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CHALLENGE OR OPPORTUNITY? CHINA'S ROLE IN LATIN AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON WESTERN HEMISPHERE, PEACE CORPS AND NARCOTICS AFFAIRS

OF THE

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UNITED STATES SENATE

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CHALLENGE OR OPPORTUNITY? CHINA'S ROLE IN LATIN AMERICA

TUESDAY, SEPTEMBER 20, 2005

U.S. SENATE,
SUBCOMMITTEE ON WESTERN HEMISPHERE,
PEACE CORPS, AND NARCOTICS AFFAIRS,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:32 p.m., in room SD–419, Dirksen Senate Office Building, Hon. Norm Coleman presiding.

Present: Senators Coleman and Nelson.

OPENING STATEMENT OF HON. NORM COLEMAN, U.S. SENATOR FROM MINNESOTA

Senator COLEMAN. This hearing of the Senate Foreign Relations Subcommittee on Western Hemisphere, Peace Corps, and Narcotics Affairs will come to order.

These are very busy times, I will note to the panelists. First I want to thank them for their attendance and participation today. This is a very important discussion. When I left, our conference was having an all-conference briefing from FEMA and the Coast Guard on Hurricane Katrina, so that will, I think, account for some of my colleagues not being here. But I did want to go forward with the hearing as scheduled. This is part of what will be an ongoing conversation and, I think, a very, very important conversation.

Minnesota native and Pulitzer Prize winning journalist, Tom Friedman, has recently published a new book called "The World is Flat." The book is a major data dump of facts about how the world has changed, particularly with the rise of China and India. On some editions the cover depicts a boat sailing over the edge of the Earth and the jacket cover says that the painting is called "I Told You So."

That is kind of a grim joke, but it is a serious warning. We have to understand the new dynamics at play in this interconnected world. In the end, we will either ride the waves of opportunity or we will be swept out to sea.

There can be no question that China is playing an increasing role in Latin America, as it is elsewhere around the world. Between 1999 and 2004 China's imports from Latin America increased sixfold and its exports more than tripled. In 2003 Latin America was the destination of fully one-third of Chinese foreign direct investment.

A number of high profile visits further illustrates China's growing interest in Latin America. Since President Jiang Zemin's 13-day tour of Latin America in April 2001, President Hu Jintao has visited Latin America twice, including Mexico earlier this month, and China's Vice President visited the region in March of this year.

The overall pattern seems to be the following: A Chinese official visits a Latin American country, China makes an attractive offer to that country: Market access for agricultural and other goods; a substantial commitment of investment; and/or the country's designation as an official tourist designation for Chinese visitors. In exchange, China gets certain benefits: The country's designation of China as a, "market economy," which decreases the country's ability to apply antidumping measures against Chinese imports and/or the country's switching its diplomatic recognition from Taiwan to China.

China's outreach in Latin America includes military cooperation. China is establishing and strengthening military exchange programs in the hemisphere even as the United States is restricting our military-to-military relations because of differences over the International Criminal Court. In 2004, 20 senior Chinese defense officials visited Latin America. In addition, China sent 125 peacekeepers to Haiti, the first military operation in the Western Hemisphere with Chinese troops.

China is also becoming increasingly active in hemispheric multilateral institutions. China gained observer status at the Organization of American States last year and would like to join the Inter-American Development Bank.

Chinese criminal elements are having an impact on the Western Hemisphere as well. It is estimated that two-thirds of Brazil's pirated goods originate in China, and a considerable amount is trafficked through the triborder region. China is a major source country for ephedra, a principal component for the manufacture of methamphetamine, which is a plague that is growing larger and larger in the United States.

China's influence is not the same throughout the region, however. Countries like Brazil, Chile, Argentina, and Venezuela view China positively as an important and growing market for their oil, copper, and soybeans. Places like Mexico, the Dominican Republic, and Central America, on the other hand, may be more concerned about the fact that many of their low-wage jobs have been displaced to China.

Overall, China's influence in the region appears unlikely to supersede the United States' any time soon. United States-Latin America trade is 10 times greater than China-Latin America trade and American investment in Latin America dwarfs China's by even greater margins. Our history, values, and geography also bind the United States to Latin America in a way that China cannot match.

However, China's staggering economic growth and its insatiable need for natural resources, particularly energy, is a global phenomenon that will have an effect in the United States and one that certainly merits our attention. At minimum, we must find ways to ensure that American influence in the Western Hemisphere is not diminished by an increasingly active China. Economically, we should be looking for ways to work cooperatively as a region to in-

crease our global competitiveness in the face of a growing China, a rapidly developing India, and a united Europe. The United States must also be aggressive in our diplomacy so as to dissuade any notion of a vacuum that China is filling in the hemisphere.

I would also challenge our witnesses to look for the opportunities presented by a major world power showing interest in this hemisphere. Are there ways to engage China in Latin America? Where there is instability in this hemisphere, can China play a constructive role? Are there opportunities for the United States, China, and Latin America to work together in ways that benefit all?

[The prepared statement of Senator Coleman follows:]

PREPARED STATEMENT OF HON. NORM COLEMAN, U.S. SENATOR FROM MINNESOTA

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However, China's staggering economic growth and its insatiable need for natural resources, particularly energy, is a global phenomenon that will have an effect in the United States, and one that certainly merits our attention.

At a minimum, we must find ways to ensure that American influence in the Western Hemisphere is not diminished by an increasingly active China. Economically, we should be looking for ways to work cooperatively, as a region, to increase our global competitiveness in the face of a growing China, a rapidly developing India, and a united Europe. The United States must also be aggressive in our diplomacy so as to dissuade any notion of a "vacuum" that China is filling in the hemisphere.

I would also challenge our witnesses to look for the opportunities presented by a major world power showing interest in this hemisphere. Are there ways to engage with China in Latin America? Where there is instability in this hemisphere, can China play a constructive role? Are there opportunities for the United States, China, and Latin America to work together in ways that benefit all?

Senator COLEMAN. We will begin today's hearing with the view from the Departments of State and Defense about how United States policy in Latin America takes into account China's growing presence. Ambassador Charles Shapiro is Principal Deputy Assistant Secretary of State for Western Hemisphere Affairs. A career member of the foreign service, Ambassador Shapiro was most recently posted as Ambassador to Venezuela. He has previously served as Director of the Office of Cuban Affairs, as Deputy Chief of Mission in Santiago, Chile, as Deputy Chief of Mission in Trinidad, and as a political officer in San Salvador.

He has held numerous posts in Washington, DC, including Executive Assistant in the Bureau of Western Hemisphere Affairs, International Relations Officer in the Office of Latin American Programs at the Bureau of International Narcotics and Law Enforcement Affairs, and Deputy Director of the Office of Andean Affairs.

Ambassador Shapiro will be supported by Mr. Robert Forden, Deputy Director for China and Mongolian Affairs at the Department of State. Mr. Forden is a career foreign supervisor officer with experience in Beijing, Taiwan, and Hanoi.

Mr. Roger Pardo-Maurer is Deputy Assistant Secretary of Defense for Western Hemisphere Affairs. Before joining the Department of Defense, Mr. Pardo-Maurer was president of Emerging Market Access, a Washington, DC, consulting firm. He was also managing partner of Access NAFTA Project Management, a trade investment advisory firm, and president of Chartwell Information Group.

Mr. Pardo-Maurer has worked as a Latin American specialist at the American Enterprise Institute and at the Center for Strategic and International Studies. He has also served as chief of staff of the representative of the Nicaraguan resistance. Mr. Pardo-Maurer is an enlisted reservist in the U.S. Army's 20th Special Forces Group.

We will begin with Ambassador Shapiro.

Ambassador SHAPIRO. Thank you very much, Mr. Chairman. I am pleased to appear before you this afternoon to discuss the diplomatic, political, and economic implications of——

Senator COLEMAN. Mr. Ambassador, if I can, since you just started, I would love to give my colleague from Florida, Senator Nelson, an opportunity to make a statement before you begin your testimony.

Senator Nelson, when you catch your breath and gather your thoughts.

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator BILL NELSON. You are very kind, Mr. Chairman. This, of course, is an enormously important subject to us, not only for the Western Hemisphere but for the entire world. The relationship that we have had with Venezuela, for example, is now being strained, and one question is whether or not it would be further strained by a growing oil relationship between Venezuela and China..

Another issue of enormous importance to us is the extension of terrorism out of the Middle East into Africa and Latin America, and how the Chinese can be our partners in fighting terrorism, because they have as much a stake in that as we do.

We are discussing Latin America today, but the United States and China are increasingly coming together, for example, in dealing with North Korea, and realizing it is not in China's interests and certainly not in America's or the rest of the world's interest that North Korea have a nuclear bomb.

So I am really looking forward to the discussion of this panel here.

Senator COLEMAN. Thank you, Senator Nelson.

With that, Ambassador Shapiro.

STATEMENT OF HON. CHARLES S. SHAPIRO, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF WESTERN HEMISPHERE AFFAIRS, DEPARTMENT OF STATE, ACCOMPANIED BY ROBERT FORDEN, DEPUTY DIRECTOR FOR CHINA AND MONGOLIAN AFFAIRS, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, DC

Ambassador SHAPIRO. Thank you very much, Mr. Chairman, Senator Nelson. It is with great pleasure that I appear before you this afternoon to discuss the diplomatic, political, and economic implications of China's engagement in Latin America and the Caribbean and the challenge and opportunity that this presents the United States and our allies and friends during the next quarter of a century.

I have provided the subcommittee with written testimony, but there are several key areas that I would like to highlight now with your permission. China's growth and development have naturally brought growing relationships with traditional United States allies in the region. This does not diminish U.S. influence or capabilities. U.S. policy toward Latin America is anchored in our strong and enduring alliances, which continue to provide unprecedented stability and prosperity in the region.

Our allies throughout Latin America believe good United States-China relations are important to global peace, prosperity, and stability. Our efforts to work with China should enhance, not impair, our regional alliances.

United States policy in Latin America is built upon a positive and constructive vision designed to advance freedom and prosperity. We promote democracy and the rule of law so that every citizen can decide what is best for him or herself and is guaranteed the right to claim his fair share of political freedom and economic opportunity. We promote free enterprise as a perpetual engine of growth. We are committed to working together with our neighbors

to make things better for the poorest among us so that things can be better for all of us.

We are working constantly to achieve our goals. We are working multilaterally with the United Nations, particularly in Haiti, and with the OAS throughout the hemisphere. With the strong support of President Bush at the Fort Lauderdale General Assembly of the Organization of American States in June, we joined with our neighbors in issuing the Declaration of Florida, which advances our agenda of democracy and transparent and accountable governments.

We have also contributed significant resources to support the exercise of democracy in the more than a dozen countries that will be holding Presidential elections through the end of 2006. That includes, among others, Haiti, Nicaragua, and Bolivia.

Our economic engagement in the region is extensive and broad-based. United States trade with Latin America and the Caribbean exceeded $445 billion in 2004 and is growing this year at the rate of 10 percent. United States investment in Latin America, direct investment, exceeds $300 billion. We have free trade agreements with Mexico and Chile. Similar benefits will soon be extended to the CAFTA–DR countries. Negotiators are meeting this week in Cartagena, Colombia, with negotiators from Colombia, Peru, and Ecuador. We also hope to soon conclude a free trade agreement with Panama.

The Millennium Challenge Account offers great promise to assist countries in making reforms necessary for long-term growth. Both Honduras and Nicaragua have completed MCA compacts.

An estimated 30 percent of foreign direct investment flows into the region come from the United States. The United States accounts for more than 50 percent of multinational firms doing business in Latin America and the Caribbean.

We would not be so bold as to claim that all of our goals have been met. There is still much to be done, but there has been progress in many areas. Today every country in the hemisphere save one has a democratic constitutional government. We have improved the basis for security cooperation in the hemisphere through a broad range of military-to-military engagement and security assistance programs. The percentage of the hemisphere's population, about 15 percent, living in extreme poverty is decreasing. Reducing poverty and increasing regional prosperity are key objectives and will be a focus of the Summit of the Americas, which will take place in November in Mar del Plata, Argentina.

For its part, China has many reasons to be engaged in Latin America and the Caribbean. We see two major trends in Chinese engagement: First and foremost, growing trade and investment to fuel China's own rapid domestic development; second, China wants to match its growing economic strength with political influence. China is the world's seventh largest economy, the world's third largest trading nation, and a major destination for foreign direct investment from around the world. To sustain economic growth, China has become more engaged with the rest of the world, including Latin America.

Chinese trade with Latin America is growing at around 25 percent a year. China may become an important new investor in the

region. Its total investment at the end of 2004 was only $8.3 billion. However, new pledged investments in infrastructure and natural resources could be a significant boost to the region if realized.

Let me go back. Our investment in the region is $300 billion. China's is about $8.3 billion. To give you a comparison, Spain's direct investment in the region is somewhere around $55 billion. China is also interested in matching its economic power with political influence. China's integration into the global economic and political community is now largely complete. We encourage China to act as a stakeholder in the international system of which it is a major beneficiary. We support China's engagement in the region in ways that create prosperity and promote transparency, good governance, and respect for human rights. We also want to ensure vital renewable resources, such as fisheries and forests, are used in a sustainable way.

Given this subcommittee's interest in narcotics, let me touch for a minute on China's role in narcotics control in the region. China has a large and developed chemical industry and, like the United States, it is one of the world's largest producers of precursor chemicals; chemicals which have legitimate uses but are also used in the production of cocaine and synthetic drugs.

