correctly determined that those objectives should not be limited to trade issues between the United States and China. The U.S. human rights objectives can, and should, be attained without terminating China's MFN status. Terminating China's MFN status could only harm U.S. trade and foreign policy interests, and ultimately, the progressive forces in China on which future progress will depend.

# THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG

**Position Paper**

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## Most Favored Nation Status for China

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### *The Issue*

The Jackson-Vanik Amendment to the 1974 Trade Act imposes a requirement on the Administration to decide each year whether to extend Most Favored Nation (MFN) tariff treatment for exports from the People's Republic of China. The annual, and often acrimonious, debate over China's MFN status undermines U.S. commercial and strategic interests and allows China policy to be exploited as a partisan political weapon.

### *Position*

**CHINA'S MFN SHOULD BE RENEWED WITHOUT CONDITIONS**

### *Rationale*

MFN is not preferential treatment. It is the standard bilateral trading relationship the U.S. maintains with all but six countries -- Afghanistan, Cuba, Laos, North Korea, Serbia and Vietnam. Every other major exporting country provides China with permanent, unconditional MFN.

*The U.S. - China relationship is multi-faceted. There are many areas of common interest as well as unilateral concerns. Maintaining a constructive dialogue across all fronts, and particularly continuing normal trade relations, is helpful to all facets of the relationship.*

***Granting MFN is key to stable US-China relations.*** Stable, predictable relations are critical, not only to both countries, but to global stability. In order to protect our vital economic and strategic interests in the Asia-Pacific region, the U.S. should pursue a policy that encourages China to integrate into the international system and uphold accepted rules and norms. This can be accomplished only if the U.S. interacts with, rather than isolates, China. Beijing's willingness to cooperate on maintaining economic stability in Asia is a good example of the benefits of engagement.

***Revocation of MFN would seriously damage Hong Kong, undermining an important bastion of economic stability in Asia.*** Hong Kong could lose as much as US$30 billion in trade and related industry revenues. GDP growth would likely be curtailed by about three percentage points. Approximately 86,000 jobs could be lost. This would cause serious damage to the Hong Kong economy, which has to date been one of the few bulwarks of economic stability in Asia, thus complicating America's efforts to foster economic recovery in the region.

***Revocation of MFN would undercut economic reform in China.*** In the past decade, China's market-oriented economic reforms have led to sweeping changes in Chinese society, resulting in dramatic improvements in living standards and the quality of life for the average Chinese citizen. Withdrawal of MFN would exact a heavy toll on the Chinese economy. Ordinary Chinese people would suffer the greatest pain, as millions of workers would lose their jobs. This would come at a time when China's efforts to reform its state-owned enterprises are already creating greater unemployment.

***American companies are a force for positive change in China.*** U.S. business has played a unique role as a catalyst for positive change by promoting American values, human welfare and the principles of free enterprise. American companies set high standards for ethical business practices, industrial safety, environmental conditions, and worker rights. The improvements in quality of life attendant upon the presence and involvement of American business in China and the prosperity created by international commerce should not be put at risk.

***Revocation of MFN would seriously jeopardize US economic interests.*** American exports totaling US$12.8 billion to China and US$15.1 billion to Hong Kong would be put at risk. As many as 200,000 American jobs could be affected, especially in agriculture, aviation and various high-technology industries. The U.S. economy would also lose the job-creating potential of a rapidly growing export market. American consumers would pay significantly more for items such as apparel, footwear, electrical appliances, and toys. The uncertainty each year over China's MFN status puts U.S. business at a competitive disadvantage. Japan and Europe are poised to benefit as China spends several hundred billion dollars over the next decade to improve its infrastructure.

***MFN renewal should not be used as an annual opportunity to pillory China.*** Some members of Congress believe that the annual MFN debate provides an opportunity to express dissatisfaction with a wide range of Chinese practices and the Clinton administration's China policy, with little harm done so long as MFN is renewed. However, publicly pillorying China every year prior to the renewal of MFN has exacted a significant relationship cost. In particular, it has bred resentment and cynicism in China, which have complicated efforts to cooperate with Beijing in important areas such as improving human rights, combating environmental degradation, controlling weapons proliferation, and strengthening regional security. The United States should vigorously pursue its objectives but without relying on counter-productive threats to revoke MFN. Such threats only serve to undermine U.S. credibility and competitiveness.

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*The American Chamber of Commerce in Hong Kong is a non-partisan, non-profit business organization. AmCham advocates the principles of free trade, open markets, private enterprise, the unrestricted flow of information, and ethical business practices. AmCham's mission is to foster the development of commerce between the United States, Hong Kong and the Asia-Pacific region.*

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The American Chamber of Commerce
People's Republic of China • Beijing

**Renewal of MFN for China**

**Position:**

**AmCham China urges Congress to uphold, without conditions, the President's decision to renew MFN treatment for China this year. MFN is not preferential treatment. It is the cornerstone of a normal bilateral trading relationship. The annual debate over China's MFN status undermines US commercial interests in China and significantly strains US-China relations. Moreover, withdrawal or conditioning of MFN this year would be a potentially destabilizing move in a region already rocked by financial and trade uncertainties.**

* * * * * * * * * * * * * * * * * * *

The American Chamber of Commerce in China strongly urges Congress to uphold so-called "most-favored-nations" (MFN) treatment for China this year.

Despite its name, MFN status is not preferential treatment. Quite the contrary, it is the cornerstone of any normal bilateral trading relationship, and amounts to no more than "normal trading rights." MFN status merely accords a country the same level of tariff rates the United States extends to imports from virtually all of its trading partners. Only four of the 227 countries with which the United States traded last year did not enjoy MFN status.

Withdrawal or conditioning of China's MFN status would invite retaliation, which would jeopardize billions of dollars of US exports to, and business in, China. China's imposition of prohibitively high tariffs on US goods, in retribution for our withdrawal of MFN treatment would, in turn, give our foreign competitors an added unfair advantage in the rapidly expanding Chinese economy and damage the ability of American companies to compete internationally.

Longer term, the annual debate over China's MFN status undermines the credibility of American companies as reliable trade partners for China and puts at risk billions of dollars in US export sales. The annual review also damages US-China relations and creates uncertainties for American exporters.

Annual review of the MFN status granted to non-market economies like China was originally conceived as a means to promote freedom of emigration from the former Soviet Union. China, by contrast, has few barriers to emigration. Using the threat of revoking MFN status to accomplish other objectives in China -- be they in the area of human rights, religious freedoms or other concerns -- has nothing to do with the original intent of the Congress. Most importantly, unilateral sanctions are a blunt instrument ineffective in producing changes in Chinese behavior. Ending the annual review of China's MFN status once and for all would be a highly constructive step to strengthen and normalize the US-China relationship and to ensure a stable environment for increased American exports to China.

(June 1998)

The American Chamber of Commerce
People's Republic of China • Beijing

**Impact of Trade with China on US Jobs**

Position:

**Trade with China -- both US exports to China and imports from China -- supports American jobs. Our ability to compete in China helps American companies achieve the economies of scale and competitive leverage needed to succeed in other international markets -- a key ingredient in sustaining a strong and thriving US economy.**

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Trade with China supports a substantial number of US jobs, both through direct exports to and imports from China, as well as in support of US operations in China. American firms are up against strong international competition in almost all industries. If a company cannot win in the China market now, it will cede job-creating growth opportunities there to European, Japanese and other worldwide competitors.

Open trade and investment create employment in both the United States and China. In 1997, based on a Commerce Department formula, over 225,000 Americans owed their jobs to over $16 billion in exports to China. These export-related jobs typically pay an average of 13-16% more than the national wage average. For each job generated directly by exports, on average an estimated two more are indirectly created. US-China trade supports tens of thousands of such jobs in US transportation companies, retail establishments, financial services firms, and consumer goods outlets.

China has become a significant export market for many categories of US goods, with year-on-year export growth in important sectors such as aircraft, agricultural oils and mineral fuels ranging from 48% to over 350%. China and Hong Kong together is the fourth-largest export market for American agriculture, with by far the most potential. Analysts estimate that 75% of the future growth in US farm exports will be in Asia, and China alone will account for 50% of that increase.

A reduction in trade with China would have a significant negative impact on jobs in the United States, and the potential job loss caused by a decrease in US exports would fall heavily on certain states. In 1997, for example, California exported $2.0 billion worth of goods to China, Washington State came in at just over $1.8 billion, Texas exported $1.3 billion, and Louisiana exported almost $1.0 billion in merchandise to China. Those four states alone accounted for about 48% of total US exports to China. As of mid-1997, China was California's 16th-largest export market--and climbing. At least 150 companies in Los Angeles and Orange counties today export merchandise to China, most of them small businesses with annual sales of $10 million or less, according to the World Trade Center Association of Los Angeles and Long Beach. The Los Angeles Customs District reported it handled 31% of total 1995 trade between the US and China and Hong Kong, creating jobs at ports and airports, as well as transportation firms, freight handlers, distributors and banks.

Similarly, if imports from China were drastically reduced, the immediate impact would be on US importers and retailers, and inevitably consumers, in trying to replace goods from China with domestic substitutes or those from other countries.

(April 1998)

The American Chamber of Commerce
People's Republic of China • Beijing

## The US-China Commercial Relationship

Position:

**AmCham China promotes US and Chinese policies that expand trade and investment between the two countries. To achieve this goal, the United States should de-politicize and normalize trade with China by extending MFN status on a permanent, unconditional basis and by removing all unilateral commercial sanctions against China. On its part, China should improve its offer to join the WTO, so that accession can be granted on commercially meaningful terms that provide American firms significantly better access to the Chinese market.**

* * * * * * * * *

The American Chamber of Commerce in China supports the policy of developing a constructive, strategic partnership between the United States and China. The current relationship is hampered by serious mutual misperceptions and disagreements which, through dialogue and cooperation, can gradually be reduced or eliminated, to the benefit of both countries. Increasing bilateral trade and investment is an important cornerstone of such a strategic partnership. Cooperation in these areas will help enable the two countries to resolve other, more difficult bilateral issues.

This year offers many important opportunities to build on the momentum already achieved in improving the bilateral relationship. One of the most important is to de-politicize and normalize the trade relationship by ending the annual debate over Most-Favored Nation (MFN) treatment for China. Trade is beneficial to the people of both countries and provides countless win-win opportunities for cooperation. Threatening to discontinue MFN seriously damages possibilities for the United States and China to work together on all issues, both those where our interests converge and those where they diverge. The US should extend MFN to China on a permanent and unconditional basis, as it does to all but four of over 200 countries with which we trade.

Similarly the United States should, finally, remove the unilateral commercial sanctions it imposes on China. These include suspension of the highly cost-effective Trade and Development Agency programs in China and denial of funding from the US-Asian Environmental Partnership. Experience has shown that unilateral sanctions are a blunt instrument ineffective in producing changes in Chinese behavior.

China's export trade has long been favored by America's open markets, while China has maintained unacceptably high barriers to US goods and services. Accession by China to the World Trade Organization (WTO) will not only consolidate and deepen Chinese market reforms of the past 20 years, but will further integrate China into the global economy, to China's benefit and to the benefit of the US and other WTO members. It is time for Chinese policymakers to open and liberalize its markets by offering a solid, commercially meaningful WTO accession package.

American business's continued ability to create American jobs and support economic growth at home mandates that we compete in markets around the world today and in the future. Our ability to compete in China on fair terms is essential, and we call on policymakers in both nations to do their part to help us accomplish these vital objectives.

(March 1998)

# Statement of the American Farm Bureau Federation

TO: SUBCOMMITTEE ON TRADE
HOUSE WAYS AND MEANS COMMITTEE

RE: MOST FAVORED NATION TRADING STATUS FOR CHINA

DATE: JUNE 17, 1998

FOR THE RECORD

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*As the national voice of agriculture, AFBF's mission is to work cooperatively with the member state Farm Bureaus to promote the image, political influence, quality of life and profitability of the nation's farm and ranch families.*

***FARM BUREAU*** represents more than 4,800,000 member families in 50 states and Puerto Rico with organizations in approximately 2,800 counties.

***FARM BUREAU*** is an independent, non-governmental, voluntary organization of families united for the purpose of analyzing their problems and formulating action to achieve educational improvement, economic opportunity and social advancement and, thereby, to promote the national well-being.

***FARM BUREAU*** is local, county, state, national and international in its scope and influence and works with both major political parties to achieve the policy objectives outlined by its members.

***FARM BUREAU*** is people in action. Its activities are based on policies decided by voting delegates at the county, state and national levels. The American Farm Bureau Federation policies are decided each year by voting delegates at an annual meeting in January.