China notifies the DEA of shipments of precursor chemicals to the United States and Mexico so that tracking may be done to prevent diversion of those chemicals for illicit purposes. Nevertheless, some precursor chemicals are, in fact, diverted from legal use to manufacturing methamphetamine destined for U.S. markets.

We are following closely what appears to be expanding military-to-military contacts between China and countries in the region, and my colleague on the panel will address that more. As China considers arms sales to the region, we will apply our general policy of seeking transparency and accountability in these sales and are concerned about the risk of diversion of weapons to illegal armed groups.

We do not have reliable figures for China's military assistance to the Western Hemisphere. However, we note that United States assistance is preconditioned on adherence to basic principles of good governance and transparency and we encourage China to adopt similar principles. I would also note that in comparison, United States military assistance dwarfs Chinese security assistance to the region.

There is much that is complementary with China in our approach to the region and much on which we look forward to cooperating with them. As the President said on May 31, our relationship with China is complex, but in recent years we have been able to communicate often to address common challenges.

Of course, we have differences with China on a variety of important issues, including human rights, nonproliferation, Taiwan, and some aspects of trade and finance, among others. We intend for our relationship with China to be based both on a realistic appraisal of our common interests and, equally important, a frank exploration of differences through dialog.

Let me conclude with a couple of observations. First, our relationships with our neighbors in the Western Hemisphere are strong and stable, based on shared values, economic ties, and defense rela-

tionships. A strong, secure United States and a strong, secure, prosperous, and stable Western Hemisphere remains our goal and a continuing reality.

Second, we must continue to work with our neighbors and with our partners around the world to ensure that China's development takes place within strong regional and global security, economic, and political arrangements. That is the policy articulated by President Bush, by Secretary Rice, and is a key objective of the United States-China senior dialog led by Deputy Secretary Zoellick. I assure you that in pursuing this goal our guiding principle remains to advance the interests and values of the United States of America.

Thank you for this opportunity to testify. I would be pleased to take your questions.

[The prepared statement of Ambassador Shapiro follows:]

PREPARED STATEMENT OF CHARLES S. SHAPIRO, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF WESTERN HEMISPHERE AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, DC

Mr. Chairman, members of the Subcommittee on Western Hemisphere, Peace Corps, and Narcotic Affairs, I am pleased to appear before you this afternoon to discuss the diplomatic, political, and economic implications of China's engagement in Latin America and the Caribbean. China's emergence—its economic and political development, its engagement in a rules-based international world, its evolution as an interlocutor on security issues in Asia and beyond—will be an important opportunity and a key challenge for the United States over the next quarter of a century and beyond. To the extent that China's engagement promotes policies that contribute to the fundamental interests of the American People, we welcome that engagement.

THE UNITED STATES IN THE WESTERN HEMISPHERE

U.S. policy in Latin America has been built upon a positive and constructive vision designed to advance freedom and prosperity in the region. We have promoted democracy and the rule of law so that every citizen can decide what is best for him or herself, and is guaranteed the right to claim his fair share of political freedom and economic opportunity. We promote free enterprise as a perpetual engine of growth. We are committed to working together with our neighbors to make things better for the poorest among us so that things can be better for all of us.

We pursue our many goals on a daily basis with our partners in the region. For example, we work multilaterally with the United Nations in places like Haiti and with the OAS throughout the hemisphere to further the interests shared by all the nations of the hemisphere. With the strong support of President Bush at the Fort Lauderdale meeting of the OAS General Assembly in June, we joined with our neighbors in the region to issue the "Declaration of Florida," which among other things advances our agenda of delivering the benefits of democracy to ordinary citizens by making governments more effective, transparent, and accountable. We have also contributed significant resources to support the exercise of democracy in 13 countries that are holding elections in the year ahead.

In November, Argentina will host the Fourth Summit of the Americas, where the focus will be on creating jobs. We are developing, in concert with the other 33 democratically elected governments in the hemisphere, a Summit Plan of Action that will meet this objective head on. We are striving for a plan of action that has meaningful initiatives, with measurable outcomes, designed to ensure that the summit has real meaning in advancing the welfare of the hemisphere's citizens. The role of governments is to help establish a framework in which the private sector can thrive; one that promotes more competitive economies, attracts investment and fosters private enterprise—small- and medium-sized enterprises in particular. In 2004, at the Special Summit of the Americas in Monterrey, the hemisphere's leaders committed themselves to practical steps to boost economic growth and open economic opportunity to all. They agreed to strengthen and enforce property rights, lower barriers to remittances, remove obstacles to starting small businesses, and increase access to capital for small businessowners. And we have already seen results. For example, in the 22 Western Hemisphere countries (excluding the United States and Canada),

the average time of starting a business has been reduced from 71 days in 2004 to 63 days in 2005. A good start, but we hope to do much better. We will strive for similar, measurable outcomes in the upcoming summit.

Our economic and trade links with countries in the region foster prosperity and promote democracy and the rule of law. The ties between economic opportunity and political empowerment are clear. Our economic relations are about breaking down entrenched interests, stigmatizing corruption, rewarding reforms that bolster competitiveness, and ensuring that the very poor have the tools they need to claim their fair share of economic opportunity.

Our economic engagement in the region is extensive and broad-based. We have comprehensive trade and investment relationships with Mexico and Chile through existing free trade agreements; CAFTA–DR was just approved, and we hope to conclude an Andean free trade agreement, as well as one with Panama, in the near future. The Millennium Challenge Account offers great promise to assist countries in making the reforms necessary for long-term growth, and two of the first four countries to have MCA compacts—Honduras and Nicaragua—lie within our hemisphere. Of course, the heavy lifting in the region, as it should be, is done by the United States private sector. An estimated 30 percent of foreign direct investment flows into the region are from the United States, and the United States accounts for more than 50 percent of multinational firms doing business in the region.

While we are not so bold as to claim all of our goals have been met—and there is still a lot to do—there has been progress in many areas. Today every country in the hemisphere, save one, has a democratic, constitutional government. We improved the basis for security cooperation in the hemisphere through a broad range of military-to-military engagement and security assistance programs. And the percentage of the hemisphere's population—about 15 percent—living in extreme poverty is decreasing, although the numbers of poor are increasing due to population growth and persistent income inequalities. Reducing poverty and increasing regional prosperity remain key objectives.

CHINA IN THE WESTERN HEMISPHERE

We see two major trends in China's engagement with Latin America and the Caribbean. First and foremost, growing trade and investment are necessary to fuel China's own rapid domestic development. Second, China wants to match its growing economic strength with political influence in order to advance its own national agenda.

CHINA'S ECONOMIC INFLUENCE

China is the world's fifth largest economy (with an economy about the same size as Italy's), the world's third largest trading nation, and a major destination for foreign direct investment from around the world. Its economy has grown at over 9.5 percent per year for the past 25 years.

Rapid growth and development are significant sources of legitimacy for the Chinese Communist Party. To sustain that growth, China has increasingly engaged with the rest of the world, including with Latin America, to secure inputs it needs and markets for its surging exports.

China's demand for Latin American goods has helped fuel economic growth in many countries. At the same time, however, China's exports, especially in textiles, apparel, and shoes, pose stiff competition for some Latin American and Caribbean producers, primarily in third-country markets.

- China's imports from Latin America reached $22 billion in 2004 and are up 16 percent in the first half of this year. Primary imports from Latin America include metal ores, soybeans, and copper.
- China's exports to Latin America reached $18 billion in 2004 and were up an additional 32 percent in the first half of this year. China's top exports to Latin America include machinery, electronics, and apparel.
- While it is difficult to attribute what portion of overall economic growth in Latin America is attributable to particular factors, it is clear that China's boom has expanded markets for Latin exports, and thus contributes to economic growth. For example, the value of Chile's net exports to China more than doubled in 2004, increasing by about $1 billion in a $94 billion economy.
- China is an important new investor in the region as it searches for resources. Still Chinese investment is rather small, at approximately $8.3 billion at the end of 2004, according to Chinese data. And the lion's share of that sum consists of investments in tax-haven countries, such as the Cayman Islands and British Virgin Islands. However, deals for future investments, primarily in in-

frastructure and extractive sectors, could be a significant boost to the region if realized.

- China is now the world's second largest consumer of petroleum, and has become a net importer of oil. We believe that securing reliable access to petroleum products from the hemisphere is an important element of China's engagement in the region, especially with Venezuela, Colombia, and Ecuador.

In comparison, U.S. trade with, and investment in, the region dwarf China's, and is distinct from what China has to offer. We provide high-tech and knowledge-based goods and services. U.S. trade with the region exceeded $445 billion in 2005, 10 times China's level; Latin America's exports to the United States are up 10 percent and imports from the United States are up 15 percent in the first half of this year. U.S. investment in Latin America is over $300 billion. The region needs and values our market and our expertise for its continued development.

CHINA'S POLITICAL INFLUENCE

China is also interested in matching its economic power with political influence in the region. China's desire to compete with and ultimately isolate Taiwan diplomatically is a key factor in Latin America, home to 12 of the 26 countries that have diplomatic relations with Taiwan. China will continue to offer assistance to countries like Dominica and Grenada, which switched their recognition from Taipei to Beijing in March 2004 and January 2005 respectively.

The Chinese are also skillfully employing "visit diplomacy." On the margins of the APEC Summit in Santiago in November 2004, where President Bush and President Hu Jintao met, President Hu Jintao also visited Argentina, Brazil, Chile, and Cuba. Hu promised tens of billions of dollars for improving infrastructure—again, mainly to improve access to, and transport of, raw materials.

In December 2004, Venezuelan President Hugo Chavez visited Beijing, signing agreements that would increase China's investment in Venezuela's oil sector and boost bilateral trade, which, as Chavez stated, could reach $3 billion in 2005, more than double the total for 2004.

In January and February 2005, Vice President Zeng Qinghong visited Mexico, Venezuela, and Peru, and attended the opening ceremony of the first ministerial-level meeting of the China-Caribbean Economy and Trade Cooperation Forum 2005 in Kingston.

En route to the United Nations General Assembly in New York, President Hu Jintao recently visit Canada and Mexico, and on September 12 signed several trade agreements on such areas as tourism, taxes, and agriculture. President Hu Jintao also promised to take action against illicit Chinese commerce arriving in Mexico.

Apart from its diplomatic competition with Taiwan, we believe China should step up to global responsibilities commensurate with the benefits that it derives from being both a member and a stakeholder in international systems and organizations. For our part, one of the most important foreign policy goals of seven American Presidents—over 30 years—has been to engage China in a way that helps it peacefully and responsibly integrate into the international system. As Secretary Rice said in her March 19 speech in Tokyo, the United States "welcomes the rise of a confident, peaceful, and prosperous China . . . [and wants] China as a global partner," but one that is "able and willing to match its growing capabilities to its international responsibilities." We also seek a China that is moving toward greater openness and rule of law at home, though it clearly has a long way to go.

China's integration into the global economic and political community is now largely complete. It has a permanent seat on the U.N. Security Council, is a WTO member, is active in the World Bank and IMF, interacts with the G–7 and G–8, plays a strong role in a number of regional bodies such as APEC and ASEAN, has contributed significantly to Asian security through the Six Party Talks, and has permanent observer status in the OAS.

We support China's engagement in the region in ways that create prosperity and promote transparency, good governance, and respect for human rights. We also want to ensure vital natural resources, such as fisheries and forests are used in a sustainable way. China's determination to achieve energy security is an important aspect of its global outreach, and it is critical that China understand the fundamentals of global energy markets. But equally important, we need to work with China and with our friends and allies to ensure that every effort is taken to promote policies that converge with our interests. We will continue to monitor China's presence in the region to ensure this is the case—that its presence does not detract from our goals of prosperity, democracy, and respect for human rights.

We expect that China's increasing engagement in the region will lead to increased cooperation between China, the United States, and other Latin American and Carib-

bean governments on matters affecting regional stability, especially terrorism; transnational crime, and counternarcotics. We view positively China's participation in the U.N. peacekeeping mission in Haiti in a way that contributes to the mission.

CHINA'S ROLE IN NARCOTICS CONTROL

Given this subcommittee's interest in narcotics, let me elaborate on China's role in narcotics control in the region. China has a large and developed chemical industry, and, like the United States, it is one of the world's largest producers of precursor chemicals, which have legitimate uses but are also used in the production of cocaine and synthetic drugs. In particular, China is the world's leading exporter of bulk ephedrine (used in cold medicines and weight loss tablets) and a source country for much of the ephedrine and pseudoephedrine imported into Mexico.

China notifies the DEA of shipments of precursor chemicals to the United States and Mexico so that tracking may be done to prevent diversion of these chemicals for illicit purposes. Nevertheless, some precursor chemicals are diverted from legal use to manufacture methamphetamine destined for the United States.

To regulate its chemical industry, China is a party to the 1988 U.N. Drug Convention and has regulations for recordkeeping and import/export controls on all chemicals included in the Convention. Several provinces have more stringent controls than called for in the Convention. In the State Department's International Narcotics Control Strategy Report we have noted, however, that China needs to improve its infrastructure to adequately monitor its large chemical production capacity and international trade in chemicals.

United States and Chinese cooperation in chemical control and counternarcotics is good and has been steadily improving. This was highlighted by a joint operation involving the DEA and several PRC law enforcement agencies in October 2004, leading to the world's largest seizure of the synthetic drug Mandrax (18 metric tons), and the seizure of 10 tons of pseudoephedine tablets (a key precursor for methamphetamine) in Los Angles in September 2004. While China is a transit country for heroin produced in Southeast Asia to international markets, the DEA's Heroin Signature Program indicates less than 1 percent of heroin seized in the United States comes from Southeast Asia.

CHINA'S MILITARY INFLUENCE

We have noted, and are following closely, what appear to be expanding military-to-military contacts between China and countries in the region. You may recall that in previous testimony before Congress, General Bantz Craddock of the United States Southern Command noted that national-level defense officials from China made 20 visits to Latin America and the Caribbean, while Defense Ministers and Chiefs of Defense from nine regional countries have visited China. In addition, we are watching closely increased educational exchanges between China and several Latin American and Caribbean countries, and seek to ensure that they do not undermine the commitment of Latin American militaries to democracy and civilian control. As China considers arms sales to the region, we will apply our general policy of seeking transparency and accountability in these sales and are concerned about the risk of diversion of weapons to illegal armed groups, which threaten the peace and security of the hemisphere.

We do not have reliable figures for China's military assistance in the Western Hemisphere. However, we note that U.S. military assistance is preconditioned on adherence to basic principles of good governance and transparency, and we encourage China to adopt similar principles. In comparison, U.S. military assistance, incorporating article 98 restrictions, dwarfs China's security assistance to the region.

OVERALL RELATIONSHIP

There is much that is complementary with China in our approach to the region and much on which we look forward to cooperating with them. As the President said on May 31, our relationship with China is complex, but, at least in recent years, we have been able to communicate often—in remarkably candid and direct fashion, when necessary—and to address common challenges—regional and global, economic and political. Of course, we do have differences with China on a variety of important issues, including human rights, nonproliferation, Taiwan, and some aspects of trade and finance, among others. Let me say again that we intend for our relationship with China to be based both on a realistic appraisal of our common interests and equally important, a frank exploration of differences through dialogue.

China's growth and development have naturally brought growing relationships with traditional U.S. allies in the region. This does not diminish U.S. influence or capabilities. U.S. policy toward Latin America is anchored in our strong and endur-

ing alliances, which continue to provide unprecedented stability and prosperity in the region. Our allies throughout Latin America believe good United States-China relations are important to global peace, prosperity, and stability. Our efforts to work with China should enhance, not impair, our regional alliances.

SOME FINAL OBSERVATIONS

Let me conclude with a couple of observations.

First, our relationships with our neighbors in the Western Hemisphere are strong and stable, based on our shared values, economic ties, and defense relationships with the countries of the region. A strong, secure United States in a strong, secure, prosperous, and stable Western Hemisphere remains our goal, and a continuing reality.

Second, we must continue to work with China, and with our partners around the world, to ensure that China's development takes place within strong regional and global security, economic and political arrangements. This is the policy articulated by President Bush and Secretary Rice, and is a key objective of the United States—China Senior Dialogue led by Deputy Secretary Zoellick. I assure you that in pursuing this goal, our guiding principle remains to advance the interests and values of the United States.

Thank you for this opportunity to testify. We would be pleased to take your questions.

Senator COLEMAN. Thank you, Ambassador Shapiro, for that optimistic presentation.

Mr. Pardo-Maurer.

STATEMENT OF ROGELIO PARDO-MAURER, DEPUTY ASSISTANT SECRETARY, WESTERN HEMISPHERE AFFAIRS, DEPARTMENT OF DEFENSE, WASHINGTON, DC

Mr. PARDO-MAURER. Thank you, Mr. Chairman. I am delighted to see Senator Nelson here, whose State has such an important relationship with Latin America. In fact, Senator Nelson's appearance tempts me to take the risk of straying from my prepared remarks and perhaps beg a question from the Senator, based on a reflection.

The last year was a big year for the People's Republic of China, or the last year or so. They can rightly take pride in having placed second in gold medals at the Olympics. They placed troops in the Western Hemisphere, participating in the U.N. force in Haiti, and they put a man in space, or two men, I think it was. There is no question but that transforms the view of the world, not only of those people who are so fortunate as to have been able to look at our planet from that perspective, but of the entire nation.

So, no question their views of their world, and their place in it, are evolving, and it is only natural that our inquiry here should take that into account and see how we can influence those views. I take this hearing as an opportunity to do so, so I am delighted to see you here. Thank you, sir.

China was only, yesterday, a marginal presence in our neighborhood, but now it is a growing feature of this new geostrategic map. At the 2004 APEC summit in Chile, President Hu of China thrilled the region by raising expectations that China would invest $20 billion, at least, and by some media reports up to $100 billion, over the next decade.

This was widely heralded in Latin America as signaling the arrival of a new age, and certainly as perceived by the Latin Americans, President Hu's tour through the Americas was all the more remarkable for having attracted scant comment in the United States.

We can expect Beijing's influence in the Western Hemisphere to grow considerably over the next decade. China offers Latin America and the Caribbean what some may see as alternatives or counterweights to the democratically accountable free markets which are the cornerstone of the inter-American system as we know it today.

Our objective, as Ambassador Shapiro has pointed out, should be to ensure that China's rise as a commercial power in the Americas opens economic opportunity for all and raises the standard of living of all our peoples, while strengthening mutual trust and security and helping to consolidate the rule of law and democratic institutions in what Michael Novak, a scholar of the Americas, has called "this hemisphere of liberty."

To the extent that China's rising political, economic, and strategic competitiveness is not properly addressed or understood, it harbors the potential to sow discord between the United States and the People's Republic of China and the region.

China is still in the early stages of its quest for global influence. I might add there were few people who, even a few years ago, realized that China was pursuing a global strategy. The rules of the game are evolving. To be helpful, the rules should help us distinguish clearly the things that are threats from the things that are not threats. They should help sort out diplomatic and commercial pursuits from strategic pursuits. They should inject predictability into the system, create efficiencies and economies, and avoid misunderstandings.

Ultimately, good rules should help identify those areas in which we can and should cooperate with China and our regional partners. The evidence suggests that in this hemisphere China is not unresponsive to United States sensitivities, but only when those sensitivities are made evident. So this process is unfolding as we speak and it is not surprising, therefore, that our understanding of China's role in the Western Hemisphere is evolving. That is why this hearing is so important and why I commend you on the spirit in which it is held.

To start with the things that we do not know, there appears to be no consensus among the experts as to whether China's policy toward the Western Hemisphere is informed by an authoritative long-term strategy, by short-term tactics, or some pragmatic mixture of both. I would suggest that our understanding would benefit further if this inquiry were to explore the broader context of China's activities in the Americas, and if your colleagues were to pose the same questions being asked here, today, to our specialists for other important regions—Africa, the Middle East, Central Asia, South Asia, and East Asia.

With few exceptions, the United States is the security partner of choice for the nations of the Americas. We should not take this for granted. It was not accomplished overnight or by shirking from difficult, and at times, thankless tasks. The friendly defense relations between the United States and the nations of the Americans are the product of hard work by generations of civilian officials of the U.S. Government and by the men and women of our Armed Forces. Our goal should be to maintain these privileged and longstanding relationships.

The importance of the Latin American democratic revolution of the 1980s and 1990s to sustaining our friendly defense relations in the Americas cannot be overstated. The virtual disappearance in this hemisphere of interstate military rivalry, so recently the bane of the continent, is one of the most cherished accomplishments of the democratic revolution. By virtually any indicator, Latin America and the Caribbean, today, comprise the least militarized region of the world.

This means that the United States is able to approach Latin America and the Caribbean as a, "economy of force," theater. We want to keep it that way. The strength of our economic and cultural ties with our neighbors permit us to maintain a strategic posture that requires a relatively and indeed historically small investment of military forces and security assistance.

This positive situation should be seen as one of the core strategic assets of the United States. Should another actor attempt to become a serious competitor for military influence and cooperation in the region, an effective response by the United States could become much more costly.

Our relationship with each country is different and is conducted on unique terms. Nevertheless, throughout the region our friendship is reflected in the entire range of military cooperation, in operations, exercises, training, equipment, education, doctrines, even uniforms, and, for lack of a better term, elan.

We do not see China as directly competitive in this area. There is no evidence of Chinese interest in establishing a continuous military presence in the region, nor is there evidence that Chinese military activities in the Western Hemisphere, including arms sales, at this time pose a direct conventional threat to the United States or its friends and allies.

That is not to say, however, that there are no concerns, and in particular we need to be alert to rapidly advancing Chinese capabilities, particularly in the fields of intelligence, communications, and cyber warfare, and their possible application in the region. We continue to be concerned about China's capabilities or activities in these areas. As I noted in my recent testimony to the House International Relations Committee, we encourage other nations in the hemisphere to take a close look at how such activities could possibly be used against them or the United States.

I hope this testimony will stimulate a discussion and better understanding of China's changing role in the world and its long-term implications for the United States and that it will stimulate a discussion of how closely the national security of the United States remains linked to the security of the Western Hemisphere. Global, hemispheric, and homeland security are a continuum, not discrete spheres, and our security is ultimately tied to the advancement of economic opportunity and democracy in this hemisphere.

Indeed, these interconnections are what inform U.S. policy toward the hemisphere. We must recognize that China and the United States will compete for trade opportunities and that competition can itself benefit the nations of this hemisphere. But we must remain mindful that China also has its own set of political, economic, and military interests, requiring us to carefully distinguish between legitimate commercial initiatives and the possibility

of political or diplomatic efforts to weaken the democratic alliances we have forged.

So, above all, I hope this hearing will challenge any complacent belief that our enduring vision of the new world as a land of freedom and opportunity for all can somehow be conceived in isolation from our long-term strategic interests.

Thank you.

[The prepared statement of Mr. Pardo-Maurer follows:]

PREPARED STATEMENT OF ROGELIO PARDO-MAURER IV, DEPUTY ASSISTANT SECRETARY, WESTERN HEMISPHERE AFFAIRS, DEPARTMENT OF DEFENSE, WASHINGTON, DC

This month's visit by Chinese President Hu Jintao to Mexico underscores China's increasing interest and involvement in the Western Hemisphere and makes it appropriate and timely for this committee to inquire what these developments mean for a region of such importance to the United States.

China, only yesterday a marginal presence, is now a growing feature of the new geostrategic map of our neighborhood. At the 2004 APEC Summit in Chile, President Hu thrilled the region by raising expectations that China would invest $20 billion, and by some media reports, up to $100 billion over the next decade. This was widely heralded in Latin America as signaling the arrival of a new age. As perceived by the Latin Americans, President Hu's tour through the Americas was all the more remarkable for having attracted scant comment in the United States.

We can expect Beijing's influence in the Western Hemisphere to grow considerably over the next decade. China offers Latin America and the Caribbean what some may see as alternatives or counterweights to the democratically accountable, free markets which are the cornerstone of the Inter-American system as we know it today.

Our objective should be to ensure that China's rise as a commercial power in the Americas opens economic opportunities for all and raises the standard of living of all our peoples, while strengthening mutual trust and security, and helping to consolidate the rule of law and democratic institutions in what scholar Michael Novak has called "this Hemisphere of Liberty."

To the extent that China's rising political, economic, and strategic competitiveness is not properly addressed or understood, it harbors the potential to sow discord between the United States and the PRC and within the region.

China is still in the early stages of its quest for global influence. The "rules of the game" are evolving. To be helpful, the rules should help us distinguish clearly things that are threats, from things that are not threats. They should help sort out diplomatic and commercial pursuits from strategic pursuits, inject predictability into the system, create efficiencies and economies, and avoid misunderstandings. Ultimately, good rules should help identify those areas in which we can and should cooperate with China and our regional partners.

The evidence suggests that, in this hemisphere, China is not unresponsive to U.S. sensitivities—but only when those sensitivities are made evident.

This process is unfolding as we speak. It is not surprising, therefore, that our understanding of China's role in the Western Hemisphere is evolving. That is why this hearing is so important, and why I commend this committee on the spirit of inquiry in which it is held.

This inquiry would do well to concern itself with:

- The competitive potential of a nondemocratic, extra-hemispheric system, with vast and growing resource requirements;
- What these developments mean for the fragile internal equilibriums of democracies for whom the United States is at present the political, economic, and strategic "partner-of-choice";
- The potential for misunderstandings; and,
- Intelligence gaps and things we do not know.

To start with the things we do not know, there appears to be no consensus among the experts as to whether China's policy toward the Western Hemisphere is informed by an authoritative long-term strategy, by short-term tactics, or some pragmatic mixture of both.

This lack of consensus necessarily injects a tentative note in our discussions, and our vision of a way ahead. It simply may be that China's approach to the Western Hemisphere must be understood as a complex and evolving process.

The drivers of China's policy toward the Western Hemisphere specifically, appear to be, in no particular priority: (1) The isolation of Taiwan; (2) the cultivation of new sources of energy, raw materials, and foodstuffs; (3) the quest to open new export markets, and (4) the recruitment of allies to diminish U.S. influence and build a "multipolar" world order. Also noteworthy is the desire for new technologies, as exemplified by the ambitious Sino-Brazilian partnership for development of earth reconnaissance satellites and the exploration of space.

Our understanding would benefit further if this inquiry were to explore the broader context of China's activities in the Americas, and pose the same questions being asked here today, to our specialists for other important regions: Africa, the Middle East, Central Asia, South Asia, and East Asia.