**STATEMENT OF**
**THE AMERICAN FARM BUREAU FEDERATION**
**TO THE**
**SUBCOMMITTEE ON TRADE**
**HOUSE WAYS AND MEANS COMMITTEE**
**REGARDING**
**MOST FAVORED NATION TRADING STATUS FOR CHINA**

**June 17, 1998**

American Farm Bureau strongly supports the continuation of normal trade relations with China by granting most favored nation (MFN) trading status. The yearly debate over the extension of MFN for China does not advance the long-term trade issues that are so important to American agriculture, nor has it forced the social and political changes sought by its opponents. Sanctions and other forms of disassociation with our trading partners have not brought about the desired changes. Farm Bureau believes that a strong and open engagement policy through trade is necessary for our economic stability and a more effective way to bring about desired change.

As a result of the FAIR Act of 1996, U.S. agriculture made the commitment to world trade in agricultural goods as critical to our future prosperity. The decline in direct government support for farmers and the increasing reliance on the world market to determine prices for producers requires open markets and fair and stable trading relations.

U.S. producers now have approximately one-third of agricultural production dependent on export markets. The current economic crisis in Asia and the imposition of unilateral trade sanctions are taking a significant toll on our ability to maintain a positive balance of trade in agricultural products. Disruptions of this magnitude threaten to reduce our ability to balance export sales with domestic consumption and will have a ruinous impact on commodity prices for farmers. With only four percent of the world's consumers within our borders, we cannot afford to create artificial barriers to the other 96 percent of the consuming population.

America's farmers and ranchers made a deal with the U.S. government. In exchange for less direct involvement and less budget impact, production agriculture trusted the federal government and Congress to support our trade and export programs and to provide the tools needed to sell our goods worldwide. We also expect our government to fight aggressively with us to reduce the barriers to trade, not create more barriers from within. Normal trade relations with China are required to advance both of these issues.

China is the sixth-largest market for American agriculture and with a growing economy and the world's largest population, China has the most potential as a trading partner not just for American agriculture but for all economic sectors in the United States. In 1997 China bought over $3.3 billion of U.S. farm products including wheat, vegetable oil, poultry, corn, soybeans, and red meat. Hong Kong purchased an additional $1.6 billion worth of agricultural commodities last year. Combined, we are dealing with an almost $5 billion market.

Increasing trade requires a commercial and functional legal framework. Chinese membership in the World Trade Organization (WTO) would bring China into a rules-based trading system under the GATT. To meet WTO requirements, China must make laws public, apply trade laws uniformly, and submit to WTO dispute resolution procedures. China's accession to the WTO must be commercially meaningful for U. S. agriculture, with expanded market access and the removal of sanitary and phytosanitary barriers that are only used to inhibit trade. MFN revocation will stop the U.S. China WTO accession process, impede our exporters by allowing China to impose greatly increased tariffs, and stop our government's efforts to expand agricultural trade in this important market.

Without normal trading relations, U.S. goods will bear higher tariffs and be less competitive in the Chinese market. Tariffs going into China could increase over 45 percent, resulting in lost sales. Revoking MFN for China will turn hard-won U.S. markets over to our competitors. Restricting trade will derail the farmers' and the government's efforts to transform agriculture to a market-oriented industry.

The American Farm Bureau Federation has been directly engaged in this issue. We have encouraged our membership to speak with their representatives on this issue. We have been organizing support from other agricultural organizations and companies. We have spoken on behalf of trade with China to the media. We know what trade means to our livelihood.

Congress and the administration worked hard to craft a market-oriented farm bill in 1996 that our producers have embraced. Without fast track negotiating authority, with continual threats of market loss due to self imposed unilateral trade sanctions and continued loss of sales due to the Asian financial crisis, denying China normal trade status (MFN) sends the wrong signal to our producers.

China is an important market to our producers and to the U.S. economy. China also plays a pivotal role in maintaining a fragile economic balance the Asian region. The American Farm Bureau urges you to move quickly to grant China MFN. We pledge to work with you to secure MFN for China.

CMA
CHEMICAL
MANUFACTURERS
ASSOCIATION

**Written Statement of the**
**Chemical Manufacturers Association**
**On the Importance of Renewing**
**Most-Favored Nation Treatment for China**

**Submitted to the**
**Subcommittee on Trade**
**Committee on Ways and Means**

**In Connection with the**
**June 17, 1998 Hearing on**
**U.S.-China Trade Relations and**
**Renewal of China's Most-Favored-Nation Status**

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The Chemical Manufacturers Association (CMA) represents more than 190 member companies that account for 90 percent of the industrial chemicals produced in the United States. The chemical industry is the largest U.S. export sector supplying one out of every ten dollars of U.S. goods exports and achieving annual trade surpluses for the past 75 years. CMA submits this statement to demonstrate its strong support for renewal of normal trade status for China.

**Renewal of Most-Favored Nation (MFN) treatment for China is vital to the future of the U.S. chemical industry.** China represents a **potential market** for U.S. producers of chemicals and allied products of nearly **$85 billion**. U.S.-based chemical companies have typically accounted for over 10 percent of China's chemical imports.

In 1997, U.S. chemical exports to China were valued at nearly **$1.93 billion**, while U.S. imports in the sector from China totaled **$1.26 billion**, leaving a **U.S. trade surplus in the sector of $667 million**. Over the period from 1986 to 1997, U.S. trade surpluses with China in chemicals and allied products totaled $8.2 billion. With China as our 11th largest export destination for chemicals, **our industry's access to the Chinese market will be jeopardized by failure to renew China's MFN treatment. More than 10,000 jobs in our industry are directly or indirectly dependent upon trade with China.**

If MFN treatment for China were to be revoked, we are fearful that China's chemical and environmental regulators would find many excuses to discriminate against our products. This would be a very costly outcome for American chemical producers. Our European competitors, whose investments in China far outstrip those of American companies, would gladly step in and fill the void we would leave behind. Our nation has learned from painful experience how difficult it is to regain market share in a country once other competitors have moved in.

**MFN status for China keeps China's market open to American trade. Revoking China's MFN status will have the opposite effect.** Cut off from the American market because of the loss of MFN treatment, the Chinese will simply turn to other trading partners for what they need, including chemicals, which are the building blocks for countless other products. The United States will be the biggest loser for years to come if we move to revoke MFN treatment for China. Well-paying American jobs and job opportunities that would otherwise be created by the growing bilateral trade flows with China will be lost.

China has the potential to be one of the largest and fastest-growing chemicals markets in the future as it increases its standard of living. Over the next 20 years, we project that the country's real growth will average nearly 10 percent annually. By comparison, the long-term average economic growth projected for the United States and our industry's traditional export

markets of Canada and Western Europe is only about 2.5 percent annually. Loss of MFN status for China will punish American consumers (through higher prices) and hurt the competitiveness of U.S. exporters (by erecting new trade barriers).

Moreover, continued MFN treatment provides a stable environment within which to develop closer trade ties with China, and to enable U.S. business to pursue this important market amid less risk and uncertainty. The importance of predictable "rules of the road" to our industry's future in China cannot be overstated, and the continuation of MFN treatment by the United States is the bedrock of a stable U.S.-China trade relationship

An example of how rules directly affect trade in our highly regulated industry with China is the following: The U.S. chemicals industry has stressed repeatedly to the Chinese how important it is to apply clear and sensible rules to international trade in chemicals. We have explained, for example, the necessity of maintaining good, strong policies to protect intellectual property rights; the importance of keeping regulatory actions transparent; and the necessity of safeguarding the confidentiality of trade secrets contained in product registration documents filed with Chinese government agencies. We have also worked to help the Chinese government implement mechanisms to ensue safe management of chemicals. Using all of these arguments, we have sought to prevent China's registration system for toxic substances from becoming a trade barrier to American chemical products in general. We can certainly expect the Chinese to question the value of international trade rules if the U.S. was to revoke MFN — the foundation for normal trade relations between any two countries.

**Renewing China's MFN status . . .**

**Is clearly in the U.S. chemical industry's interest.** Our industry is this country's largest export sector and, without question, China will remain an important market for America's chemical producers. We have maintained a trade surplus with China in the chemicals sector over the last 10 years (see table below).

**Creates jobs in America.** The chemical industry's strong export performance world-wide directly supports some 182,000 jobs, fully 17.7 percent of the industry's total employment of 1.03 million high-tech, high-wage jobs. Most of the industry's jobs are in Texas, Louisiana, New Jersey, Illinois, South Carolina, Georgia, North Carolina, Ohio, Tennessee and Virginia. Foreign trade indirectly supports a further 160,000 jobs in our industry.

**Maintains a stable, rules-based environment for continuing the development of U.S.-China trade.** Renewal of China's MFN status adds credibility to the idea that property rights, rules and commitments must be respected if international trade – in chemicals, as well as other products – is

to develop in an orderly fashion with lowered risk and uncertainty. Combined with China's long-term growth potential, the U.S. chemical industry will have a more stable climate within which to operate and to make future business decisions.

**Chemicals and Related Products Trade: U.S. and China (U.S.$, millions)**

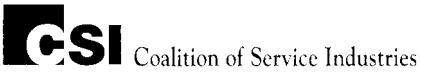
| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|---|---|---|
| **US exports to China** | 1308 | 1136 | 1054 | 1671 | 1208 | 839 | 1502 | 2008 | 1722 | 1929 |
| **US imports from China** | 225 | 270 | 337 | 392 | 509 | 582 | 723 | 874 | 1034 | 1262 |
| **Trade Surplus** | 1083 | 866 | 717 | 1279 | 699 | 257 | 779 | 1134 | 688 | 667 |

**Importance of the Chemicals Sector to World Trade and to the U.S. Economy**

- Chemicals comprise the second largest commodity group in world trade, accounting for 9 percent of world merchandise trade, and one-eighth of world trade in manufactures. World trade in chemicals exceeds $500 billion annually.

- The chemicals and related products sector is America's largest exporter. In 1997, U.S. chemical exports totaled a record $69.5 billion – larger than agriculture ($55.9 billion) or aircraft/aerospace ($38.3 billion). Chemicals and related products represent more than ten cents out of every dollar of U.S. exports. In 1997, the chemicals industry rang up a global trade surplus of $19.1 billion. This continues an unbroken history of more than 70 years of U.S. trade surpluses for the chemical industry.

- Our industry's contributions to the U.S. economy go well beyond its steady trade surpluses, which over the past 10 years add up to a total of $172 billion. The industry's $69.4 billion in overseas investments consistently provide additional net income to U.S. accounts. Net international earnings realized by our industry were $6.9 billion in 1996 (the most recent year for which data are available) and totaled $43 billion over the 1987-1996 period.




*Statement for the Record of Robert Vastine*
*President, Coalition of Service Industries*
*Before the Subcommittee on Trade*
*House Committee on Ways and Means*
*Wednesday, June 17, 1998*

MFN AND US SERVICES TRADE WITH CHINA

It is a pleasure to contribute the views of the Coalition of Service Industries (CSI) to the Subcommittee's deliberations on US trade relations with China. CSI was founded in 1982 for the purpose of ensuring that liberalization of trade in services was made a major focus of international trade negotiations. CSI continues to work to expand business opportunities for US service companies in foreign markets by removing barriers to their trade and investment, and to develop policymakers' awareness of the increasingly important role services play in creating high quality US jobs, exports, and economic growth. It represents US companies in global financial, telecommunications, professional, transportation, travel and tourism, and information technology services, among others.[1]

The US service sector recorded a trade surplus of almost $86 billion in 1997, as services exports reached $254 billion and services imports $168.8 billion. Services constituted 27% of all US exports in 1997. To give you an idea of the pace of growth of services exports, and its potential for US business and US jobs, the services surplus in 1985 was only about $300 million.

**US Services Trade Surplus with China**

US trade and investment in China have boomed since the initiation of trade relations. Yet with its population of 1.22 billion China is still an enormous market whose potential has only begun to be realized, especially for services, which depend so much on obtaining a local presence within the Chinese market.

In goods trade the US had a deficit of $49.8 billion in 1997, on exports of $12.8 billion and imports of $62.6 billion.

By contrast, in services trade there was a US surplus of $1.1 billion on exports of $3.1 billion, and imports of $2 billion in 1996 (data for 1997 are not yet available). In addition, the average growth rate of US services trade exports to China is 17.9 percent from 1992 to 1996.[2]

[1] For a list of Coalition of Service Industries member companies, please see Attachment "A".
[2] Source for all trade statistics: U.S. Department of Commerce.