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The importance of the Latin America's Democratic Revolution of the 1980s and 1990s to sustaining our friendly defense relations in the Americas cannot be overstated. The virtual disappearance in this hemisphere of interstate military rivalry—so recently the bane of the continent—is one of the most cherished accomplishments of this Democratic Revolution. By virtually any indicator, Latin America and the Caribbean today comprise the least militarized region of the world.

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This is not to say, however, that there are no concerns. In particular, we need to be alert to rapidly advancing Chinese capabilities, particularly in the fields of intelligence, communications, and cyberwarfare, and their possible application in the region. We continue to be concerned about China's capabilities or activities in these areas. As I noted in my recent testimony to the House International Relations Committee, we encourage other nations in the hemisphere to take a close look at how such activities could possibly be used against them or the United States.

I hope this testimony will help stimulate discussion and a better understanding of China's changing role in the world and its long-term implications for the United States.

I also hope this testimony will stimulate a discussion of how closely the national security of the United States is linked to the security of the Western Hemisphere. Global, hemispheric, and homeland security are a continuum, not discrete spheres, and our security is ultimately tied to the advancement of economic opportunity and democracy. Indeed, these interconnections are what inform U.S. policy toward the Western Hemisphere.

We must recognize that China and the United States will compete for trade opportunities and that competition can itself benefit the nations of this hemisphere. But we must remain mindful that China also has its own set of political, economic, and military interests, requiring us to carefully distinguish between legitimate commercial initiatives and the possibility of political or diplomatic efforts to weaken the democratic alliances we have forged.

Above all, I hope this hearing will challenge any complacent belief that our enduring vision of the New World, as a land of freedom and opportunity for all, can somehow be conceived in isolation from our strategic interests.

Senator COLEMAN. Thank you.

First, an observation. I have a very strong belief that as we look into the next decade and decades to come; as we see a Europe that is eliminating trade barriers and political divisions and trying to develop a unified economic strength; as we see the emergence of a growing China; a growing India; that ultimately our ability as the Western Hemisphere to work together to take advantage of the resource opportunities that we have, of the labor opportunities, our future lies in working together as a hemisphere. We must build upon what I get from both of you gentlemen, which is an optimistic assessment based on the longstanding ties between the United States and Latin America and Central America.

One of my concerns, though, is what Ambassador Shapiro talked about: China's growing economic strength with political influence. My question then is about that political influence. The nature of democracy in Central America and Latin America is still fragile; concerns obviously that many of us have about the direction that Venezuela has taken, the political instability in Peru, the rise of the cocaleros and what is happening in Bolivia with an election coming soon, in Nicaragua the Bolanos administration being squeezed by Ortega on the left and Aleman on the right.

With that concern about the fragility of what you have both reflected upon—the democratic revolution, Mr. Pardo-Maurer, that you talked about—for a country that does not have a deep and abiding commitment to democratic principles, can we talk a little bit about your perspective of Chinese foreign policy objectives when it comes to Latin America? Do we see any involvement in some of the political divisions that were being played out in some of the countries that I have talked about?

How would you describe China's goal or their vision when it comes to some of the challenges that democracy is facing in Central America and Latin America?

Ambassador SHAPIRO. Mr. Chairman, I am going to defer to my colleague here, who is an expert on China whom I brought along, Mr. Forden from East Asian and Pacific Affairs Bureau of Department of State.

Senator COLEMAN. Mr. Forden.

Mr. FORDEN. Thank you, Mr. Chairman.

Well, I am not an expert on the political dynamics of Latin American countries, so I would defer to Ambassador Shapiro on the effects of China's foreign policy or potential effects in the domestic political scene. But in terms of China's foreign policy on Latin America in general, we do not see any evidence that China has a concerted policy or interest in intervening in the domestic political dynamics in these countries that you mentioned.

I think primarily from our point of view what China is looking at is growing economic ties to these countries, opportunities to secure access to resources that they need to fuel their domestic economic development, opportunities to seek access and expanded access to markets for their exports of their goods, and a foreign policy in this hemisphere which is mostly designed to secure and maintain good relationships with those countries in Latin America, with the primary purpose of maintaining and securing their economic ties.

Ambassador SHAPIRO. If I may add to that, Mr. Chairman, these markets in Latin America are important to us and they are of increasing importance to China, both as a market for Chinese exports and as a place where they purchase the things that they need. To the extent that that trade is taking place in an open manner with a level playing field, to the extent that Latin American countries are wealthier from selling their exports to China, those countries are going to be more stable and they are going to, in turn, be better trade partners for the United States as well. There is no reason why China should not be involved in Latin America the way that other economic powers, we hope, will not only trade with Latin America, but Latin America will trade among itself.

Senator COLEMAN. Mr. Pardo-Maurer.

Mr. PARDO-MAURER. Mr. Chairman, I concur with the remarks of both of my colleagues and I would add the following. We do need to be alert to the possibility of a sort of Gresham's law working here, where the bad money drives out the good. As Ambassador Shapiro said, what is important is that there be a level playing field. The fact is that American, United States, commercial relations with Latin America are embedded within a much larger context than merely economic considerations. We have a human rights component to our diplomacy. We have cultural aspects to our diplomacy. There is all kinds of other things that go on within the context of our economic relations.

What is more, I would argue that our relationship, the relationship of United States businessmen with Latin American businessmen, is one that also takes place within a larger social context. So from that point of view there is something very real out there, which we call the Inter-American System, that is undergirded not only by binding institutions between governments, but by ethics and mores and a common vision of the world.

China is not part of that system at all. It is not a democracy, it is not a place where you can speak freely. It is a place, as my colleague indicated, whose interests in Latin America are economic. So from that point of view, we need to be sure that we are able to work with the Inter-American System so that China is competing on a level playing field.

What is the equivalent of the Corrupt Foreign Practices Act that should restrict businesses from not bribing businesses or governments in other countries for contracts and so forth? What is the equivalent of Rotary Club or Kiwanis or any of these many other organisms of civil societies that act as watchdogs and that shape the behavior of the business community?

These exist in Latin America and the degree of development of civil society in each country is different, and, therefore, a one-size-fits-all approach will not necessarily work. But I think by working together within the Inter-American System we can help bring China in as a constructive partner that builds up institutions and ultimately is a more constructive player on the world stage. So I think we need to keep that in mind.

Senator COLEMAN. Thank you.

Senator Nelson.

Senator BILL NELSON. Ambassador Shapiro, given that we import 13 percent of our daily consumption of oil from Venezuela,

what is going on between China and Venezuela and how is that going to affect us?

Ambassador SHAPIRO. Thank you for the question, Senator. I have to note that we talked about this in Caracas as we were jogging through the neighborhoods around my house.

Senator BILL NELSON. And that was 2 years ago.

Ambassador SHAPIRO. That was 2 years ago.

What Venezuela supplies China is primarily "orimulsion," which is a hybrid fuel developed in Venezuela, a mixture of bitumen and water, that is used in powerplants. I think at the peak our estimate was that they were selling 100,000 barrels a day of orimulsion. Right now it looks like it is at about 40,000 barrels a day of orimulsion.

The China National Petroleum Company has a joint venture with PDVSA, the Venezuelan oil company, to produce this orimulsion. PDVSA has opened an office in Beijing and China is active in Venezuela.

But the one thing I would like to note is that the Chinese Ambassador to Venezuela, in a press interview with the Venezuelan press, noted China's interest in furthering its energy relationship with Venezuela, but went on to note that China does not seek to replace the United States market, adding that North and South America are Venezuela's natural markets.

Senator BILL NELSON. When was that statement made?

Ambassador SHAPIRO. It was made earlier this year, Senator.

Our ports in the gulf are 4 days away from Venezuela. China's ports are, I think, 3 weeks away from Venezuela.

Senator BILL NELSON. How do you square that statement with the statements of the President of Venezuela threatening to cut off oil to the United States?

Ambassador SHAPIRO. Venezuela sells the United States somewhere around 1.4 million barrels a day of oil, primarily to its own subsidiary, Citgo. The United States does not buy oil from countries. We buy oil from companies. Companies import that oil. That is a market-driven decision that is in the interest of both the seller, like any market-driven decision, and in the interest of the buyer.

Our refineries on the gulf coast are designed to refine Venezuelan crude oil, which is very heavy and has a high sulphur content. At this point Chinese refineries cannot process that oil.

Senator BILL NELSON. How long would it take them to develop those refineries?

Ambassador SHAPIRO. They could do that. It would require an investment of billions of dollars and would take—I cannot give you an exact date because it would depend upon how much money they are willing to put into it, not just in refineries, but also in tanker capacity to transport that oil from Venezuela to China. It is 4 days sailing time to the United States and 20 days sailing time to China. Obviously, you need five times as many tankers to carry the same amount of fuel to China.

Senator BILL NELSON. So your conclusion and advice to this committee, then, is that despite the bombastic statements by Hugo Chavez, President of the Bolivarean Republic of Venezuela, it would be impractical for him to suddenly cut off his oil shipments

to the United States and look elsewhere on the world market, particularly to China?

Ambassador SHAPIRO. He could do it. The world markets would adjust. It would be very expensive for Venezuela. It would be very expensive for the United States.

Senator BILL NELSON. Mr. Chairman, thank you. I have got to go on to another hearing. We have Max Mayfield up there. We have got a hurricane ravaging across Key West as we speak.

I have asked my questions with a certain edge on my words, but I am one of the people who wanted to have a good relationship with the leader of Venezuela. The Ambassador and I have talked long and hard, and yet I have been very upfront and critical of the Chavez government. I am disappointed because I thought that our relationship with Venezuela would get better, but it got worse because of the rhetoric that came out of Venezuela.

Your comments have been most helpful in light of the rhetoric that we have heard.

Senator COLEMAN. I appreciate your concern, Senator Nelson. I had a chance to visit with President Chavez and he had made the comment to me that: I could cut oil off from Citgo just like that. My comment was: You could cut off your left arm, too; would you feel better? I think it would hurt. I think it would hurt.

Certainly what I am hearing today is about the realities of space, distance, market, production, a range of other things. That is something, at least for today, we are not going to lose a lot of sleep over. But again, these are things worth keeping an eye on. So I appreciate your concerns. Thank you, Senator.

Let me continue by talking about the military foreign affairs perspective, and then I am going to move on to some other issues. But I believe, Ambassador Shapiro, in your written testimony I recall a concern being raised about, "As China considers arms sales to the region, we will apply a general policy of seeking transparency and accountability in these sales, and are concerned about the risk of diversion of weapons to illegal armed groups which threaten the peace and security of the hemisphere."

Either to the Ambassador or to Mr. Pardo-Maurer: I would be interested if you can tell us what groups are we talking about and how serious is that concern?

Ambassador SHAPIRO. Senator, that is a general concern about all arms sales anywhere in the world. But my concern is this area of the world. At this point in time, I believe that China's sales to the Western Hemisphere are somewhere around 2 percent of total purchases by Latin American and Caribbean countries. So it is quite small.

That said, we are in touch with the Chinese. We are working with the Chinese. We want to ensure that those sales are transparent, that they go to the intended users and do not get diverted to illegal armed groups anywhere.

Senator COLEMAN. Mr. Pardo-Maurer, anything to add to that?

Mr. PARDO-MAURER. As Ambassador Shapiro said, that is a general concern. There are other countries that are selling weapons to specific countries in Latin America. I could cite Russia with Venezuela, that we have repeatedly, repeatedly, at the highest levels expressed our concerns to and our desire that they work within the

established procedures for transparency and confidence and security-building measures of the Inter-American System.

As a general principle, I would say the smaller the items sold the greater our concern. It is much harder to keep track of a single round than it is to keep track of an aircraft carrier. To the degree that China is pursuing military relationships with the region, we have to think in terms of where are we going to be 5, 10, and 15 years from now. That is the way they think. We are told that they have a 50-year plan. We do not know if that is true. We do not know if that is what it is.

But suppose they do have a 50-year plan? In that sort of scenario, everything we have been talking about—their energy relationships, their diplomatic relationships, even their cultural and demographic relationships—take and a different light.

Senator COLEMAN. I am going to spend a little more time with the second panel talking about article 98 agreements that we have and the impact that is having on our IMET training of military personnel in Latin America. When I was in Brazil, Uruguay, Chile just a couple weeks ago, those issues came up consistently. We are losing the ability to strengthen the military-to-military contacts because of some of the concerns about article 98 and the inability then to continue on with IMET training.

Do you see a void being created by that, and is anyone rushing to fill the void? In particular, is China looking to fill the void?

Ambassador SHAPIRO. We are supportive of concluding article 98 agreements in those countries where we do not have them. We think that it is important. We do not perceive a void. I want to avoid that word. We are continuing to work to the extent that we can.

The number of Latin American students who go to China to study each year is minimal. I saw an estimate that was under 50 total regionwide. I think 2,500 Latin American students, military students, were in the United States last year at various military schools. The same thing applies to our military assistance personnel in U.S. Embassies and to military sales. "Void" is not a word that I would use, sir.

Senator COLEMAN. Mr. Pardo-Maurer, do you want to add? Is "void" too harsh a word, too strong a word?

Mr. PARDO-MAURER. What I would say is that we have different types of relationships with different countries and in some countries we have very, very active, important relationships where we are working on solving serious problems that affect us both. Colombia and the United States would be a good example. We have an agreement with Colombia.

We aim to have good relations with all the countries in the region. The article 98 agreement is a way to ensure that our service members will not be subject to kangaroo courts and governments that change depending on the weather. This has happened before in Latin America.

So I think the concerns we are seeking to address by article 98 are very, very, very important concerns. When we lose our ability to provide material or perhaps even more importantly in the case of Latin America, where relationships are such an essential part of

our military engagement, then, yes, we have to counterbalance that. It was never an easy decision. It was never an easy decision.

Where we have probably seen the most difficult situation is with regard to IMET, the money that we use for training. There is no question but that this has made it much more difficult to bring qualified Latin American officers and enlisted men to the United States to train. That is an extremely important part of our relationship.

I would not say that I have seen other countries rushing to fill a void or whatever you want to call it, but it has led other countries to look elsewhere. There is no question that China is ramping up its cooperation. They have established what is the largest Latin American studies program in the world. That is new. Who knows what may happen 1 or 2 or 3 years from now with military relationships?

It is not just China. Venezuela and Cuba are offering alternatives for training, not in the military field, but Cuba just recently graduated 12,500 Latin American students in—they call them doctors; we would call them paramedics. But nonetheless, they are training professionals to deal with health issues that are not being addressed in the countries where these students came from.

So our ability to develop relationships has been hampered, there is no question.

Senator COLEMAN. I would say, first of all, I fully understand the concerns that are reflected in the article 98 agreements and the protection that we are looking to afford to American service men and women, which they rightly deserve. I do think, Ambassador, that we are creating a void when it comes to IMET, that those relationships are very, very important, and to the extent that we are losing—these are our friends—the ability to strengthen those relationships, then a void is created. It may be in a specific area and it certainly does not void, using that term, all other relationships. But I think something is lacking there.

But what I am hearing is that we are not seeing anybody rushing into that at this point in time. But clearly, other countries, and China in particular, are looking to strengthen those relationships. Relationships are important.

Ambassador SHAPIRO. They are important and they are the relationships that are made by young officers as they go through their career that are important. We want to have them, so that we know them, they know us, they know our culture, our military culture, and so that we can work with them.

That is why we are working so hard to conclude these ASPA agreements.

Senator COLEMAN. I mentioned it particularly in regard to China because it gets back to my earlier question, that we have a culture, a military culture, still built on foundations of democracy and foundations of rule of law, and that is not the Chinese experience, democracy. So we are losing the ability to train young military officers with a fundamental respect and appreciation for what democracy has to offer, and if that is then being filled in any way by countries that do not have that same tradition, we should be concerned. We are not talking about economics now. We are not talk-

ing about GDP. We are talking about fundamental respect for human rights. We are talking about fundamental respect for democracy, rule of law, and the impact that has on the military. You want officers who understand that. If somehow what we are offering is being replaced, it raises concern.

Mr. Pardo-Maurer.

Mr. PARDO-MAURER. Yes. I would just like to throw a poignant example into the discussion here. I was just in Peru with Secretary Rumsfeld, where we visited with President Toledo. President Toledo was from a very humble family, an indigenous family from the highlights of Peru, I believe one of 16 children, 7 of whom died in infancy. Someone, somewhere, saw this young man back in the sixties and said: He can play soccer. And he went on a soccer scholarship to the University of San Francisco and from then went on to get a Ph.D. in economics from Stanford on scholarships and eventually became President of his country.

I can tell you, we have a good friend in President Toledo. President Uribe of Colombia has said few if anyone have been as supportive of his efforts as President Toledo. So that is the kind of difference that a single scholarship can make.

Senator COLEMAN. I share that perspective. President Toledo said he is President by accident and where he grew up people did not get that, an education. He did and is President of his country. I am tempted to have my kids learn to play soccer better if that is the path.

Let me ask one other foreign relations question and then I want to just turn to economic matters. President Lula has spoken of developing a strategic partnership with China. Can anyone give me their sense of what does that mean? Has Brazil achieved this? What are the implications for the United States regarding that relationship? Mr. Forden. Ambassador.

Ambassador SHAPIRO. Well, when President Hu went to China they signed a number of agreements that promise great investment. It will be interesting to see how many of those are actually realized, how much money actually is invested.

Senator COLEMAN. When you said "President," you mean when President Hu went to——

Ambassador SHAPIRO. Brazil.

Senator COLEMAN. Brazil. You said to China.

Ambassador SHAPIRO. I am sorry. I apologize. I got it backward there.

Both are regional powers, both Brazil and China. It is normal that they would trade with each other and that they should seek to improve their relations with each other. We do not see that as a threat to the United States. We see it as a normal part of both of those countries as their economies are growing and as they have more power, economic power and political power beyond their borders, to deal with each other.

Let me go back to the point we have been making throughout, and that is that rules are important. What we want to see are rules of the game. We think it is important for China to have an interest in the rules. Because it has investments in Latin America, it will have an interest in stability in Latin America. We want to ensure that Chinese investors and Chinese exporters compete on a

level playing field with United States investors and United States exporters.

Senator COLEMAN. Mr. Pardo-Maurer.

Mr. PARDO-MAURER. We, at the Defense Department, have a very particular interest in what is happening in terms of the scientific and technical cooperation between Brazil and China. We, at the Defense Department, take the science capabilities of the Southern Cone countries very, very seriously. By many measures—and this is, if I may put in an advertisement, this is a good subject for further inquiry by the Western Hemisphere Subcommittee.

By many measures, the Southern Cone is one of the fastest growing regions of the world for quality scientific research and articles. That is according to the National Science Foundation. I can get this report to you.

We recognize this. In 2002 we established an Office of Naval Research office in Santiago. We established a counterpart from the Army in Buenos Aeres and we have made a lot of progress toward establishing an Africa office for Brazil.

They are doing tremendous research and we are benefiting from that. Dr. Sega, a former astronaut colleague of Senator Nelson who is the Director of Defense Research Engineering, came to Brazil with Secretary Rumsfeld to further our cooperation in this area. When we see Brazil developing very, very fruitful relationships in aerospace, in satellite technology, even launching satellites with China, what we see is a country that we want to be working with, too. Everything we can do to strengthen that scientific relationship is important.

What is important is that countries like China and Brazil and everyone else see that this can be mutually beneficial. This is not a zero sum world at all when it comes to that kind of research. We can cooperate, and our aim in establishing these offices in the Southern Cone is to promote just that kind of interchange and cooperation.

Senator COLEMAN. Though we talk about interchange and cooperation, we have sent a very strong message to the Europeans, a very strong message of concern about selling military technology, scientific capability that can be converted to military use, to the Chinese. Have we communicated that same message to Brazil or countries in the Southern Cone that have access to technology that would be of concern were it to be sold to the Chinese?

Ambassador SHAPIRO. It is not a policy vis-a-vis Europe. It is a global policy of the United States, our concerns concerning certain exports to China.

Senator COLEMAN. So I take it then the answer is——

Ambassador SHAPIRO. Yes.

Senator COLEMAN [continuing]. That it is as applicable to the Southern Cone——

Ambassador SHAPIRO. It is a consistently applied policy, yes.

Senator COLEMAN. Let me just ask if I can, two other questions. First, regarding human trafficking. Ambassador, any concerns the State Department may have regarding Chinese human traffickers operating in Latin America and the Caribbean? How are we working to address this?

Ambassador SHAPIRO. Yes, it is a concern. We estimate that between 20 and 30,000 Chinese migrants enter the United States illegally each year. Now, they are not just going through Latin America. They are going through Asia, Europe, Canada, and Latin America to get to the United States.

We are working with the Chinese, we are working with the governments of Latin America, to try to stop that, interdict that traffic. We have stopped several ships recently in the Pacific. It is not just a Chinese phenomenon. Other Latin Americas are coming by ship up the west coast of Latin America to the United States. So we are working to stop that. The Coast Guard is working very hard on it and we are working with governments on that.

Our Trafficking in Persons Office at State Department has paid particular interest to the whole trade in people, which is a very lucrative and illicit trade.

Senator COLEMAN. How would you then describe the level of Chinese cooperation as we are working with them to stop this?

Ambassador SHAPIRO. I have to turn to my China expert.

Mr. FORDEN. Well, as Ambassador Shapiro mentioned, Mr. Chairman, this is an issue that has drawn a lot of attention from our Office of the Ambassador for Trafficking in Persons. Geared toward our annual review of the trafficking in persons problem around the world, our annual report, we have an ongoing dialog with China. We share our concerns with them. The Government of China has been cooperative, has officially agreed and cooperated with us that this is a problem that they would like to work with us to attack and to try and stop.

We have worked together with—our law enforcement people have worked with their law enforcement people on individual cases. But given the enormity of China's population and the push pressures from population pressures there and the pull of opportunities in the United States and other places outside of China, it is a problem that is not likely to go away very quickly, but one that we are working with China to resolve.

Senator COLEMAN. Thank you, Mr. Forden.

Mr. Pardo-Maurer, does the Pentagon have any concerns relative to China and the Panama Canal?

Mr. PARDO-MAURER. There is a common concern out there that somehow, because a company—this emerged a few years back because a company controlled by Chinese investors had gained control of the terminal facilities of the canal, that somehow this was going to be a threat, and it is not, that we can tell.

The redevelopment of the Panama Canal is going to be one of the biggest infrastructure projects in history. It is probably a $16, $20, $25 billion project. Panama has reached the final stages of the decision to go ahead with this, and they are going to be looking for investors. They are going to be looking for governments and companies and individuals who are going to be stakeholders in this project. It is something that we have looked at.

I think it is very much in the interest of the United States to ensure that this project goes ahead in ways that strengthen the countries that use it responsibly and that are members of the responsible global trading community. Now, China is one of the largest users of the canal and fast-growing. I think it is the third largest

user. So from what we can tell, it is in their interest to have a canal that works and is dependable and is reliable.

So to me the canal is actually a classic example of how bringing China in or helping China become a responsible trading partner, a responsible member of the world trading community, is in our interest. It makes the Panama Canal, which is truly—it is Panama's of course, but it is a global asset. It makes the canal something that they have an interest in cherishing and defending.

So there are two aspects to this. One is who controls the canal from here to the future, and that is Panama's prerogative. The canal belongs to Panama. The other is securing international cooperation so that the canal is safe.

We do know that al-Qaeda has sent people to scope out the canal and that it was on their list of targets. So to the degree that China can be a partner in protecting that asset, whether because of what it knows in its part of the world or other ways, that is an important thing.

I am not sure I answered your question by saying that, but the short answer is that the most common concerns that I have seen out there, that because a certain company that has Chinese investors, controls the terminal facilities of the canal, that, therefore, we need to be concerned, that I think is not a concern.

Senator COLEMAN. You have answered the question. The question stemmed from those kind of conversations and concerns that have been raised.

But I do appreciate, to the entire panel, your going beyond that, because, as I said after listening to the testimony before the questioning, I felt this was rather optimistic, which is nice. I am an optimist. This was a rather optimistic perspective on what is happening with China and Latin America—that, in fact, we in the United States have a history, have relationships, have strong economic ties with the hemisphere that far exceed other ties. Even though China certainly is looking to expand its place—the need for resources, opportunity for markets—the sense I am getting is that that does not have to be a threat, that we can work with China, and in the end if we can add to the economic opportunity, add to the economic security, and continue to work with China and this community of democratic nations, this is not a bad thing.

So this has been very, very helpful. I want to thank you gentlemen for your testimony, and this panel is excused.

Our second panel is composed of: Mr. Stephen Johnson, senior policy analyst for Latin America, the Catherine and Shelby Cohen Davis Institute for International Studies at the Heritage Foundation. Mr. Johnson is a former State Department officer who worked at the Bureaus of Inter-American Affairs and Public Affairs as a writer and researcher, as director of the Central America Working Group, and as chief of the editorial division in the Bureau of Public Affairs.

A former Air Force officer, he served as Assistant Air Force Attaché in Honduras. Later as a member of the Air Force Reserve, he was a Public Affairs Officer and Strategic Planner in the Office of Public Affairs for the Secretary of the Air Force, and was also a Public Affairs Officer for the United States Southern Command.

Dr. David Lampton is dean of faculty, George and Sadie Hyman Professor, and director of China Studies of the Johns Hopkins School of Advanced International Studies, as well as founder and director of China Studies at the Nixon Center. Before assuming these posts, he was president of the National Committee on United States-China Relations in New York City from 1988 through 1997.

Prior to 1988, Dr. Lampton was founder and director of the China Policy Program at the American Enterprise Institute and associate professor of political science at the Ohio State University. Dr. Lampton is the author of numerous books and articles on Chinese domestic and foreign affairs.

Dr. Gal Luft is codirector of the Institute for the Analysis of Global Security. He has published numerous studies and articles on security and energy issues in various newspapers and publications, appears frequently in the media, and consults to various think tanks and news organizations around the world.

We will begin with Mr. Johnson, then go to Dr. Lampton, and end with Dr. Luft. With that, gentlemen, thank you for being here today and I look forward to your testimony.

STATEMENT OF STEPHEN JOHNSON, PH.D., SENIOR POLICY ANALYST FOR LATIN AMERICA, THE HERITAGE FOUNDATION, WASHINGTON, DC

Mr. JOHNSON. Thank you, Chairman Coleman.

Members of the committee, it is an honor and a privilege to appear before you today to discuss the influence of the People's Republic of China in Latin America. I would commend you, as the previous panel did, for holding a hearing as China carves a role for itself in this hemisphere and undoubtedly will become a factor in affecting relations between the United States and its neighbors.

The United States has become the greatest power in the world based on its tradition of free choice. Choice goes hand in hand with competition to keep markets vibrant and government accountable. Human talent from all over the world has come here to prosper by these values.