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US services firms such as accounting, law and architecture firms, insurance companies, banks, telecommunications, travel and tourism, and financial information companies have been engaged in negotiating access to the Chinese market for some years. As many of them will attest, it is a lengthy, complex, and difficult process. It is worthwhile, of course, because of the size of the potential market. But the current processes required for entry cry out to be regularized and made transparent. The best hope of doing so is through continued economic engagement with China.

**Most-Favored-Nation Treatment**

According to China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC), US firms financed 24,366 joint ventures in China totaling $17.5 billion by December 31, 1997, or 7.9 percent of all foreign investment in China. These results of the US policy of engagement with China entirely depend on sustaining US Most-Favored-Nation (MFN) treatment of China's exports, and the Coalition of Service Industries strongly supports this objective. It would not be possible to continue the effort to develop US services exports in the absence of MFN for China.

Revoking MFN would undoubtedly have harmful consequences for US exports and for US jobs. US companies would surely lose market share to foreign companies. Access to China's markets would narrow.

For US companies that now have a presence in China, the political backlash against foreign companies that could result from congressional disapproval of MFN could set back years of hard-fought gains. These are the companies that have been on the forefront of pushing for market opening reforms and that have laid much of the groundwork for future services sector liberalization in China. After investing both significant resources and their confidence in China and the Chinese people, these companies would likely be among the hardest hit by a reversal of the policy of engagement with China.

CSI's member companies strongly believe that continued engagement with China is the best way to urge China to reform its services markets to permit US firms to establish and compete in China's market.

**China's Accession to the World Trade Organization**

China has been seeking entrance into the world's multilateral trading system for over a decade. The US services industry supports China's membership in the World Trade Organization (WTO), but only under commercially viable terms through acceptable commitments to liberalize its service sectors. The long effort to secure substantial services liberalization commitments from China as the price of its admission to the WTO would be completely undermined by refusing to extend MFN treatment.

CSI and its member companies have communicated the needs of the US services sectors for China's prospective accession to the WTO to senior Administration officials, the Congress, and key Chinese officials. In December 1997, CSI Chairman Dean O'Hare spelled out the needs of specific services sectors in a letter to Ambassador Barshefsky, Secretary Rubin and other key officials.[3] In their responses, both Ambassador Barshefsky and Secretary Rubin emphasized the US determination to secure "substantial commitments" for market access from China during the on-going bilateral WTO accession negotiations.[4]

In brief, CSI requests that China commit to the regulatory principles set forth in the "Reference Paper" to the WTO Agreement on Basic Telecommunications and the commitments made by so many other countries in the WTO Agreement on Financial Services. Other sector requirements include the opening of the Chinese insurance market with no numerical limits and total geographic scope by a date certain in a reasonable timeframe; rights of establishment for international accounting and management consulting firms; free market access and national treatment for financial information services, including the publication and distribution of printed financial news information in China; establishment and national treatment for travel and tourism services; and a dismantling of remaining barriers to the free flow of information and transactions over the Internet. CSI continues to work closely with the Office of the US Trade Representative and the US Department of Treasury to closely define the services sectors' market access needs.

CSI also communicates with key Chinese officials to promote liberalization of China's services sectors. CSI and its members meet with representatives of the Embassy of the People's Republic of China as well as representatives from the Permanent Mission of the People's Republic of China to the United Nations and other International Organizations in Geneva. In order to fully communicate services sector needs directly to the Chinese, CSI plans a mission of its member company representatives to China this fall to meet with key officials. We would welcome congressional participation in this effort.

**Conclusion**

The US services industry is eager to be fully engaged in the China market and will continue to press the Chinese for increased liberalization of trade at every opportunity. We hope the US Congress will assist our efforts by renewing MFN for China and supporting President Clinton's trip to China later this month.

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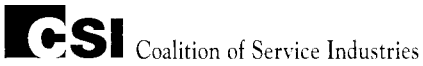
[3] For the complete text of CSI's letter to Ambassador Barshefsky and Secretary Rubin, please see Attachment "B". A complete list of recipients is included.
[4] For the complete text of Ambassador Barshefsky's and Secretary Rubin's responses, please see Attachments "C" and "D", respectively.




**Members of the Coalition of Service Industries' Working Groups**

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AMERICAN COUNCIL OF LIFE INSURANCE
AMERICAN CONSULTING ENGINEERS COUNCIL
AMERICAN EXPRESS COMPANY
AMERICAN INSTITUTE OF ARCHITECTS
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
AMERICAN INSURANCE ASSOCIATION
AMERICAN INTERNATIONAL GROUP, INC.
ANDERSEN WORLDWIDE
AT&T
BANK OF AMERICA
CHARLES SCHWAB
THE CHASE MANHATTAN BANK
THE CHUBB CORPORATION
CIGNA CORPORATION
CITICORP/CITIBANK
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DELOITTE & TOUCHE
DOW JONES & COMPANY, INC.
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EDS
EQUIFAX
ERNST & YOUNG
EXPERIAN
FIDELITY INVESTMENTS
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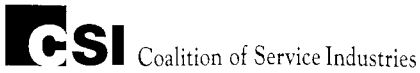
VISA USA, INC.
WILMER, CUTLER & PICKERING




December 5, 1997

Ambassador Charlene Barshefsky
US Trade Representative
Office of the US Trade Representative
Winder Building 600
17th Street, NW
Washington, D.C. 20508

**RE: China Accession to the World Trade Organization**

Dear Ambassador Barshefsky:

The member companies of the Coalition of Service Industries (CSI) have a strong interest in the outcome of negotiations on China's accession to the World Trade Organization (WTO). We fully support China's membership in the WTO, but we believe it is essential that the terms of accession be of concrete and substantial commercial value to US service providers. Anything less would undermine the fledgling multilateral rules on trade in services and would be a signal to other countries that our commitment to liberalizing services trade is weakening.

US service industries, as you know, are increasingly strong contributors to the US trade balance, accounting for more than $200 billion in exports and a trade surplus of $80 billion last year. A continuation of this superb performance requires, among other things, expanded market access abroad, as well as opportunities to deepen our companies' participation in foreign markets. China ranks among the top priorities for every service exporter's trade and foreign investment plans. Our ability to participate in the Chinese market holds significant promise for us and is essential for China's successful economic modernization.

Our objective is to obtain from China market access and national treatment commitments for a broad range of service industries under the General Agreement on Trade in Services (GATS). This, in our view, is the key to evaluating China's services offer because so many of the GATS provisions (in addition to market access and national treatment) only take effect in sectors for which the signatory country has scheduled specific commitments. With regard to individual service sectors, these commitments should include the following measures:



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- *Accountancy and Management Consulting*

  China's scheduled commitments should cover the full range of services provided by "accounting" firms, including accounting, auditing, and bookkeeping services, as well as tax, management consulting, and legal services. China should assure international firms the rights to: choose local affiliates on free contractual terms equivalent to worldwide norms; establish branches and other offices authorized to perform statutory work throughout the country; and advertise their professional services. In addition, China should adopt the use of international accounting and auditing standards for all publicly held companies in China.

- *Financial Services*

  China's scheduled commitments should clearly address the need for full national treatment for US and other foreign financial services firms. These companies continue to face significant administrative restrictions which hamper their operations in China or, in the case of insurance, have almost no market access. Two U.S. insurance licenses in five years is totally unacceptable. The absence of transparency and of a sound legal and regulatory structure also greatly hinders market access. China has expressed its intention to liberalize its services markets, and has begun to do so in some areas. US and other foreign financial services institutions, however, are still subject to non-transparent case-by-case approval for new representative offices and branches. Finally, China severely restricts the ability of foreign institutions to handle local currency transactions.

- *Financial Information*

  The Chinese and US governments recently entered into an interim agreement governing the dissemination of financial information in China. The successful negotiation of this agreement indicates that the Chinese recognize that placing restrictions or tariffs on the free flow of financial information will only hamper China's own financial institutions and increase their costs. China should build on this partial, interim agreement by scheduling binding commitments covering the panoply of services provided by the financial information industry, including commitments in the following areas: financial information, on-line information processing and retrieval, including transaction processing, on-line database retrieval, value-added service, news agency and publishing. At the very least, the Chinese must commit to free market access for current and future products and services that fall within the financial information sector, as well as to providing national treatment in any regulatory schemes governing this sector.

- *Telecommunications Services and Information Technology*

  The success achieved in the WTO Group on Basic Telecommunications provides significant leverage to require substantial commitments from China in telecommunications. At a minimum, China should commit to a date certain for full liberalization and provide a series of concrete steps of progressive liberalization leading to that date. In addition, China should adopt and implement the Reference Paper in its entirety.

- *Electronic Commerce and Transborder Data Flow*

  Knowing that investment is highly dependent on the free flow and availability of financial information, we strongly recommend that the Chinese dismantle the remaining barriers to the free flow of information and refrain from erecting new ones, including transactions conducted over and information provided through the Internet. There is general agreement among nations that the free flow of information across country borders is essential to the growth of world trade and the health of global commerce. The free flow of information globally facilitates and enhances: communications, customer relationships and services, product marketing, research and development, access to financial services and credit, order processing, human resource development, travel preferences and more. The growth of electronic commerce via the Internet and company Intranets depends on the unimpeded global flow of information. Today, large companies depend on unfettered information networks to offer and provide their geographically dispersed customers and prospects with a broad array of products and services at competitive prices. Tomorrow, all sizes and types of companies will rely on the free flow of electronic commerce to transact business locally and globally.

- *Travel and Tourism*

  China should agree to repeal by a date certain its law prohibiting non-Chinese companies from establishing full service travel agencies in China. As part of this liberalization, China should permit non-Chinese companies the same rights that are enjoyed by travel companies in other WTO countries. A full service travel license would permit the sale of standard tourist financial services, such as travelers checks, and would permit all licensed travel agents to act as ticketing agents for international and domestic airlines.

In addition, the problem of regulatory transparency in China deserves special attention. Our companies uniformly cite the lack of transparency as a major obstacle to their operations in China. Correcting these problems is vitally important to service industries, which tend to require a local presence to serve customers and frequently operate in highly regulated environments.

We appreciate the enormous effort that you and your colleagues are making to secure China's accession to the WTO on commercially viable terms. We are ready to help in any way that we can, and we would be happy to meet with you and your staff to discuss the issues outlined above in more detail.

Sincerely,

Dean R. O'Hare
Chairman

Attachment: List of CSI members and affiliates

## CHINA LETTER

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EXECUTIVE OFFICE OF THE PRESIDENT
THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20508

FEB 0 ...

Mr. Dean R. O'Hare
Chairman
Coalition of Services Industries
805 15th Street, N.W., Suite 110
Washington, D.C. 20005

Dear Mr. O'Hare:

Thank you for your letter regarding China's accession to the World Trade Organization (WTO.) During the market access portion of our WTO negotiations with China, services has emerged as one of the most difficult and critical issues.

Throughout the negotiations, USTR has maintained that China will only accede to the WTO on commercially meaningful terms. Anything short of substantial market access for U.S. goods and services will be unacceptable. At the December Working Party meetings in Geneva, China tabled a revised services offer that, while improved in some areas, revealed that much work remains. On a positive note, we are working closely with other Working Party members to coordinate positions in many areas of mutual interest. Perhaps due to this cooperation, the Chinese are showing signs of understanding the importance of scheduling real commitments in services.

Thank you again for sharing your concerns. I look forward to CSI's continued support.

Sincerely,

Charlene Barshefsky

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

January 6, 1998

Mr. Dean R. O'Hare, Chairman
Coalition of Services Industries
805 15th Street, N.W.
Suite 1110
Washington, D.C. 20005

Dear Mr. O'Hare:

Thank you for your letter on China's accession to the World Trade Organization (WTO).

The Administration has asserted consistently that China's accession to the WTO must be on a commercially meaningful basis. In line with that policy, in our bilateral negotiations with the Chinese, we have emphasized the importance of market access issues, including substantial and credible commitments in services.

China has recently revised its services offer. The new offer contains limited concessions in, among other areas, financial services. Nevertheless, fundamental shortcomings remain. We would like to see China more directly address market access and national treatment restrictions on foreign financial institutions, for example. In the months ahead, we will continue to encourage our Chinese counterparts to make substantial commitments in this area.

I appreciate your bringing to my attention the concerns of your member companies, and thank you again for writing.