Starting in the 1960s, there was ideological competition from abroad. The Soviet Union was able to intrude, supporting a dictatorship first in Cuba and later insurgencies in Central America. In the end, liberal reforms won out. Encouraged by the United States, reforms have generally helped Latin America states become more politically, economically, and commercially viable.

Once again, emissaries are coming from the other side of the world, this time to compete in commerce, diplomacy, and military-to-military relations. We are not sure that we like it. The People's Republic of China is a Communist State that is embracing market-based commercial concepts, but it is still a nonmarket economy where a disciplined totalitarian party through the central government retains full authority over nonstate investment and trade.

Latin America is rich in natural resources and developing markets, which China needs. There is no question it has its foot in the door and seeks access to advance its own interests, as any nation would.

We can shrink from this intrusion or we can attempt to contain it. But maybe it is best to look after our hemispheric interests and

mitigate China's presence by relying on an old friend: Competition. Specifically, we can do this by consolidating trade relationships with Latin America and dropping our own protectionist barriers, developing comprehensive relations as opposed to narrow interest diplomacy, such as counternarcotics, minimizing unproductive restrictions on assistance to our neighbors, and by pressing harder for democratic and economic reforms, prioritizing support for these purposes, and reenergizing our public diplomacy.

China is not only a nation, but also the world's oldest continuous civilization, with more than 3,500 years of written history. Relatively recently, it suffered hard times. Communism did little to help. But in 1978 Communist Party leader Deng Xioa-Peng introduced economic reforms that have steadily transformed the PRC into a socialist market economy. Twenty-five years into this experiment, we witness that China has one of the world's largest economies, the third biggest defense budget, the highest population of any nation at 1.3 billion persons. According to the World Bank, its gross domestic product of $1.6 trillion is growing about 9 percent per year, and at $230 billion in trade it is our second biggest partner in commerce, something that we should think about as we look at how we might want to contain its relations in Latin America.

Resources must feed that economy and China does not have sufficient oil, natural gas, aluminum, copper, iron to satisfy those needs. Furthermore, China needs trade partners to buy its electronics, apparel, toys, and footwear. Asian neighbors are competing for many of the same markets, as are Europe and the United States.

For China, Latin America has promising characteristics. It is relatively unindustrialized and has lots of raw materials. Moreover, signing purchase agreements with the, perhaps, corrupt officials who lead some of the governments—and I say some of the governments, not all of them—is much easier than dealing with a panoply of private corporations because it makes possible one-stop shopping.

China's main rival for global preeminence is the United States. It sees the United States preventing Taiwan's reunification with the mainland and thwarting Beijing's rise as a power. While it has become our second largest trade partner after Canada, China challenges our influence where it can. It may soon possess more attack submarines than we do.

Science, sports, and military exchanges characterized Sino-Latin American relations in the 1980s. Economic ties did not develop significantly until after 1990, President Yang Shangkun visited Latin America with an upbeat message: "A new international political and economic order," he called it. Soon after that, the pace picked up. In April 2001 Chinese President Jiang Zemin made a 12-day visit to cement trade ties and attack Washington's unipolar scheme. Last November, President Hu Jintao flew to Argentina, Brazil, Chile, and Cuba, where he signed 39 bilateral agreements and announced $100 billion in investments over the next 10 years.

Because China's demand for oil has been growing to satisfy industrial needs and demands for consumers, it has pursued agreements with such producers as Venezuela, Ecuador, Colombia, Argentina, Brazil, and even Mexico. Obviously, the best fit is Ven-

ezuela, whose authoritarian leader Hugo Chavez directly controls the state oil industry. President Chavez even invited the Chinese National Petroleum Corporation to help explore the rich Orinoco Belt and last year President Chavez advanced an agreement with Colombia to build a pipeline to the Pacific Port of Tribugá to enable China to access Venezuelan oil from the Pacific coast.

China also has a bid on concessions to Ecuador's major oil fields and also has interests in an Argentine firm that has concessions on fields in northern Argentina as well as Peru.

On the military front, China has expanded ties through exchanges. It reportedly has direct military-to-military relations with Venezuela, as well as Argentina, Chile, Peru, and Uruguay. The PRC began collaborating with Brazil on spy satellite technology in 1999, providing needed rocket launch expertise in exchange for digital optical technology. Access to Brazil's space tracking facilities could give it the ability to attack United States satellites.

But perhaps the most fruitful collaboration of all has been with dictator Fidel Castro in Cuba. In 1999 China was reportedly intercepting satellite signals from facilities in eastern Cuba. In 2000 it obtained access to a base outside of Havana to intercept U.S. telephony along the east coast. In 2001, Russia announced it would abandon its extensive electronic espionage center at Lourdes and the PRC now reportedly occupies it.

At first blush, expanding ties between Latin America and China may seem like a good fit. China makes deals on the spot without a lot of strings. Its transactions are based on simple exchanges, and China's markets are indeed expanding. However, such dealings pose problems. It shames American-style bottleneck diplomacy. Latins find that obtaining any kind of assistance from us requires compliance on a battery of restrictions from protecting the environment to signing promises not to send U.S. military personnel to the International Criminal Court. Some say, why bother?

Latin American leaders have noticed that China's exports are much cheaper than their own, and our own as well—leading to big trade deficits. Chinese goods are made by laborers who toil for about a third of the wages of Latin American counterparts and tolerate worse working conditions. For every dollar's worth of goods Mexico sells to China, we are told, the PRC reportedly makes $31 from exports to Mexico.

Now, some analysts believe that China is encouraging a commodities-based trade model that will supplant the progress that the region has made toward industrialization. While countries like Chile and Brazil have gotten beyond raw materials exports, powerful Presidents and comfortable oligarchies may be tempted to fall back on plantation economics. Income gaps between the rich and the poor may widen. Greater inequality and political instability could depress U.S. exports to the region and worsen migration problems.

In conclusion, the United States and China have competing interests in Latin America. The best way to address them is to rely on America's strength, which is competition. U.S. policymakers should make true competition paramount, and in doing so they should accelerate free trade agreements by dropping agricultural and steel subsidies that dissuade potential partners and cost taxpayers money. United States trade relations with Andean neigh-

bors and eventually the Southern Cone countries can open market access for both United States and Latin America enterprises and provide a solid outlet for nonstate industrial growth.

We should adopt more comprehensive relationships as opposed to single-issue diplomacy, such as counternarcotics, as we had initially with Colombia. Plan Colombia is working because the United States is helping its South American partner expand public safety zones, reactivate the economy, and strengthen public institutions.

Cut strings on assistance to the greatest extent possible. Certifications and restrictions are blunt instruments that do not necessarily cover every situation and even harm some U.S. security interests.

Press harder for reforms. U.S. support for democracy and economic reforms has actually declined over the past 15 years. United States public diplomacy, which is reactive toward Latin America, needs strengthening and needs to be more supportive of our development agenda.

Mr. Chairman, thank you for this opportunity to address the committee. I could easily go on. But this is a big subject. Thank you very much.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF STEPHEN C. JOHNSON, SENIOR POLICY ANALYST FOR LATIN AMERICA, THE KATHRYN AND SHELBY CULLOM DAVIS INSTITUTE FOR INTERNATIONAL STUDIES, THE HERITAGE FOUNDATION, WASHINGTON, DC

Chairman Coleman, members of the committee, it is an honor and a privilege to appear before you today to discuss the influence of the People's Republic of China in Latin America.

I commend you for holding a hearing on this topic as China carves a role for itself in this hemisphere and undoubtedly will become a factor affecting relations between the United States and its neighbors in the Americas.

I testify today as an individual and do not necessarily reflect the views of my employer, the Heritage Foundation.

STRANGERS IN THE NEIGHBORHOOD

The United States has become the greatest power in the world based on its tradition of free choice. Choice goes hand in hand with competition to keep markets vibrant and government accountable. Human talent from all over the world has come here to prosper by these values. Ironically, most of our neighbors in Latin America are just awakening to the benefits of competition, abandoning imposed rule for electoral choice and open markets.

The region is awakening to another kind of competition as well. When distances were great and communications poor, the United States was the dominant actor and could warn extra-hemispheric powers against meddling in the neighborhood. By the 1960s, the Soviet Union was able to intrude, supporting Fidel Castro's dictatorship in Cuba and, later, insurgencies in Central America.

Although some countries, like Colombia, have always been democratic and trade oriented, Soviet intervention triggered competition between right-wing authoritarianism, democracy, and Marxism. In the end, liberal reforms won out. Encouraged in by the United States, they have generally made Latin American states more independent politically, economically, and commercially.

Now, emissaries from the other side of the world are coming to our hemisphere to compete in commerce, diplomacy, and military relations. And we are not sure we like it. The People's Republic of China (PRC) is a Communist State that is embracing market concepts. But it is still a nonmarket economy where a disciplined totalitarian party, through the central government, retains full authority over nonstate investment, import, export, and financial decisions.

Latin America is rich in natural resources and developing markets—which China needs. There is no question it has its foot in the door and seeks access to advance its own interests. We can shrink from this intrusion or attempt to contain it—with disastrous consequences in each case. Perhaps the United States can best look after

its hemispheric interests and mitigate China's presence by relying once more on its competitive tradition. Specifically by:

- Consolidating trade relations with Latin America and dropping our own protectionist trade barriers;
- Developing comprehensive relationships as opposed to narrow-interest diplomacy such as counternarcotics;
- Minimizing unproductive restrictions on assistance to our neighbors; and by,
- Pressing harder for democratic and economic reforms, prioritizing support for these purposes and re-energizing public diplomacy.

CHINA'S AGENDA IN THE AMERICAS

China is the world's oldest continuous civilization with more than 3,500 years of written history. In the mid-1800s, the ruling Qing Dynasty began to crumble, inciting a period of decline and foreign intervention. At the end of World War II, China's Nationalist government had been weakened by a decade of war against Japan, and was wracked by corruption and incompetence. Then the Nationalists embarked on a civil war against Chinese Communist Party bases and were defeated.

By 1950, Communist leaders like Mao Zedong believed their authoritarianism would return China to glory, a belief that expired after 30 million starved to death in state-induced famines in the early 1960s, and another 10 million perished in fanatical ideological campaigns. In December 1978, after several "great leaps" backward, the Communist Party leader Deng Xiaoping introduced economic reforms that have steadily transformed the PRC into a remarkable hybrid—a "socialist market economy"—in essence a Communist State that uses market-based pricing principles.

Feed the Dragon. Twenty-five years into this experiment, China has the world's second largest economy, the third biggest defense budget according to some analysts, and the highest national population of any nation at 1.3 billion persons. According to the World Bank, its gross domestic product of $1.6 trillion is growing about 9 percent per year. Resources must feed that economy and China does not have sufficient oil, natural gas, aluminum, copper, iron, to satisfy energy or manufacturing needs. Furthermore, it needs trade partners to buy its electronics, apparel, toys, and footwear.

Asian neighbors are competing for many of the same markets, as are Europe and the United States. But Latin America has promising characteristics. It is relatively unindustrialized and has lots of raw materials. Moreover, authoritarian leaders and/or corrupt oligarchies control a number of governments. Signing purchase agreements with them is much easier than dealing with a panoply of private corporations and enables one-stop shopping.

Challenge the United States. China's main rival for global preeminence is the United States. It sees the United States preventing Taiwan's reunification with the mainland and thwarting Beijing's rise as a power. Once isolated, it now plays key roles in Asian geopolitics and aspires to do so elsewhere. Besides status as a nuclear nation, it is a member of the United Nations Security Council, the World Trade Organization, the Group of 77 developing nations, Asia Pacific Economic Cooperation group, and holds observer status in the Organization of American States.

And while it has become our second largest trade partner after Canada, it challenges our influence wherever it can. In fact, it may soon have more attack submarines than the United States, with the addition of four Russian Kilo-class subs and new diesel-electric vessels equipped with technology that will allow them to run more silently than some nuclear technology.

According to former U.S. Ambassador to Beijing James Lilly, ". . . the facts are that they run massive intelligence operations against us, they make open statements against us, their high-level documents, show that they are not friendly to us." Its military white papers promote power projection and describe the U.S. policies as "hegemonism and power politics."[1]

Isolate Taiwan. Separate since the 1949 civil war, free, prosperous Taiwan has been the "renegade province" that must be reunified with the PRC. Part of Beijing's plan to bring it back into the fold has been to isolate it diplomatically. In the 1950s, most of Latin America had relations with Taiwan. Then, the Cuba's Fidel Castro regime established ties with China in 1960. Then Chile led a major shift in favor of the PRC in 1970. Globally, just 25 countries accord Taiwan status—a quarter of them in Latin America: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua,

[1] Jane Bussey and Glenn Garvin, "China Exerting Regional Influence, Analysts Warn of Political, Strategic Challenges to U.S. in Latin America," the Miami Herald, April 15, 2001, p. 1–A.

Panama, and Paraguay. Taiwan pays dearly, providing development aid and disaster assistance to these states.