Sincerely,

Robert E. Rubin

**Committee on Ways and Means**
**Subcommittee on Trade**

**Hearing on U.S.-China Trade Relations**
**and Renewal of China's Most Favored Nation Status**
**June 17, 1998**

**Statement of the Distilled Spirits Council of**
**the United States, Inc.**

## I. Introduction

This statement is submitted by the Distilled Spirits Council of the United States, Inc. (DISCUS) for inclusion in the printed record of the hearing held by the Subcommittee on Trade of the Committee on Way and Means on June 17, 1998 with respect to the renewal of China's most-favored-nation status and U.S. objectives in ongoing negotiations over conditions upon which China will enter the World Trade Organization (WTO). The Distilled Spirits Council of the United States is the national trade association which represents U.S. producers and exporters of distilled spirits. DISCUS members account for approximately 85 percent of all spirits produced in the United States and exports U.S. distilled spirits products to more than 120 countries. Our members firmly believe that China is a critical market for future exports, and we are thus keenly interested in securing the removal of barriers to U.S. exports to China.

## II. Renewal of Most Favored Nation Treatment for China

The Distilled Spirits Council of the United States strongly supports the renewal of MFN status for China, and also believe MFN status should be granted on a permanent basis. China is a fundamentally difficult market for exporters to enter due to cultural, regulatory and physical barriers, which are in addition to significant official trade barriers. The annual debate over renewal of China's MFN status introduces an unnecessary degree of uncertainty with respect to developing long term market strategies in China. Thus, we believe China's MFN status should be renewed again this year, as it has been every year since 1980, and should be renewed on a permanent basis in the future to create a stable trading environment required by U.S. companies to develop the market in China for their products.

## III. Barriers to U.S. Distilled Spirits in China

The U.S. distilled spirits industry currently faces tremendous barriers to trade with respect to the China market. High tariffs force trade into unofficial channels, which makes it difficult for U.S. spirits exporters to develop and implement long term market development strategies. Besides high tariffs, there are many other barriers to trade such as a limited number of government importers, restrictive distribution system, and intellectual property rights violations. Together, these barriers prevent U.S. exporters from realizing the true potential of this fast growing market.

Many of these barriers are incompatible with the fundamental objectives of the General Agreement on Tariffs and Trade (GATT). Negotiations on China's accession to the World Trade Organization (WTO) offer the opportunity to bring China's legislation and practices into conformity with GATT/WTO, which will permit U.S. distilled spirits exporters to succeed in penetrating the vast China market.

## A. Rationalization of Importation and Distribution System

Foreign firms are at a severe disadvantage to domestic producers since they are barred from distributing and marketing their own products, official imports are limited to government controlled importers, and customs treatment is uneven throughout China. It is essential that the terms of China's accession to the WTO guarantee foreign firms national treatment with respect to importation, distribution, and marketing of imported distilled spirits.

### 1. Restrictions on Distribution by Foreign Firms

Foreign firms are prohibited from setting up wholly foreign owned distribution companies. They are even currently barred from investing in joint-ventures with Chinese distributors. This has lead to a thriving gray market for imported distilled spirits. Since domestic spirits manufacturers and distributors do not face such restrictions on their commercial activities, foreign-based producers are placed at a substantial competitive disadvantage. Therefore, the right of foreign companies to establish distribution subsidiaries must be guaranteed as part of the terms of China's WTO accession protocol. In addition, U.S. negotiators should use this opportunity to identify differences in regulation as they are applied to private and government-owned distribution networks.

### 2. Government Monopoly of Imports

Traditionally, China only gave the right to import distilled spirits to the China National Cereals, Oils and Foodstuffs Import and Export Corporation (CEROILS). While some other government controlled entities have secured import rights, the current system is still too restrictive to allow foreign spirits producers to meet demand for their products. The quota system for distilled spirits was eliminated in December of 1995 according to the terms of the 1992 Memorandum of Understanding (MOU), but the restrictive issuance of licenses that facilitates the existence of the government monopoly of imports remains a significant barrier to expanding imports into China. The curtailment of the control of government entities over imports of distilled spirits will encourage the creation of competing private importers and distribution networks. This competitive environment is more likely to be able to meet demand, and begin to replace the gray market for imported distilled spirits.

### 3. Automatic Registration

China introduced an automatic registration system when the quota system was dropped at the end of 1995 in compliance with the 1992 MOU. The automatic registration system is administered by the State Planning Commission, and is purportedly only to be used for statistical

purposes. However, the system has become another way to control who may participate in the distilled spirits trade, as well as to restrict the volume of imports.

**B. Reduction of Tariffs**

High tariffs restrict access for imported distilled spirits to the Chinese market. These high tariffs, which are assessed on an ad valorem basis, are largely responsible for the substantial volume of imports entering through unofficial channels.

**1. Tariff Levels**

Despite a reduction from 150 percent to 80 percent on March 1, 1995, and a further reduction to 65 percent on October 1, 1997, China's tariffs on imported distilled spirits are still excessive. High tariffs place officially imported products at a significant competitive disadvantage in the market place. During the Uruguay Round negotiations, major participants agreed to eliminate tariffs on whisky and brandy over a period of ten years. More recently, other Asia-Pacific countries have agreed to eliminate tariffs on all distilled spirits products. The United States should insist that China also reduce significantly and ultimately eliminate its tariffs on imported distilled spirits as part of the terms of accession to the WTO.

**2. Ad Valorem Rates**

The distilled spirits industry has advocated the use of specific rates in assessing tariffs on distilled spirits. Specific tariffs are more easily applied and reduce the incentive for importers to undervalue imports, particularly when faced with high tariff levels. The conversion of China's tariffs to specific rates would reduce the incentive for importing spirits through unofficial channels, while minimizing the adverse impact on suppliers of high value products. China should adopt a specific tariff as an interim step toward the eventual elimination of tariffs on imported distilled spirits.

**C. Application of Domestic Taxation**

China's application of domestic taxes to imported spirits adversely affects the competitiveness of foreign suppliers of distilled spirits in two respects:

**1. Ad Valorem Consumption Tax**

China has harmonized its consumption taxes for various types of distilled spirits, with a single rate of 10 percent. While this harmonization is welcome, China still uses an ad valorem method to calculate the consumption tax, which tends to be discriminatory to high quality imported products. As part of its terms of accession, China should adopt a system of specific taxation, utilizing a single rate of tax for all distilled spirits based on alcohol content, as is used by the United States and most other industrialized countries.

**2. VAT**

It is widely reported that in some cases the VAT has only been levied on imported products, and that many domestic producers do not pay VAT at all. The inequities and irregularities in the administration of the VAT must be addressed to ensure that imported consumer products, including distilled spirits, are not subject to discriminatory taxation. The terms of China's accession to the WTO should require China to provide national treatment in its application of the VAT to imported distilled spirits.

**D. Protection of Intellectual Property Rights**

China has a serious problem with counterfeiting of domestically produced premium spirits brands. U.S. spirits exporters are very concerned that the high level of unofficial imports also will lead to rampant counterfeiting. As part of its terms of accession, the United States should insist that China fully adhere to the provisions of the Agreement on Trade Related Intellectual Property (TRIPS), including the provisions related to the protection of trademarks and appellations of origin for distilled spirits.

**E. Transparency and Enforcement of Laws and Regulations**

The lack of transparency in the implementation and enforcement of China's laws and regulations continues to pose a significant barrier to expanding trade. The 1992 U.S.-PRC Memorandum of Understanding (MOU) on Market Access requires China to publish all laws and regulations affecting trade. The United States should insist that China reiterate its MOU commitments as part of its protocol of accession to the WTO. In addition, the recently passed Foreign Trade Law requires China to practice a uniform trade policy and publish all its trade regulations in a complete and transparent manner. Unfortunately, the latter law only covers trade in goods, but not services, such as distribution. U.S. distilled spirits producers would like to see this law extended to cover services, such as distribution.

**IV. China's Accession to the World Trade Organization**

DISCUS supports the early accession of China to the WTO, provided a commercially meaningful accession agreement is reached. The U.S. distilled spirits industry has already used the WTO dispute settlement procedures to eliminate discriminatory taxation in Japan; China's membership in the WTO would provide an avenue to attack entrenched barriers in the future. It is essential, however, that the majority of these barriers be removed as part of the terms of China's accession to the WTO.

In recent WTO accession negotiations, China has presented proposals that will perpetuate discriminatory treatment of imported distilled spirits. If China's current proposals on tariff levels and distribution rights are adopted, U.S. distilled spirits exporters will be frozen out of a potentially vast market, and will not be able to benefit from the improved trading environment that will result from China's accession to the WTO.

Specifically, DISCUS understands that China has proposed a tariff rate on distilled spirits of 40 percent ad valorem. This is far in excess of the average tariff levels proposed by China, and is one of the few remaining "peaks" in China's tariff offer. To provide the degree of access we seek to the Chinese market, China's tariff offer must be significantly improved.

The second area in which the U.S. distilled spirits industry faces discriminatory treatment is in the area of distribution services. China has proposed allowing most industrial sectors to establish wholly foreign owned distribution subsidiaries, with the exception of several sectors, including distilled spirits. Establishing a wholly owned distribution network is critical to our long term success in the China market. Without the ability to control distribution, U.S. distillers will not enjoy the full benefits of the reductions in China's import tariffs.

## V. Conclusion

U.S. exporters of distilled spirits face significant barriers to access in China. With tremendous potential demand for their products, U.S. distillers are committed to developing the Chinese market, and to expanding exports to China through official channels. Negotiations on the terms of China's accession to the WTO provide an excellent opportunity to secure the reduction or removal of these barriers. The U.S. distilled spirits industry has requested the U.S. government to secure the following commitments from China as a condition of accession to the WTO:

- the right of foreign suppliers of distilled spirits to engage directly in the importation and distribution of their products;
- the substantial reduction and eventual elimination of tariffs on imported distilled spirits;
- the conversion of ad valorem tariffs and taxes to specific rates based on alcohol content;
- the strengthened protection and enforcement of trademarks and geographical indications for distilled spirits; and
- the uniform and transparent application of all trade laws and regulations affecting imported distilled spirits.

The achievement of these objectives in the context of China's WTO accession will allow U.S. exporters of distilled spirits to take full advantage of the commercial opportunities presented by the potentially vast market for their products in China. The renewal of China's MFN status at the present time, and on a permanent basis in the future, will provide the stable trading environment needed for U.S. companies to expand their trade ties with China in the years ahead.

The Distilled Spirits Council of the United States appreciates this opportunity to present its views on this important matters to the Committee.

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ASSISTANT VICE PRESIDENT/TRADE

MARK Z. ORR
VICE PRESIDENT
INTERNATIONAL ISSUES & TRADE

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**STATEMENT OF MICHAEL C. MAIBACH**
**VICE PRESIDENT, GOVERNMENT AFFAIRS**
**INTEL CORPORATION**

**ON BEHALF OF THE**
**SEMICONDUCTOR INDUSTRY ASSOCIATION**

**HEARING ON UNITED STATES-CHINA**
**TRADE RELATIONS**

**JUNE 17, 1998**

I appreciate the opportunity to appear before the Subcommittee on Trade of the Committee on Ways and Means to present the views of the Semiconductor Industry Association (SIA) on U.S.-China trade relations. I would like to focus my remarks today on the two issues at the forefront of this relationship -- the annual renewal of China's "Most Favored Nation" trading status and China's potential accession to the World Trade Organization.

Before discussing the SIA's position on these important issues, however, I would like to take a minute to give some background on the U.S. semiconductor industry.

**The U.S. Semiconductor Industry**

A recently released economic study found that the semiconductor industry is now America's largest manufacturing industry in terms of economic value-added -- contributing 20 percent more to the U.S. economy than the next leading industry. This industry has surged to first place from 17th place in ten short years, surpassing industries such as aircraft, aircraft parts and equipment and pharmaceuticals.

U.S. semiconductor makers employ 260,000 people nationwide, and the presence of the industry is widespread – 35 states have direct semiconductor industry employment. And these are high paying jobs. The average wage in the semiconductor industry is approximately $55,000, nearly twice the average of private industry overall.

Semiconductors are an increasingly pervasive aspect of everyday life, enabling everything from computers to automobiles to modern defense systems to the Internet which is, in fact, a world wide web of silicon chips. They have sparked the growth of the U.S. electronics industry, which provides employment for 4.2 million Americans in all 50 states.

U.S. semiconductor producers are highly committed to maintaining their lead in both semiconductor manufacturing and technology. Last year, the U.S. semiconductor industry devoted 18 percent of its revenues to capital spending and another 12 percent to research and development -- among the highest of any U.S. industry.

While investing heavily in the industry's future competitiveness and technological capabilities, SIA members also have always actively sought to secure foreign market access for U.S. products. Because the semiconductor industry is so global in nature – roughly half of the U.S. industry's revenues are derived from overseas sales – the SIA has been dedicated since its inception to promoting free trade and opening world markets.

For example, the U.S. industry has been at the forefront of efforts to eliminate tariffs on semiconductors and related products worldwide. At SIA's urging, the United States, Japan and Canada eliminated their semiconductor tariffs in the mid-1980s. Last year, another 39 countries agreed to eliminate their semiconductor tariffs through the proposed Information Technology Agreement (ITA), and last year, during his summit meeting with President Clinton, President Jiang Zemin agreed that China would join the ITA.

Given China's potential to become the largest single market for semiconductors within a few decades, the SIA believes it is essential that the United States both maintains normal MFN trading status with China and ensures that China accedes to the WTO on a commercially sound basis.

**Semiconductors in China**

U.S. semiconductor firms are making substantial commitments to expand their market presence in the People's Republic of China. At the same time, China is seeking to foster its own electronics industry, with a particular emphasis on microelectronics, and is rapidly moving to integrate its economy more fully into the world trading system. As part of this process, the Chinese government and its electronics industry are inviting closer contacts with the U.S. semiconductor industry, and significant opportunities and challenges have already become evident.

While statistical data on Chinese semiconductor demand and output are limited, the market currently is estimated to be over $8 billion and it is growing at a rapid rate. Since 1985, the average growth rate in semiconductor demand in China has been about 24 percent per year. A number of observers believe that in light of China's growing domestic demand for electronics products, China will become the world's third largest semiconductor market by 2002 and the second largest market by 2010.

Presently, local production can only supply about 20 percent of China's semiconductor needs, and these represent primarily low-end devices used in consumer electronics products like refrigerators, washing machines, radios, and televisions. Virtually all sophisticated semiconductors needed by Chinese electronics firms must be imported, a pattern that will not change significantly over the short run. This continuing shortfall creates a major commercial opportunity for U.S. producers.

At the same time, the Chinese government, through its Ministry of Information Industry -- formerly the Ministry of Electronics Industry -- is undertaking a significant effort to develop a competitive domestic Chinese semiconductor industry. While most semiconductor technology in China is currently at the 1-2 micron level, the Chinese government is undertaking a number of projects designed to obtain cutting edge manufacturing technology at the 0.35-0.50 micron level, which would allow the Chinese industry to compete with the U.S. industry and other key world semiconductor producers.

The focus of this Chinese government plan to develop its own industry is an effort to persuade foreign firms to invest in China and share their technology with Chinese firms through joint ventures and other partnership arrangements. In return, suggestions are made that increased market access may be made available to those firms willing to transfer technology. Reform of such practices must be at the heart of any agreement to admit China to the WTO.

**Most Favored Nation Trading Status**

Any discussion of U.S.-China trade relations must begin with a discussion of China's trade status. Under the Jackson-Vanik amendment, the President each summer must renew -- subject to Congressional disapproval -- normal trading status for China, a status known for historical reasons as "Most Favored Nation" status.

The term "Most Favored Nation," or "MFN," is very much a misnomer. MFN is actually the starting point for nearly all U.S. trade relationships. In fact, the United States denies MFN status to only 6 countries, and many countries receive preferential tariff rates better than MFN tariff rates.

As most Members of Congress have consistently recognized, the United States cannot maintain the process of improving our relationship with China by isolating China. Indeed, a failure to renew China's MFN status would have the primary effect of sanctioning American industries. China's reaction to increased tariffs would likely be retaliation against U.S. products. And while other countries would scramble to fill the void, the real effect would be felt by American companies and American workers.

For these reasons, SIA supports renewal of China's MFN status again this year. SIA also supports granting China permanent MFN status once it has become a full member of the WTO on commercially acceptable terms.

**Information Technology Agreement**

Last October, President Jiang Zemin announced that China would join the Information Technology Agreement (ITA) as soon as possible and thereby permanently eliminate its tariffs on semiconductors, semiconductor manufacturing equipment and related information technology products. This announcement was an important first step toward China's accession to the WTO on commercially acceptable terms. Unfortunately, there has been little progress towards implementation of this commitment, although SIA remains hopeful that this issue can be resolved at the upcoming Clinton-Jiang summit meeting in Beijing later this month.

Currently, China imposes tariffs of 6-12 percent on semiconductors. Chinese tariffs tend to be higher on low-end semiconductors which China can make domestically, and lower on complex devices which must be imported. Elimination of these tariffs will spur development of a competitive microelectronics industry in China, as it has in other nations. It will allow U.S. producers to sell advanced semiconductors to their Chinese customers at the lowest possible price, thereby both increasing U.S. exports and strengthening the developing Chinese electronics industry. Expeditious elimination of Chinese semiconductor tariffs through China's implementation of the ITA will also benefit the Chinese semiconductor industry by paving the way for it to participate in the recently established World Semiconductor Council.

A related benefit of China's signing the ITA will be the permanent elimination of the very high tariffs -- up to 35 percent -- still on the books in China for semiconductor manufacturing equipment and other high technology capital equipment imported into China. The SIA is pleased that these tariffs were again suspended as of January 1, 1998, but remains concerned that this suspension could later be overturned. In the last three years, China has offered, eliminated, and then offered again tariff and value added tax (VAT) exemptions for imports of capital equipment for foreign enterprises. Implementation of the ITA will ensure that such tariffs will not be later reimposed. This increased certainty, in turn, will promote foreign investment in China.

**Other Policy Issues Relating to China's Accession to the WTO**

The SIA supports China's bid to join the WTO, but only if that accession is accomplished on a commercially sound basis. In addition to the tariff issue discussed above, the SIA has a number of concerns with regard to trade and investment in China, including: (1) China's trade regime, especially its limitations on trading and distribution rights; (2) purchasing practices of China's state-invested enterprises; (3) investment restrictions in China, including those related to government pressure to transfer technology; (4) intellectual property protection; (5) Chinese targeting of particular sectors, including microelectronics in general and the semiconductor industry in particular; and (6) the U.S. ability to apply the non-market economy provisions of U.S. antidumping law to China. These particular concerns are described in detail below.

1. China's trade regime needs restructuring and does not currently conform to WTO requirements. China's foreign trade regime is a complex system with many anomalies which restrict the operations of U.S. firms in China:

- Trading Rights. "Trading rights," (e.g., the ability to import and export from China), are limited to certain designated enterprises, including certain foreign-invested firms, which can trade products they manufacture in China. U.S. firms doing business in China that lack such rights must conduct their business through firms that hold such privileges. Moreover, a foreign company generally cannot directly sell or service end products, spare parts or components not made in China. These limitations are significant impediments to U.S. semiconductor firms' ability to access the Chinese market, and, if not eliminated, may undermine the benefit of other trade liberalization measures agreed to by China. SIA is encouraged by reports that China has committed in the WTO accession negotiations to provide trading rights to all Chinese firms within 3 years of its accession to the WTO, and urges that it move as quickly as possible to provide such trading rights to all firms, without discrimination on the basis of nationality.

- Distribution Rights. Equally important as the right to import is the right to distribute goods within China. The current system forces U.S. producers to sell through Chinese distributors, adding at least an additional 10 percent in costs and

adversely affecting service, inventory, and delivery. The inability to deal directly with end-users is a particular problem in the semiconductor industry, where the design and development of application-specific chips requires extensive contact between semiconductor producers and the ultimate end-users of the chips. This critical issue remains to be negotiated in the context of China's commitments to provide market access and national treatment for foreign service providers.

- Transparency. China's trade regime continues to lack transparency. Rules and procedures are not consistently published, and are subject to varying "interpretations" by individual officials. China should commit to publishing fully all relevant laws, regulations and decisions relating to trade and investment. SIA also believes that China should move to a system of advance notice and publication for comment of all laws and regulations affecting trade and investment, as well as to establish a system to obtain official interpretations of legislation once it is published (through judicial decisions that are published and authoritative administrative statements).

2. China's accession to the WTO must include a guarantee that state-invested enterprises will make purchases based on commercial considerations. Enterprises wholly or partially owned by the Chinese central, provincial or local governments (state-invested enterprises) continue to make up a significant portion of the Chinese economy. However, many of these enterprises are inefficient and burdened with costly social responsibilities unrelated to their core businesses. As a result, the state-sector of the Chinese economy is under increasing pressure. As of 1996, half of China's state industrial enterprises incurred net losses, and profits of state-sector companies had fallen to less than 1 percent of GDP -- down from 6 percent in the early 1980s.

Reform of the state sector is therefore at the top of the agenda for China's leaders. President Jiang Zemin and Premier Zhu Rongji have put forward a plan to "manage the large and let go the small," pursuant to which the state would retain shareholdings only in the largest 1,000 state-invested industrial firms, allowing approximately 117,000 smaller remaining firms to be merged, taken over by private investors, or dissolved.

This proposed reform plan has significant implications for the electronics sector, given its designation as one of four "pillar industries" – industries the Chinese government has targeted as essential to the nation's economic future. State-invested enterprises already control a significant share of the trade in electronics goods into and out of China. For example, the Chinese government controls the China Electronics Corporation (CEC), which in turn owns or controls a significant share of China's electronics industry, including major consumers of semiconductors for consumer electronics and computer production. In addition, in the spring of 1997, the Chinese government announced the formation of Project 909, a joint venture between Shanghai Hua Hong Microelectronics and Japan's NEC to produce state-of-the-art semiconductors in the Pudong New Area outside Shanghai. Hua Hong is a Chinese government-owned company, and its chairman is Hu Qili, the former Minister of Electronics Industry.

As a result of the continuing active government role in the electronics sector, there is a significant risk that as Chinese semiconductor production increases both in volume and quality, other state-invested enterprises will be encouraged by Chinese officials to purchase from domestic suppliers. Such discrimination could significantly burden or restrict U.S. semiconductor sales in China in the future.

These risks have been increased by recent reports that, as the Chinese government moves out of many sectors, it will actually focus more attention on building up a select group of national champions in the electronics industry. Given the development of a potentially strong state-invested electronics sector in China, containing both semiconductor producers and consumers, it is essential that Chinese state-invested enterprises make purchases and sales only on the basis of commercial considerations. Unfortunately, current WTO rules do not effectively cover the purchasing decisions of state-invested commercial enterprises. For example, such enterprises are not covered by the GATT Government Procurement Code because the purchases of the enterprises are for the purpose of manufacturing commercial goods, not for government use.

Given the inadequacy of current WTO rules on this subject and the potential long-term significance of state-invested enterprises in the Chinese electronics sector, the SIA urges that China's protocol of accession to the WTO include affirmative obligations on the part of the Chinese government to:

(1) ensure that its state-invested enterprises (including partially state-invested and recently privatized enterprises that were formerly state-invested) make purchases on the basis of commercial considerations; and

(2) afford the enterprises of other WTO Members adequate opportunity, in accordance with customary business practices in market economies, to compete for sales to state-invested enterprises.

SIA also believes that the protocol should require the Chinese government to refrain from taking any measure, including administrative guidance, to influence or direct state-invested enterprises as to the quantity, value, or country of origin of goods purchased or sold, or otherwise impair the purchase or sale of goods. In addition, the WTO should review on a regular basis whether China's state-invested enterprises are in fact making purchases on the basis of commercial considerations. Where a WTO member country believes that the Chinese state-invested enterprises in a particular sector are acting in a manner inconsistent with the above-recommended obligations, it should be able to initiate consultations through the Working Party with China. This special Working Party should remain in place until the Working Party has determined that state-invested enterprises no longer control a significant portion of the Chinese economy or any significant sector.

3. Investment restrictions in China limit U.S. market opportunities and may force U.S. firms to transfer technology to Chinese firms. While Chinese officials, especially at the local and provincial level, are quite interested in promoting foreign direct investment in China, a number of complex requirements exist for foreign-owned ventures. These rules place a number of restrictions on foreign investment:

- Ownership Restrictions. 100 percent foreign ownership of manufacturing facilities is permitted in China, but it appears that, under an unpublished policy applicable to the electronics industry, 100 percent of such a facility's output must normally be exported. A 70/30 foreign majority-owned joint venture is generally required under the same policy to export 70 percent of its production, but there are no uniform rules; each arrangement is negotiated on a project-specific basis. For instance, in one case Chinese authorities reportedly removed the export requirement from a contract, provided the U.S. firm agreed instead to reinvest all profits earned from domestic sales.