WESTERN WELCOME MAT

Science, sports, and military exchanges characterized relations in the 1980s. Economic relations did not develop significantly until after 1990. A year after China repressed dissidents in Tiananmen Square, President Yang Shangkun visited Latin America. His trip heralded the beginning of an increasing number of high-level missions to lay the foundation for "a new international political and economic order," as he described it.[2]

The pace picked up at the turn of the new century. In April 2001, Chinese President Jiang Zemin presided over a 12-day mission to cement economic and trade ties, as well as attack what he called Washington's "unipolar" scheme.[3] His itinerary included Argentina, Uruguay, Brazil, Cuba, and Venezuela. In November, Li Peng, the chairman of the Standing Committee of the People's National Congress followed up. Last November, President Hu Jintao flew to Argentina, Brazil, Chile, and Cuba where he signed 39 bilateral agreements and announced $100 billion in investments over the next 10 years. This May, Communist Party chairman, Jia Qinglin, visited Colombia, Mexico, Uruguay, and Cuba.

Building on simple commercial agreements, China has advanced to economic assistance, direct investment, a few joint ventures, and military ties. When Argentina's financial collapse rippled through South America's Southern Cone, China quickly seized the chance to increase its stake in Argentina and Brazil, even though U.S. investment declined by nearly half. Joint ventures include partnerships with Great Dragon Telecom in Cuba and in Casanare Department in Colombia. China is partnering with Brazil to improve its railways and establish a link to the Pacific to cut transportation costs on iron ore and soybeans. Chile's congested port at Antofagasta may get a facelift thanks to the PRC.

Because China's demand for oil has been growing to satisfy industrial needs and demands of consumers, it has pursued investments and agreements with such oil producers as Venezuela, Ecuador, Colombia, Argentina, Brazil, and even Mexico. The best fit is with Venezuela whose authoritarian leader Hugo Chavez directly controls the state oil industry. President Chavez has invited the Chinese National Petroleum Corporation (CNPC) to participate in exploring in the rich Orinoco belt. Meanwhile, the CNPC has invested $300 million in technology to use Venezuela's Orimulsion fuel in Chinese powerplants.

For now, Venezuela plans to increase exports to China by 300,000 barrels per day and recently signed an agreement with Colombia to build a pipeline to the Pacific coast of Port of Tribuga, since supertankers cannot transit the Panama Canal. A proposal with Panama would modify a pipeline there to facilitate Pacific shipping. On a visit to Beijing last year, President Chavez said shifting exports to China will help end dependency on sales to the United States.

In 2003, China bid on concessions to Ecuador's major oil fields. The same year, the CNPC acquired a stake in the Argentine oil and gas firm Pluspetrol that operates fields in northern Argentina and Peru. While Mexico's Constitution prohibits foreign investment in Pemex, a boost in petroleum exports is expected to address Mexico's trade gap with the PRC. And, although it has no current profile in Bolivia, China's market and presence could be ideologically acceptable to a future populist President, like Evo Morales, in lieu of Western private investment.

On the military front, China has expanded ties through exchanges. It reportedly has direct military-to-military relations with Venezuela, as well as Argentina, Chile, Peru, and Uruguay. The PRC began collaborating with Brazil on spy satellite technology in 1999, providing needed rocket-launch expertise in exchange for digital optical technology that will permit high resolution, real-time imaging. Moreover, access to Brazil's space tracking facilities could give China the ability to attack U.S. satellites with a variety of technologies under development.

Perhaps the most fruitful collaboration has been with dictator Fidel Castro in Cuba. In 1999, China was reportedly intercepting satellite signals from facilities in eastern Cuba. In 2000, it obtained access to a base outside of Havana to intercept U.S. telephony. In 2001, Russia announced it would abandon its extensive electronic espionage center at Lourdes. PRC personnel now reportedly occupy it. A February 2004 agreement cloaks such operations under the pretext of technical communications cooperation. In fact, Radio China International signals originate from Cuba.

[2] Beijing Liaowang Number 15, Xinhua News Agency, April 9, 2001, pp 3–4, cited in "Chinese Infrastructure Projects in Latin America," Intellibridge, July 19, 2004, p. 2.

[3] Jane Bussey and Glenn Garvin, op. cit.

But so, too, does interference with U.S. east coast radio communications and air traffic control according to Federal Communications Commission complaints.[4]

WILLING PARTNERS

At first blush, expanding relations with China may seem a good fit. Dealing with China, a major world power, elevates a small country into the big leagues of global actors. It provides respect for those living in the shadow of the prosperous U.S. colossus. The novelty of frequent high-level visits suggests that American leaders—who visit less often—have ignored the region.

Few Requirements. China makes deals on the spot without a lot of strings—its transactions are based on simple exchanges. Their leaders have broad authority to negotiate foreign deals with worrying about legislative oversight, rule of law, or altruistic objectives. And, there is no need build up Latin American trade capacity to deal with diverse businesses, because these Chinese leaders represent state monopolies—which meshes well with Latin American government ownership or management of telecommunications, mining, and energy industries.

Leverage Against Uncle Sam. China's markets are expanding—a temporary boon to resource-rich Latin America. Imports from the region have grown more than 600 percent in 5 years.[5] Compared with United States-Latin America trade figures for 2004 at $410 billion, China's $40 billion trade with the region might seem inconsequential. But Chinese trade and investment gives Latin politicians and business elites, who largely control commodities, a bargaining chip to boost prices when dealing with the United States.

CONCERNS FOR WASHINGTON

Even so, China's growing influence poses problems for both the United States and Latin America.

Bad for Bottleneck Diplomacy. China's flexibility cuts into U.S. leverage. Obtaining any kind of assistance from the United States requires compliance on a battery of restrictions from observing human rights, protecting the environment, signing agreements not to send U.S. military personnel to the International Criminal Court, not assisting current or former terrorists, or violating orders not to use U.S.-provided equipment for any other than its stated purpose. American commitments also depend on legislative approval and can be reversed, depending on the mood of the U.S. Congress.

Competition for Resources. China offers direct investment in infrastructure development to obtain commodities. The United States, on the other hand, has no direct-tie state industries and can only offer development aid, now in decreasing amounts. Millennium Challenge Account (MCA) money may be less of an incentive to democratize governments and liberalize markets with Chinese competition. There is a 1- to 2-year lead time from the time an MCA award is proposed to when it is dispersed, during which some volatile governments can back away from market-oriented performance requirements.

Growing Trade Deficits. Latin America leaders who sign trade and investment deals with the PRC have noticed that China's exports are more affordable than their own—contributing to trade deficits. After all, Chinese goods are made by laborers who work for a third of the wages of Latin American counterparts and who tolerate worse working conditions. Officials in Argentina, Brazil, and Mexico have signaled their unease about trade with such a hot competitor. This month, Mexican President Vicente Fox made it clear to visiting President Hu Jintao that dumping electronics and clothing was unacceptable. For every dollar's worth of goods Mexico sells to China, the PRC makes $31 from exports to Mexico.[6]

Disinterest in Economic Reform. Some analysts believe that China is encouraging a commodities-based trade model that will supplant the progress Latin America has made toward industrialization. While countries like Chile and Brazil have gotten beyond raw materials exports, powerful Presidents or ruling oligarchies may be tempted to fall back on plantation economics. Income gaps between the rich and poor may widen. Moreover, those economies might not be sufficiently diversified to withstand

[4] Cited by Albert Santoli, "China's Strategic Reach into Latin America," testimony before the U.S.-China Economic and Security Review Commission, 124 Dirksen Senate Office Building, Washington, DC, July 21, 2005 at www.uscc.gov/hearings/2005hearings/written_testimonies/05_07_21_22wrts/santoli_albert_wrts.htm (September 18, 2005).

[5] See U.S. International Trade Administration at www.ita.doc.gov/td/industty/otea/usfth/tabcon.html (September 18, 2005); and Kerry Dumbaugh and Mark P. Sullivan, "China's Growing Interest in Latin America," Congressional Research Service, April 20, 2005, p. 2.

[6] James C. McKinley, Jr., "Mexico Builds Trade Ties with China," The New York Times, September 13, 2005, p. 3.

downturns in commodity prices. Some 44 percent of Latin Americans already live below the poverty line. If these countries fail to adopt reforms, social inequality, and political instability could depress U.S. exports to the region, and worsen migration problems.

Eye on America. From electronic espionage facilities in Cuba to port facilities run by Hong Kong billionaire Li Ka-Shing's Hutchison-Whampoa conglomerate in Panama, China has an eye trained on the United States. U.S. intelligence agencies are aware of this, it is possible that Washington's penchant for focusing on one threat at a time could leave America vulnerable.

RECOMMENDATIONS

The United States and China have competing interests in Latin America. Washington would like to see its hemispheric neighbors develop into stable, democratic, prosperous trade partners that embrace the rule of law. Beijing sees the region as a source of raw materials, a market for manufactured goods, as well as platform for power projection. U.S. interests probably coincide more with Latin American needs. In contrast, China represents an opportunity to temper American dominance with broader alliances.

Unfortunately, Chinese aid and commodity imports may buy time for state industries, powerful Presidents, and influential oligarchs. Most of all, such commerce could delay needed reforms and industrialization that might lift half of the Latin America's people out of poverty. America's strength is competition. It should influence the rules of the game in that direction. As a good neighbor and acting in both its own, Latin America's interests, and even China's, the United States should:

- Accelerate free trade agreements—the hallmark of U.S. policies toward the region since the 1990s. As inducement, America should drop its agricultural and steel subsidies that dissuade potential partners and cost taxpayers money. U.S. trade relations with Andean neighbors and eventually Southern Cone countries will open market access for both U.S. and Latin American enterprises and provide an outlet for industrial growth.
- Adopt more comprehensive relationships as opposed to single-issue diplomacy such as counternarcotics. Plan Colombia is working because the United States is helping its South American partner to combat terrorism, expand public safety zones, strengthen institutions, reactivate the economy, and promote rural peace.
- Cut strings on assistance to the greatest extent possible. Certifications and restrictions are blunt instruments that do not cover every situation. Occasionally they backfire by withdrawing support for allies in areas of mutual interest—such as security. If the U.S. Congress considers them necessary, they should be tailored to do minimal damage to key interests.
- Press harder for reforms, use public diplomacy. Once Latin America had elected leaders and fledgling markets in the 1990s, U.S. support for democracy and economic reforms declined. Although it is each country's responsibility to solve its own problems, external pressure can encourage progress. U.S. public diplomacy, which is mostly reactive toward Latin America, should be strengthened and more supportive of U.S. development goals.

CONCLUSION

The Department of State tells us that total trade between China and the United States grew from $33 billion in 1992 to over $230 billion in 2004. U.S. companies have entered agreements establishing equity joint ventures, contractual joint ventures, and wholly foreign-owned enterprises in China. Cumulative U.S. investment in China is valued at $48 billion.

In a globalized world, the Monroe Doctrine has declining relevance. Democracies have relations with whom they wish and nation competitors like China cannot be blocked from visiting the hemisphere. However, the United States can be more proactive in consolidating relations with its neighbors and promoting a truly open, competitive marketplace.

Thank you, Mr. Chairman, for this opportunity to address the committee.

Senator COLEMAN. Thank you, Mr. Johnson. I do appreciate the very specific recommendations that you have set forth in both your written and your oral testimony.

Dr. Lampton.

STATEMENT OF DAVID M. LAMPTON, PH.D., DIRECTOR, CHINA STUDIES PROGRAM, PAUL H. NITZE SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS HOPKINS UNIVERSITY, WASHINGTON, DC

Dr. LAMPTON. Thank you, Mr. Chairman, for inviting me to be here today. I would ask that the full statement—I am going to be brief—be entered into the record.

Senator COLEMAN. Without objection.

Dr. LAMPTON. I first want to associate myself with the end remarks you made at the previous panel. I found myself entirely in agreement with that; it reflects my perspective.

I have three overriding messages in this testimony. To start, I do not believe it is accurate to conceive of the PRC as an 8-foot giant striding across Latin America; most of the testimony we have heard has been very moderate and certainly consistent with that. Indeed, if China overpromises, such as the $100 billion that we have heard about, when its economy is humming today, it runs the risk of disappointing Latin America when Chinese growth slows, as it will.

Moreover, China has substantial problems in projecting its power, certainly military power. There are conflicts of interest between China and Latin America that will reduce Beijing's ability to cooperate in the region. And Latin America's interests in the United States will remain enormous for the foreseeable future.

We must restore balance to our views of China, a balance that does not exaggerate Chinese power while respecting it.

Second, although Chinese activity in the region can complicate U.S. diplomatic life, for example with respect to Cuba and the Chavez regime that we have been talking about in Venezuela, overall Chinese economic activity in the region, carried out under relatively free trade conditions, will boost the economic wellbeing in Latin America, though some economic sectors in the region will be hurt.

In fact, I talked with some Mexican scholars early last week, and they were very alarmed at what is happening to Mexican manufacturing employment. So there are going to be resource-extracting countries that do rather well. There are going to be labor-intensive industrial sectors that are going to be hurt quite a bit. But nonetheless, a healthier, more diversified Latin America is in the interest of the United States.

Finally, though the focus of this hearing is Chinese activity in Latin America, Latin America is not the principal foreign policy priority of Beijing.

I have been asked briefly to address the issue of China's global strategy and the role Latin America plays in that strategy. The PRC's national strategy can be described succinctly: China seeks sustained, rapid economic growth to provide the long-term foundation for comprehensive national power.

China has less than the global per capita average of almost every single natural resource, including water, petroleum, other precious metals, not to mention arable land. Beijing, therefore, counts on its foreign policy to provide needed markets, natural resources, capital, and technological inputs, and to create an international envi-

ronment so that China does not have to spend excessively on defense.

Latin America fits into this strategy because of its resources and markets and is part of Beijing's economically driven foreign policy. Chinese actions are not principally to compete with the United States geopolitically.