- Export Targets. Despite the absence of any explicit legal obligations to meet specific export percentages (except for purposes of obtaining preferential tax treatment or qualifying to establish a wholly foreign-owned enterprise) many U.S. companies have been pressed by the Chinese approval authorities to agree to export targets. While such rules are not always enforced, a company can legally be held accountable for non-compliance at a future date.

- Local Content Requirements. There are localization requirements for parts and materials for products made in China which are not technically legal requirements, yet firms must file localization plans with their foreign investment application. The Chinese government also audits foreign firms to determine local content. What constitutes local content can be subject to many definitions. For example, importation via a Chinese distributor can qualify a part as "local." Chinese sectoral industrial policies also contain local content requirements.

- Pressure to Transfer Technology. Ownership restrictions, export targets and local content requirements may be imposed not only as strict legal obligations, but also as quid-pro-quos for decisions by government officials at both the national and sub-national level. Regardless of their form, these measures are often used as levers to obtain transfer of technology from foreign firms.

Existing WTO rules on Trade-Related Investment Measures (TRIMs) do not adequately discipline these measures. Yet these measures can have a real and significant competitive impact on U.S. electronics firms, as advanced technology is often the key to competitive success. To the extent that China can maintain such measures, U.S. exports in the electronics sector, such as semiconductors, may be restricted. Moreover, such investment restrictions have a negative effect on China, as they discourage the investment necessary to develop a local Chinese electronics industry on a commercially sound basis.

China's protocol of accession to the WTO should therefore include an explicit provision requiring China to refrain from taking any measure which requires a foreign enterprise to invest, enter into any form of joint venture arrangement with a domestic entity or to transfer any technology or intellectual property to a domestic entity, except in accordance with WTO rules. Such a provision must prohibit any measures that force technology transfer – including any which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain any approval or advantage.

4. Intellectual property protection is inadequate. China has enacted patent, copyright, and trademark laws, but their credibility requires strengthened enforcement. While there has been no piracy of semiconductor intellectual property to date, China's level of technological development does not yet permit it to manufacture advanced U.S. products or misappropriate U.S. chip designs. However, China's capabilities in the semiconductor sector are rapidly advancing. Therefore, the SIA remains very interested in issues relating to intellectual property protection in China and strongly supports the U.S. Trade Representative's efforts over the last few years to negotiate agreements with China to ensure increased enforcement of Chinese patent, copyright and trademark laws.

Of particular concern is the fact that compulsory licensing remains authorized under Chinese patent law whenever "necessitated by the public interest." The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) prohibits the compulsory licensing of semiconductor technology except in certain limited circumstances. China should revise this law to bring it into conformity with the TRIPs Agreement as part of its WTO accession.

Accession to the WTO would also require China to enact specific legislation extending intellectual property protection to semiconductor layout designs (maskworks). In 1996, the SIA was told that a draft semiconductor layout design protection law had been prepared by the Ministry of Electronics Industry and was under review by the Chinese Patent Office. This is a positive development and every effort should be made to encourage the Chinese government to continue to move forward on this front as expeditiously as possible. The SIA would like the opportunity to review and comment on the draft legislation prior to its enactment and would be willing to assist the U.S. and Chinese governments in a cooperative effort designed to ensure that this legislation is fully consistent with all TRIPs obligations.

The SIA believes that China's protocol of accession to the WTO should commit China to abide by the obligations of the TRIPs Agreement as a developed country, without any transition period before the obligations are enforceable. This is in China's interest, as it will encourage the high technology foreign investment it seeks to promote the development of its economy.

In 1997, China reportedly did agree in the WTO accession negotiations to observe all obligations of the TRIPs Agreement upon its accession to the WTO. This is a welcome development for which the Chinese government deserves credit. However, it is equally important that China begin taking concrete steps to bring its laws into full conformity with these TRIPs obligations and to ensure full and effective enforcement of these laws throughout China.

5. Targeting of the electronics sector may restrict U.S. market opportunities. The Chinese government has designated four "pillar" industries for targeting as essential to the nation's economic future: automobiles, electronics, machinery and petroleum/petrochemicals. Within electronics, emphasis has been put on microelectronics.

There have been repeated reports that the Chinese government had drafted an electronics industrial policy to promote development of its domestic industry. However, this policy plan has

not been issued publicly. Obtaining information on the current status of the proposed electronics industrial policy remains an SIA priority objective.

While no details are currently available, earlier reports indicated that the electronics industrial policy could proscribe foreign majority ownership of semiconductor firms, establish export performance requirements for Sino-foreign joint ventures, and provide the basis for eventual displacement of foreign semiconductors in China by domestically-made devices. Last year's establishment of Project 909, in which a foreign company (NEC of Japan) was granted a 28.6 percent share in a Sino-foreign joint venture in return for supplying the advanced technology for the venture suggests a continuing Chinese government focus on development of a domestic semiconductor production capability. The Chinese government has said that this joint venture is just the first step for Project 909, which ultimately envisages the establishment of four or five advanced semiconductor producers in China, with a dozen specialized plants around the country and around 20 design, development and research institutes. The production bases now appearing in China are centered in Beijing, Shanghai, Shenzhen and Wuxi.

Of particular concern to the U.S. semiconductor industry are policies to pressure foreign firms to transfer advanced technology. If such policies were adopted, either explicitly or as a matter of practice in connection with government approval of specific foreign investment projects, the SIA believes that they would restrict market opportunities for U.S. semiconductor firms. They would also prove counterproductive over the long run to China's interests because they would discourage the foreign investment necessary to promote China's technological, economic and market development.

The 1992 U.S.-China Memorandum of Understanding (MOU) on Market Access provides that China will eliminate the use of import substitution policies and measures. A number of the elements outlined above are arguably inconsistent with this commitment. WTO rules also limit China's ability to establish local content requirements. The SIA believes that any future policies governing China's economic development should adhere to the provisions of the 1992 MOU and WTO rules.

In this regard and consistent with the transparency obligations of the WTO, China should also commit to publish any internal policies or administrative guidance relating to its officially published industrial policies. The negotiation of China's accession to the WTO provides the appropriate forum for obtaining commitments by China to make the necessary reforms with respect to its electronics industry policy.

6. The United States must maintain the ability to apply the non-market economy provisions of U.S. antidumping law to Chinese exports. Chinese trade officials have cited the use of the U.S. antidumping law against Chinese exports as a "trade barrier" they wish to see removed in the WTO accession negotiations. In particular, Chinese officials are seeking to eliminate application of the non-market economy (NME) provisions of the U.S. antidumping law to Chinese exports, on the grounds that China is now a market economy.

U.S. antidumping law currently provides that, in the case of exports to the United States from a non-market economy such as China, the Department of Commerce is to determine the "normal value" of the product under investigation by valuing the non-market economy producer's factors of production in a surrogate market economy country which is a significant producer of comparable merchandise and which is at a level of economic development comparable to the non-market economy. These NME provisions are critical to ensuring a fair comparison of the normal value of goods produced in China with the export price of those goods in the United States. Without such provisions, the Department of Commerce would have to rely on the price charged for the goods in question in China, which, due to the substantial state control in many Chinese electronics firms, may bear little relationship to true market prices or the actual cost of production of semiconductors and other electronics components in China. Without the NME provisions of the antidumping law in effect, Chinese state-invested enterprises could in the future make significant below-cost sales of semiconductors in international trade, adversely affecting both the foreign trade and the domestic economy of the United States.

A provision therefore should be included in China's WTO protocol of accession to permit the United States to continue to apply the NME provisions of the antidumping law to China. The current draft protocol includes proposed text to this effect, but it has not yet been agreed upon.

**Conclusion**

China's semiconductor market represents a major opportunity for the U.S. industry, but there are significant risks and hurdles to be addressed as well, especially with regard to the rapidly growing Chinese market.

In microelectronics, China could become one of the world's leading producers, and, as such, it warrants continued monitoring to ensure that China's trade and investment regime does not discriminate against foreign producers. Ongoing bilateral and multilateral negotiations with China over the terms of its full integration into the world trading system can be utilized to address those aspects of the Chinese system which are problematic from the perspective of the U.S. semiconductor industry. Failure to renew MFN status for China, however, would be extremely detrimental to the interests of the U.S. semiconductor industry.

The U.S. Government is actively pursuing resolution of U.S. industry concerns in negotiations over China's accession to the WTO. SIA strongly supports the efforts of the USTR and other U.S. Government agencies in this regard. Meanwhile, in meetings with SIA, officials of the Chinese government and its electronics industry have demonstrated receptivity to many of the U.S. industry issues of concern outlined above. The SIA believes that the potential exists for a productive joint effort to address these issues in the context of China's accession to the WTO.

**TESTIMONY FOR THE RECORD**

**BEFORE**

**THE WAYS AND MEANS COMMITTEE**

**OF**

**THE U.S. HOUSE OF REPRESENTATIVES**

**SUBCOMMITTEE ON TRADE HEARING**

**ON**

**JUNE 17th, 1998**

**ON MOST FAVORED NATION TRADE STATUS**

**FOR CHINA**

**WASHINGTON, D.C.**

**BY**

**BRYAN McCANLESS**

**PRESIDENT**

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The membership of the National Business Association strongly opposes Most Favored Nation trade status for China because of the economic and social consequences to the United States of America and other countries around the world.

## Introduction

Chinese military and industrial capabilities are currently expanding at significant rates. This expansion is being aided by trade and investment between China and the United States. Since the end of the Cold War, the United States has moved from a geopolitical approach in foreign affairs to a commercial strategy. But even with expanded foreign trade and the prosperity it has provided, this shift in policy has left us **vulnerable** to those who would ignore the genuine national security of America's citizens and families for financial gain.

One of the surest ways to obliterate peace is with foreign policy that values profit above all else. Such a foreign policy is being conducted now between the United States and the People's Republic of China. We are told that China is moving towards democracy. As China's aging dictators pass away, they will theoretically leave in their place democratic capitalists like ourselves. But a closer look begs the question, "Who is really changing whom?" From the beginning, America has been a bright, shining light, a beacon of hope to the downtrodden because of the ideals our founding fathers held sacred. No country has done more for human rights than has America. But now, with the almighty dollar being the only thing held sacred by some, it appears America has changed, adopting trade policies that show no regard for moral concerns just to appease Big Business and multi-national corporations.

The reality that America has traded her soul in the name of free trade should shame every American who enjoys the liberties of this free country -- sacrificial liberties that were paid for with the blood of brave Americans who gave no thought to their own welfare, but willingly laid down their lives so that we could be free. But can any one of us honestly say that the America we know today is worthy of the heroes who died for her? And who among us here today could honestly look one of these American patriot's in the eye, were they living today, and defend our actions with the Chinese government? Not one of us could, if we are honest.

## Lessons From History

History shows us that as far back as the Seven Years War, there has always been a period of time following every major conflict when people have believed the incessant threat of war is passing away, yielding a new,

enlightened era. In an article for Strategic Review (Fall 1997), William R. Hawkins writes that this school of thought stems back to Voltaire and Immanuel Kant, and blossomed in the liberalism of the early 19th century. Central to this view was the hope that as imperatives of geopolitical diplomacy receded, opportunities for free foreign trade would open and join the world in the peaceful pursuit of mutual economic gain. Richard Cobden, who led the British Free Trade Movement, claimed trade was "the grand panacea" and under its influence, "the motive for large and mighty empires, for gigantic armies and great fleets would die away."

The conventional mercantilist paradigm empowered governments to control trade and direct investments with the goal of building up manufacturing and financial capabilities of their territories relative to the capacities of other countries. Liberals, however, didn't consider this an appropriate economic policy for an **enlightened** era. In 1821, only six years after Napoleon's defeat at Waterloo ended a quarter-century of civil wars and foreign invasions, British economist James Mill wrote the following in his *Elements of Political Economy:*

> *There is, in the present advanced state of the civilized world, in any country having a good government and a considerable population, so little chance of civil war or foreign invasion, that, in contriving the means of national felicity, but little allowance can be rationally required of it.*

Another statement of government's need to redirect its attention to the promotion of free trade was made by 19th century French economist Jean-Baptiste Say, who advocated ending diplomatic corps, saying ambassadors were no longer necessary and should be replaced by consuls whose purpose would be the promotion of trade. Say influenced **Thomas Jefferson, who reduced America's foreign service and also laid off most of the U.S. Navy.** A century and a half later which saw two world wars, the Cold War and numerous civil and foreign disputes, this liberal philosophy has reemerged, not on the fringe of American politics but dead center in both the Democratic and Republican parties, thus proving the British economist and his "enlightened" friends wrong about free trade.

**Most Favored Nation: Fact & Fiction**

As we consider MFN status for Communist China, the powerbrokers tell Americans, *"Don't Worry, Be Happy".....there's no military or economic threat from China* -- even though Americans continue to lose jobs because of our free trade policy with China.

The fact of the matter is that MFN allows China to export goods to the U.S. at the lowest tariff rates available -- virtually duty free in most cases -- but does not mean that U.S. exports have reciprocal access to the Chinese market. For this reason, MFN is considered a concession by the U.S. Beijing, on the other hand, operates one of the most protected markets in the world, exporting four times the amount of goods it imports from the U.S.

The Clinton Administration has relied heavily on big and emerging foreign markets to sustain the U.S. economy. But China's market has always been an **illusion**. Its role in the U.S. economy today is little more than it was at the turn of this century -- about four percent of U.S. commerce. Even within Asia, U.S. exports to China were only $11.8 billion in 1996. According to the U.S. Trade Representative, China took less than seven percent of American exports to Asia. The numbers have not gone up, either. U.S. exports to Japan and the Pacific Rim went up by $55 billion between 1993 and 1996 but only by $3 billion to China during the same period. The fact that the U.S. exports more to Singapore and Taiwan than to China, and more than twice as much to South Korea, dispels the myth that China is central to our economic position in Asia. America's real allies are the democratic-capitalist states on the Pacific Rim, not the Beijing dictatorship.

**Follow the Exports**

To realize the gravity of our current situation, we must first know and understand why the Chinese government only allows oil and food in the category of consumption imports. Beijing wants investment and technology to build its industrial base, ultimately reshaping the balance of power in Asia, and is using U.S. trade policies to help build China's military might. A 1994 Government Accounting Office report stated: "In the People's Republic of China, sophisticated manufacturing technologies acquired through cooperative programs with the West are being adapted for **Chinese military use**."

In the 1996 MFN debate, Rep. Bill Archer (R-TX), Chairman of Ways and Means, stressed the commercial gains that could be made from supporting China's infrastructure programs in "high technology, aerospace, petrochemicals and telecommunications." American firms have been encouraged through various programs to transfer capital and specific skills to China's industry. For example, Xian Aircraft builds components for Boeing airliners and fighter-bombers for the Chinese military. Pratt & Whitney's Canadian unit and China National South Aeroengine & Machinery Company produce gas-turbine and jet engines together. Although these engines are said to be for civilian use only, we know they're also adaptable to cruise missiles. A proposed facility to produce these engines in the Hainan province of

Zhuzhou already produces the WP-11 engine used in China's existing **cruise missiles**. Beijing has been buying advanced machine tools from a number of U.S. sources that are used to manufacture advanced weapons systems. Much of this equipment, said to be for civilian use only, has ended up at military-owned factories. The cold reality is that the hard currency (U.S. Dollars) China receives from the sale of Chinese products in America is the engine running China's military build-up, which threatens America's security.

Most alarming is that high-tech deals have been facilitated by the relaxation of U.S. export controls over sensitive and dual-use technology. The Clinton Administration sees the struggle in Asia as one of American firms and their rivals competing for business in China, rather than a future geopolitical challenge to the U.S. from a China armed with advanced weapons.

We really shouldn't be surprised to see commercial technology ending up with the military since all aerospace manufacturers in China are owned by the state. Aviation Industries of China oversees both domestic and foreign interests. The company's president, Zhu Yuli, has said that China will seek an "equal partnership" with foreign firms "to narrow the gap between its aviation industry and the more advanced countries."

Shun Zhenhuan, Senior Researcher at China's State Planning Commission, has pointed to China's rise in the aerospace industry and its connection to foreign partners:

> *In the last decade, aviation industry factories have manufactured the most modern aircraft in history. Of the more than 20 types of aircraft on our assembly lines, 75 percent are new types put into production this decade. A new lot of fighters, attack planes, bombers, helicopters and unmanned planes have been furnished to the army...We manufactured aircraft parts and engine parts for a dozen foreign factories or companies, thus earning foreign exchange.*

The U.S. Office of Naval Intelligence notes in a report that China is developing at least a half-dozen tactical combat aircraft, " at a time when many nations are finding it difficult to finance a single program."

Shun emphasizes this point about finances when he advises managers to *"Focus on exports, combine production with trade, technology with commerce...Have both exports and imports to keep the foreign exchange balance and to win more foreign exchange...Boldly attract the investment of foreign capital, raise funds in every way, and actively use them...Develop substitutes for import products or analyze foreign technology and master imported products as much as possible for reproduction and imitation."*

This view is typical in a regime that has learned to play on the naivete and short-term focus of foreign capitalists to build its own national power.

Another Chinese mercantilist, General Ding Henggao, has written, "At a time of peace and development, world competition is essentially about comprehensive national power, and the key is the competition in science and technology...One of the reasons we are not looked down upon in the world is that we have built a relatively complete defense industry, and we have been able to research and manufacture various types of conventional and strategic nuclear weapons."

Henggao views military production, domestic economy and international trade as interrelated. "To satisfy domestic needs, the defense industry should try to develop products for export and expand exports. This will then open a source of income and accumulate funds to be used for imports...***We should seize every favorable opportunity to import advanced technology from abroad, especially new and high technology.*** We should expand our technology cooperation and exchange with foreign countries."

General Ding, chairman of the Commission on Science, Technology and National Defense Industry, directs "the socialist modernization" of China's entire military-industrial complex. General Ding is also a member of the "Local War" faction which sees a very real near-term chance for conflict in East Asia. The focus is on modernizing the military over the next ten years.

**A Question of Semantics**

Throughout the MFN debate, proponents have argued that Beijing should be treated as a "normal" trading partner. Now there's an effort in place to change the language of "most-favored-nation" to "normal trading status" so as to remove any implication that doing business with a regime is to favor its policies. What's interesting in this semantics shuffle is that China may be more "normal" as an emerging Great Power than some realize. Beijing's international economic policies are really traditional, much like those of Jean Baptiste Colbert, the mercantilist Finance Minister for Louis XIV in 17th Century France. Colbert controlled imports but encouraged foreign craftsmen to come to France. He built roads, ports and shipyards to stimulate commerce. He also enacted reforms to create a large domestic market and the ability to take care of it. In Colbert's words, "Trade is the basis of finance and finance is the sinew of war."

China's trade surplus with the U.S. provides Beijing with the foreign exchange it needs to buy foreign weapons and technology. This hard currency surplus gave China $39.6 billion in 1996 and $33.4 billion in 1995. Compare this to the fiscal 1997 U.S. Defense budget of $43.8 billion for **the entire American military.**

Further strengthening China's military position is the fact that The People's Liberation Army completely owns and operates over 50 corporations engaged in foreign trade. China Poly Group, the largest of these corporations, is headed by General He Ping, son-in-law of China's late strongman Deng Xiaoping. Commerce with these military enterprises and other state-owned companies further enriches and strengthens the current autocratic Chinese regime.

**The Russian Factor**

Russia has been China's main source for arms, thus far. As Princeton's Kent Calder has observed, with Russia holding the greatest military yard sale in history, "the Chinese, flush with hard currency from their soaring, multibillion-dollar transpacific trade surpluses, stocked up."

Of particular concern is the aid Russia is providing Beijing in developing its new Type 093 nuclear attack and Type 094 ballistic missile submarines. These will far exceed the abilities of China's current fleet of noisy, unreliable vessels.

When Boris Yeltsin visited China in April of 1996, agreements were touted by both sides as part of a "strategic partnership." A communiqué issued at the end of the summit declared opposition to U.S. hegemony as the basis of Russian-Chinese cooperation. According to Stephen J. Blank with the Douglas MacArthur Professor of Research at the Army War College, "Russia needs China's markets. It also needs arms sales, peace along the borders with Central Asia...and China's help to enter into the Asian economic-political order." In return, Moscow has given diplomatic support to Beijing's agenda in the Far East.

This partnership became more important to Russia when China agreed to make all future arms purchases in cash rather than bartering trade goods. However, China's ability to follow through on this promise depends on the continued flow of U.S. trade dollars to Beijing. Once in Russia, this money can be used to support their military-industrial complex. As Radio Moscow has commented, "With money earned from the sale of Russian military equipment to China, Russia will be able to fund the development for itself of the most up-to-date types of armaments."

**From Russia To The Rest Of The World**

China has not limited weapon purchases to Russia. Instead, the Chinese have moved on to buy missiles from France and Italy. Even Israel has upgraded China's Russian designed tanks and is reportedly working on

aircraft projects. Geopolitically, Europeans have little to fear from China to offset the lure of its money. The United States is the country facing the tiger.

China's concentration on air and naval power indicates their intention to project power into the Pacific. Beijing wants to do more than protect its coastal provinces. It wants to make good on its offshore claims to the Diaoyutais, Paracels and Spratley Islands, which are presumed to hold the key to vast undersea oil reserves and to the renegade province of Taiwan. For this reason, the Chinese Navy has adopted an Offshore Active Defense which emphasizes decisive offensive tactics. By the year 2000, the Chinese navy plans to control the seas out to the first island chain defined by a line running from Japan to Taiwan, the Philippines and Borneo, down to Sumatra. All of Beijing's disputed island claims fall within this vast ocean territory. Yet, beyond this is the "second island chain" to which Chinese naval forces expect to reach by the early 21st Century -- a line that reaches out past the Marianas, Guam and Palau, and incorporates the entire Pacific Rim economy in much the same way that Japan once envisioned a Greater East Asia Co-Prosperity Sphere under its military supremacy.

**Real People, Real Lives, Real Pain**

The extent of China's human-rights violations is staggering. Consider these documented facts:

-- China's one-child-per-couple mandate has led to widespread sex selection abortion. Least desired are baby girls and many who are born alive are abandoned by their parents, often left to starve in state-run orphanages.

-- Chinese women are forced to have abortions, and some are involuntarily sterilized. Women in their eighth and ninth months of pregnancy have literally been dragged from their homes by family planning officials, tied down with their feet in stirrups, and their babies forcibly aborted.

-- In 1995, Hong Kong newspapers reported that aborted human fetuses were being cannibalized in China and sold as health food.

-- Christians and other people of faith are systematically tortured in China. Amnesty International reports cases of Christian women hung by their thumbs from wires, beaten with heavy rods, denied food and water, and shocked with electric probes.

-- Bishop Su was imprisoned for fifteen years and told of being beaten so severely with an instrument that it splintered. Undeterred, the police tore down a wooden door frame and continued beating Bishop Su until it, too, splintered. The bishop was then hung by his wrists from a ceiling and beaten around the head. In another episode, he was placed in a cell that contained water at varying levels from ankle to hip deep, and was left there for days, unable to sit or sleep.

-- Forever seared in the minds of all who watched via satellite in 1989 is the image of courageous Chinese students who marched to their deaths in Tiananmen Square, bravely quoting America's Declaration of Independence against the backdrop of a papier-mâché model of our Statue of Liberty. How ironic that those brave students understood this priceless gift of liberty more intimately than America's political leaders who take freedom for granted and systematically trade our liberties away, one congressional act at a time.

**We Must Deny China Most Favored Nation Status**

We've been told the best way to bring China around to our way of thinking is to grant them special privileges and, in time, they'll come to know the error of their ways. Only a fool buys into that kind of logic. If a child misbehaves and you want to correct his behavior, do you take away privileges or grant them? You take them away, of course! Only by feeling the negative consequences of his actions is a child likely to change his bad behavior. If, on the other hand, there are no negative consequences, but instead, only positive reinforcement, the child will continue to behave any way he chooses. What incentive have we given the Chinese government to stop the torture of its people? None. Instead, we have coddled them -- at a time when they were less of a threat to our nation -- and now continue to empower them -- at our own peril -- through Big Business' need for greed.

Denying most favored nation status to China will cut back an important source of revenue that is fueling the Chinese arms build-up. Although human rights abuses in China cannot be ignored, the more pressing issue right now for America is how best to deal with the emerging power of China. Our current policy is called "constructive engagement" but those are just new words for "appeasement." Unless we have the courage to acknowledge our mistakes with China and move in a direction that is beneficial to the United States, we have no assurance that our liberties won't be trampled by the Chinese government as were those of the small army of students in Tiananmen Square.

The Beijing regime's shift from Marxism to nationalism is designed to retain the loyalty of the rising business class, as well as to win back the allegiance of those who fled the turmoil of China's years of civil war. These expatriates built commercial networks that now control substantial investment capital. With assets estimated at $2 trillion, these family based empires still hold dear their Chinese cultural roots. Their wealth also gives them great political influence throughout the Pacific Rim and Southeast Asia. The U.S. has seen evidence of this through the campaign financing scandal which

involved the Indonesian-based Lippo Group. The Riady family, who own Lippo, fled the same southern coastal area of China which the "commercial" school sees as the breeding ground of reformers.

Beijing's appointment of shipping magnate Tung Chee-hwa as chief executive in Hong Kong demonstrates the autocratic regime's ability to find business and professional people to carry out its rule.

The Chinese have an ancient proverb that says, "A rich country makes for a strong army." This same wisdom has empowered major civilizations throughout history. The National Business Association believes that any portrayal of economic growth and military strength as rival concerns, or even as separate concerns, is dangerous. In our current situation, it can lead to policies that undermine U.S. capabilities at the same time it enhances the power of rival states. Such is the lesson we are learning about China being granted MFN status.

**Challenge to Congress**

NBA, as a major representative of small businesses in America, believes that our current situation with China is detrimental to our country's long term goals for peace and prosperity.

The NBA urges Congress to be statesmen and stateswomen instead of politicians and vote NO on Most Favored Nation Status for China.

We are grateful for this opportunity to speak on behalf of the many men and women from small businesses and middle class families who are looking to you, our elected leaders, to make America a beacon of hope once again, and a country built on strength of high moral character rather than a country sold to the highest bidder, one parcel at a time.

# STATEMENT

# OF

# U.S. INTEGRATED CARBON STEEL PRODUCERS

## HEARING ON UNITED STATES-CHINA TRADE RELATIONS AND RENEWAL OF CHINA'S MOST-FAVORED-NATION STATUS

## BEFORE THE SUBCOMMITTEE ON TRADE COMMITTEE ON WAYS AND MEANS

## JUNE 16, 1998

# Statement of

# U.S. Integrated Carbon Steel Producers

# on

## United States-China Trade Relations
## And Renewal of China's Most-Favored-Nation Status

**June 17, 1998**

This statement sets out the views of five major integrated U.S. producers of carbon steel products -- Bethlehem Steel Corp., U.S. Steel Group a Unit of USX Corp., LTV Steel Co., Inland Steel Industries, Inc., and National Steel Corp. -- on U.S.-China trade relations and renewal of China's Most-Favored-Nation (MFN) status. We commend the Subcommittee for holding this hearing and appreciate the opportunity to express our views. We welcome the Subcommittee's active oversight of one of the most important U.S. bilateral relationships.

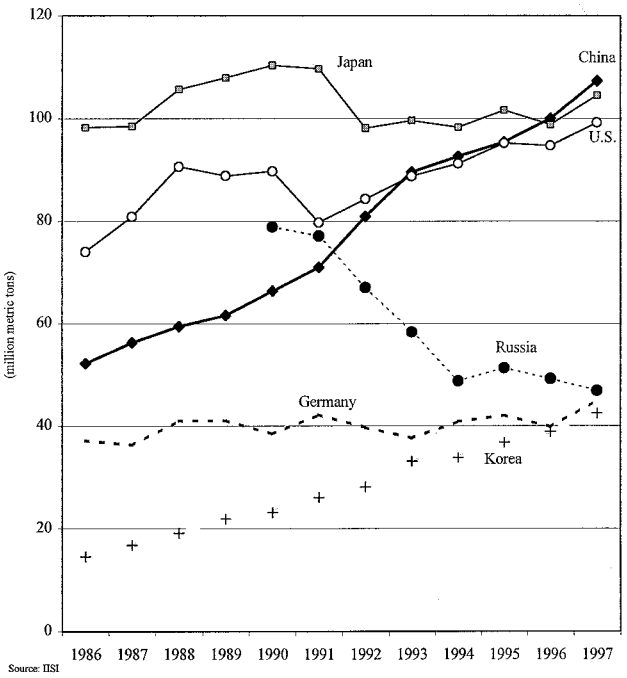
**Background -- MFN Renewal and WTO Accession**

Carbon steel producers support renewal of MFN status for China but are deeply concerned about China's respect for the obligations and fair trading rules that accompany participation in an open trading system. We believe these concerns can best be addressed in the negotiations concerning China's proposed accession to the World Trade Organization (WTO), and in the protocol expected to result from those negotiations.

The two pillars of the WTO are free and fair trade -- elimination of barriers coupled with clear and enforceable rules against unfair trade. In the steel sector and many others, China today does not trade fairly. This makes the clarity and enforceability of fair trading rules a matter of paramount importance in the accession talks.

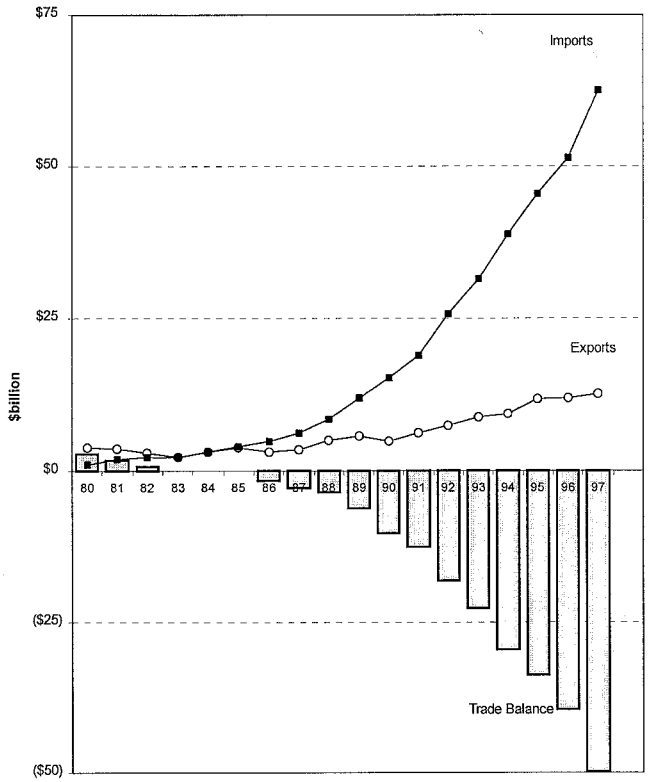
China's efforts to join the WTO provide the United States with a unique opportunity to address serious trade issues facing many U.S. industries, including steel. Concerns over these issues have heightened recently as China reasserts itself as a central force in the international economy. China's status as the world's largest steel producer underscores China's emergence as a major player in global trade. (See Chart 1.) Illustrative of recent trade trends, Chinese exports of cut-to-length carbon steel plate to the U.S. market grew from zero in 1993 to 300,000 tons in 1996.

Chart 1:
The Rapid Increase in China's Steel Production
Has Made It the World's Largest Steel Producer




China's rapidly growing economy offers a huge potential market for U.S. exports. There continue to exist, however, substantial barriers to accessing this market, as evidenced by the U.S. trade deficit with China -- nearly $50 billion in 1997 (see Chart 2), and projected to increase in 1998. Among the many causes of this deficit are Chinese policies that promote export-led growth in certain sectors while restricting imports through a discriminatory and nontransparent trade and investment regime. Many of these policies are inconsistent with both the letter and spirit of the WTO agreements.

Chart 2:
U.S. Merchandise Trade with China
1980 to 1997




Source: U.S. Department of Commerce

With an appropriate protocol of accession, U.S. steel producers are prepared to support China's accession to the WTO. Draft protocols considered so far, however, do not adequately address several key issues. Of these, three are of particular importance to the steel industry: antidumping rules, purchasing by state-owned enterprises, and subsidies. These issues must be addressed, and addressed successfully, well before the conclusion of the accession negotiations.

**Non-Market Economy Antidumping Rules**

For purposes of antidumping analysis, U.S. law provides that, in the case of imports from a nonmarket economy ("NME") such as China, the Commerce Department is to determine the "normal value" of a product under investigation by valuing the NME producer's factors of production (plus amounts for general expenses and profit) in a surrogate country that is similarly developed but market-oriented. This methodology is critical to ensuring a fair comparison of the normal value of NME goods with the export price of those goods to purchasers in the United States.

Chinese trade officials argue that China is no longer a non-market economy and therefore should not be subject to NME antidumping rules in the United States, the EU and other jurisdictions. Notwithstanding certain reform initiatives, a substantial percentage of Chinese manufacturers continue to be state-owned and controlled, and state control over input prices persists. This is especially true in the steel industry. Recent antidumping cases both inside and outside the steel sector underscore that China remains a non-market economy for these purposes. The Commerce Department's consistent findings in this regard should not be disregarded, to the detriment of U.S. steel producers, simply to ease China's WTO accession.

GATT signatories (now WTO members) have long applied NME antidumping rules. The basis for the NME methodology has been a note to GATT Art. VI which recognizes that, "in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, . . . importing contracting parties may find . . . that a strict comparison with domestic prices in such a country may not always be appropriate." The mere possibility of a finding that China, in view of the partial reforms completed there, does not meet this standard means that the ability to continue using NME methodology with respect to Chinese goods must be made explicit in China's protocol of accession.

Were the Commerce Department to begin relying on state-controlled prices, the Chinese Government could easily manipulate prices in such a way as to mask the true level of dumping taking place. For this reason, application of a "market economy" antidumping analysis is inappropriate and will produce inequitable results so long as prices and enterprises remain under state control in China. In the accessions of other non-market countries such as Poland and Romania, the continued ability to use NME methodology has been made explicit for this very reason.

To reduce the risk that applying NME antidumping rules to post-accession imports from China would be found inconsistent with the WTO agreements, clear language must be included in China's protocol that specifically guarantees the right of the United States and other countries to continue to apply NME antidumping rules with respect to goods of Chinese origin. China should remain subject to NME rules at least until such a time as it no longer maintains substantial state control over prices. The language included in the current draft protocol, intended to meet this concern, has not been accepted by China.

Fundamental for an acceptable protocol, the applicability of NME antidumping rules should be addressed decisively at an early stage in the discussions. Experience has shown that such issues cannot be effectively addressed in the pressured atmosphere that prevails at the end of a negotiation.

**Purchasing by State-Owned and State-Invested Enterprises**

Despite its emergence as the world's largest steel producer, China continues to import some steel products from countries such as Japan and Russia. However, the Chinese Government is undertaking a significant effort to boost domestic steel production, with the goal of reaching self-sufficiency and ending imports of basic steel by the year 2000.

Consequently, the very real risk looms that the Chinese Government will exercise the power it maintains over state-owned and state-invested enterprises in the steel sector and downstream industries in order to induce these enterprises to purchase only domestic steel. If these Chinese enterprises fail to purchase steel based on commercial considerations, and are instead influenced by the Chinese Government's import substitution policies, foreign steel products will no longer be able to be sold in China.

Such a closing of China to steel imports will not only affect U.S. exports, but will divert third-country exports away from China and toward the world's few open markets for steel. The United States -- the world's largest open market for steel -- would face an even greater onslaught of excess world steel production, often at dumped prices.

Accordingly, China's protocol of accession should include an affirmative obligation on the part of the Chinese Government to ensure that state-owned and state-invested enterprises make purchases solely on the basis of commercial considerations. The protocol should also provide for a regular review of purchasing decisions by Chinese state-owned and state-invested enterprises to ensure compliance with this obligation.

**Subsidies**

The accession protocol should commit China fully to WTO subsidy rules and include a realistic and enforceable schedule for phasing out existing subsidies. A protocol "annex" reportedly establishing a timetable for phasing out Chinese subsidies has not been made publicly available. This schedule must be fully vetted with Congress and affected U.S. industries well before any accession pact is finalized.

Equally important is ensuring, through appropriate protocol provisions and statutory amendments, that U.S. anti-subsidy laws can be applied to offset and deter such subsidies. While China already is a prolific subsidizer, the risk of improper use of subsidies in an economy like China's increases as the economy becomes more market-oriented. U.S. trade remedies must be capable of responding effectively to this problem both during and after China's transition.

**Conclusion**

Carbon steel producers welcome the Subcommittee's active oversight of one of the most important U.S. bilateral trading relationships. U.S. steel producers support renewal of MFN status for China. As U.S. trade with China continues to grow, however, domestic and international rules applicable to that trade will assume significantly greater importance.

As China seeks to benefit from membership in the WTO, it must agree to be bound by the obligations imposed on Members, and therefore reform its legal and commercial structures consistent with the requirements of the international trading system and its rules. It is well-accepted that the accession pact must be "commercially viable" if accession is to be in the U.S. national interest. From the carbon steel industry's perspective, no protocol can be "commercially viable" unless it successfully addresses the fundamental issues of antidumping rules, purchasing by state-owned enterprises, and subsidies.