Secondarily, China is in Latin America—and I have been surprised, nobody has mentioned the following—to reduce the degree to which states in the region recognize Taiwan. Currently 12 of the 24 nations that recognize Taipei globally are in Latin America and the Caribbean. Indeed, I understand Taiwan's President is on his way down to Latin America. I am sure he has multiple objectives, but one I am sure is to stem the loss of Latin American countries that recognize the Republic of China.

With respect to policy recommendations, I have three. To start, notwithstanding our many disagreements with the PRC in the trade, human rights, proliferation, Taiwan, and other areas, America has a symbiotic relationship with the PRC. We need each other. Beijing needs the jobs, the technology, the markets, and relatively secure external environment that the United States can provide. The United States needs cooperation on issues such as the global war on terror, as we have seen recently in North Korea, and a host of other national and transnational issues. Huge numbers of American families benefit from the low interest rates that Beijing helps make possible through its purchase of U.S. debt.

As we think about China's interaction with Latin America, our policy should be devised against this larger background of common as well as competitive interests.

Second, China's growing involvement in Latin America is not a crisis for United States foreign policy. To the degree that it is a subject of concern, the focus should be on positively increasing U.S. influence in the region rather than being overly sensitive. And I very much agree with Mr. Johnson: The whole area of public diplomacy, students, all of that, and just the obstacles that now exist to getting business people and students into the United States, that is where we really ought to focus and not worry so much about what Beijing is doing.

Finally, if Washington takes a broad future-oriented perspective, we may be surprised at some of the common interests we share. That list of shared or broadly compatible interests, in my view, includes the following: One, if China invests in oil and energy resources in Latin America when others are not prepared to do so, the PRC is contributing to a larger global pool of available energy. Latin American oil brought to the surface by Chinese companies or firms or interests probably is going to end up in the United States, as we just heard in the previous panel, the same way that Asian oil brought to the surface by American companies and interests probably is going to end up in China and Japan.

Second, the United States is China's most important market for exports and getting to the entire eastern half of the United States market depends considerably on the Panama Canal. As China builds resource and food relations with the big eastern seaboard nations of Brazil and Argentina, the canal and free passage through it assumes ever more importance to Beijing. The idea that

the PRC would somehow choose to impair passage through the canal strikes me as very unrealistic. That was the conclusion I drew from the earlier discussion on the first panel.

Finally, the 2005 annual report of the Pentagon on the military power of the People's Republic of China makes clear that China still possesses very limited long distance conventional power projection capacity. This is going to remain true for a very long time, though improvements are occurring. It was only in July 2002 that a Chinese naval vessel first circumnavigated the world. There is no Sino-American military competition in Latin America now and there will not be for the foreseeable future. In short, a zero sum view in this globalized world is no longer appropriate and Chinese-United States-Latin American interaction is a good example of that new reality.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Lampton follows:]

PREPARED STATEMENT OF DAVID M. LAMPTON, DEAN OF FACULTY, HYMAN PROFESSOR, AND DIRECTOR OF CHINA STUDIES PROGRAM, SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS HOPKINS UNIVERSITY, AND DIRECTOR, CHINESE STUDIES PROGRAM, THE NIXON CENTER, WASHINGTON, DC

Mr. Chairman and subcommittee members, thank you for inviting me to share my views on the People's Republic of China's (PRC) growing activity in Latin America with you.

I have three overriding messages in this testimony: To start, I do not believe it is accurate to conceive of the PRC as an 8-foot giant striding across Latin America compromising vital American interests. China has, and will continue to have, substantial problems projecting its power (certainly military power), there are conflicts of interest that diminish Beijing's ability to cooperate in the region, and Latin America's interests in the United States will remain enormous for the foreseeable future. We must restore balance to our views of China, a balance that does not exaggerate Chinese power while respecting it. Washington's relations with our southern neighbors should be a major U.S. foreign policy concern; currently, a defensive worry about China's regional activities do not rise to the level of a major foreign policy concern, particularly given other challenges.

Second, although Chinese activity in the region can complicate U.S. diplomatic life, for example with respect to Cuba and the Chavez government in Venezuela, overall Chinese economic activity in the region carried out under relatively free trade conditions will boost economic well-being in Latin America, though some economic sectors in the region will be hurt. A healthier, more diversified Latin America is in the interests of the United States. As a matter of principle, if the Chinese wish to invest in the Western Hemisphere, as the rest of the world is investing in the PRC, this should be welcome.

And finally, though the focus of this hearing is Chinese activity in Latin America, Latin America is not the principal foreign policy concern of Beijing. Rather, building ties within the PRC's own region and with nations along its periphery is Beijing's central focus, along with keeping healthy ties with the United States. Moreover, China is trying to improve relations with the EU, Russia, Central Asia, Africa, and India. Beijing's still limited capacities for influence are going to be spread pretty thin.

The topic of this hearing leads me to address three sets of issues below:

I. CHINA'S NATIONAL STRATEGY, FOREIGN POLICY, AND ACTIVITIES IN LATIN AMERICA

China's National Strategy and Broad Foreign Policy: In our pluralized, checks and balances system, it is hard to imagine that a complex society can have a fairly coherent national strategy; one that embraces both internal development and foreign policy. I believe that the PRC does have a broad national strategy, that this strategy has implications for internal development and foreign policy, and that Beijing is (with remarkable consistency and skill) implementing this strategy at home and abroad, though there are problems—sometimes big problems. Beijing's policy in Latin America is one reflection of all this. Nonetheless, the clarity of the strategy and the overall skill with which it is being implemented invites the United States to be correspondingly coherent and nimble.

The PRC's national strategy can be described succinctly and was devised by Deng Xiaoping in the late 1970s and early 1980s and evolved thereafter: (1) China's future lies in global integration; (2) to be globally integrated, the PRC must be economically competitive; (3) to become economically competitive requires rapid, sustained economic growth, which in turn requires two things—internal stability and an absence of large-scale external threat for a long time; (4) with respect to the domestic requirements for high-speed economic growth, one needs high savings, high domestic and foreign investment, and a workforce that has material incentives and higher levels of education; (5) in terms of the foreign policy requirements, China needs an absence of external military threat (relatively low defense expenditures for a sustained period), markets and access abroad, capital and technology inputs from abroad, and resources to fuel economic expansion—China has less than the global per capita average of almost every single major natural resource, including water, petroleum, and other precious minerals, not to mention arable land.

Every day that China's leaders get up in the morning, the first thing on their minds is how to meet the internal challenges the country faces in maintaining both high-speed growth and tolerable social stability. They look at foreign policy from the perspective of providing the conditions and resources that will make the management of their domestic challenges possible. Foreign policy is a means to essentially domestic ends. America's genuine problems with Chinese foreign policy stem not principally from a Chinese desire to diminish U.S. power, though Beijing would like to see an international system more balanced in power terms. Rather, U.S. problems with Chinese foreign policy often stem from Beijing's domestically driven policies that often ignore the broader consequences of China's actions, or nonactions. What do I mean? China needs oil, so it develops relations with Sudan, not caring much about the murderous situation in Darfur. China wants stability on its borders, so it is reticent to push Pyongyang very hard on its nuclear weapons program(s). Beijing needs internal cohesion, so sometimes its leaders use anti-Japanese nationalism to forge unity at home as, incidentally, do some in Japan. Increasingly China and America, in the words of Deputy Secretary of State Robert Zoellick, need to act as common "stakeholders" in an increasingly fragile and interdependent international system. China is not out principally to weaken the United States, it is out to meet the needs of its people. Beijing needs to pay more attention to the international consequences of that effort.

Beijing's Interests and Activities in Latin America: Latin America is a moderately and increasingly important market for inexpensive PRC manufactured goods—it provides employment in China. Latin America is an important source of agricultural produce such as soya and corn that China needs at affordable prices. Latin America is an important source of minerals such as iron for the world's biggest consumer of steel and a major source of copper—China accounted for 100 percent of global demand growth in copper during 1995–2003. Some Latin American countries have energy reserves (e.g., Venezuela, Brazil, Bolivia, Peru, and Colombia) and China has accounted for about 50 percent of the growth in global oil demand in the last 3 years; in 1995–2003 the PRC accounted for 68 percent of global oil demand growth. China's emerging middle class (perhaps 250 million or more persons if one has a modest threshold for middle-class status) is eating more meat, buying more houses, and purchasing more automobiles.

Looking at the Panama Canal, that waterway has facilitated the explosive growth in United States-China trade as well as rapid trade expansion between China and Latin America itself. In FY 2004, the Panama Canal Authority reported that China was the number two origin of cargo going through the canal and the number three destination of cargo going through the canal. Overall, China was the number two user of the canal as measured by the total origin and destination of cargo tonnage going through it. It is worth noting, however, that the United States, in the number one position, has more than three times the tonnage moving through the canal in terms of origin and destination.

There is another interest for the PRC that is important—Taiwan. Taipei has formal diplomatic relations with only 26 countries around the world, mostly in the South Pacific, Latin America, the Caribbean, and Africa. Fourteen of the thirty-three nations in Latin America and the Caribbean recognize the Republic of China (Taipei), and Taiwan's own Yearbook describes the region as a diplomatic "stronghold."

Beijing is employing its economic power to provide inducements to remaining governments to move into the PRC's diplomatic column, as does Taipei which frankly acknowledges that it too "stimulate[s] investment by Taiwanese entrepreneurs in countries with diplomatic ties with Taiwan" [ROC Yearbook]. One will note that when Chinese President Hu Jintao visited Latin America in November 2004 and in

September 2005, there were both signings of investment, trade, and cooperative agreements and reaffirmation of each country's support for the "one China policy."

Perhaps the most notable thing about PRC activity in Latin America is the frequency of visits by senior Chinese leaders—they are paying a lot more senior-level attention to the region than is the United States. China's Premier Wen Jiabao was in Mexico in late 2003, China's President Hu Jintao was in the region in 2004 and 2005, and China's Vice President Zeng Qinghong was there in January 2005, not to mention innumerable other visits by lower ranking Chinese officials and trade groups. For their part, Latin American Presidents and senior officials have been trekking to China in great numbers; the Brazilians under President Lula are particularly active. The resulting cooperation has been extensive, measured in the tens of billions of U.S. dollars in promised trade and investment in resource and infrastructure projects and signed deals for agricultural imports. In his 2004 speech to the Brazilian Congress, President Hu said China would invest up to $100 billion regionally in the decade to follow. With Argentina and Brazil, China is cooperating in high-tech areas such as space and satellite projects. Nonetheless, we need to keep this in perspective—in 2003, trade with China accounted for only 3.8 percent of Latin America's total trade; the United States accounted for 48 percent.

II. THE POINTS OF FRICTION IN CHINA'S RELATIONS WITH LATIN AMERICA

There are several areas where Chinese interests and those of individual countries in the region are not identical (sometimes incompatible); this causes frictions. China's capacity for cooperation in Latin America is finite and so while Washington appreciates Beijing's assets it also ought to recognize PRC liabilities. Some examples:

- In 2004 China was contracted to take delivery of large volumes of soya beans from Brazil, but the global price dropped by around $50 per ton between the contract and delivery dates. Given the volume of beans in transit and their perishable nature, the Chinese erected some health barriers and refused to take timely delivery until renegotiations produced a more satisfactory price. The larger point is that China, as a big importer of food, has an interest in low prices, which is contrary to exporters' interests. This same dynamic will apply to relations with Latin American resource exporters who will want high prices for the commodities that China will want to buy as cheaply as possible. In short, importers and exporters have natural conflicts.
- In a related vein, President Hu Jintao was just in Mexico and the interaction between Mexican President Fox and the Chinese President made it clear that a major point of contention is Mexico's very large trade deficit with the PRC—Mexico imported $93 worth of goods from the PRC for every $3 it exported to China. So countries with a trade surplus with Beijing (like Brazil in 2003) will have a different view than nations that run perennial deficits with the PRC.
- During trips to the region by senior Chinese leaders, rhetoric about large future PRC investments is employed, but China remains a poor country in per capita terms and in many cases actual investment in Latin American economies may fall well short of expectations. If this occurs, China's failed promises will not be preferred over the failed promises of others.
- Last week I met with a group of scholars from Mexico who study China. I asked what was on their mind with respect to the PRC and they responded: "Lots of our manufacturing [has been] lost to China—clothing, toys; it has cost [Mexico] a lot of industry." "Many enterprises are angry [at China]." "Medium and small enterprises are not competitive [in Mexico]; labor costs [here in Mexico are too high]." "Mexico opposed China's entry into WTO very strongly [till the end], but the Mexican Government can do nothing because of low Chinese wages." Different sectors and nations in Latin America will differentially benefit from economic ties with China. Resource extractors and high value-added suppliers will gain—many labor-intensive manufacturers will lose. What economists call "readjustment" is called "unemployment" and "insecurity" by ordinary people. The economic dislocation caused by globalization will create a great deal of friction between the PRC and many in Latin America.
- And finally, a Chinese official who is an observer at the Organization of American States, Cai Runguo, pointed to the cultural barriers that separate China and Latin America: "Chinese entrepreneurs have very little knowledge of [South America], and when they have begun to invest or explore the possibilities of investment they have encountered difficulties."

In short, Beijing will make progress in its relations with Latin America, but it will not be frictionless.

III. U.S. INTERESTS AND A POLICY PERSPECTIVE

To start, policy recommendations should take account of the overall character of the United States-China relationship and the overall interests Washington and Beijing have in ties with each other. Notwithstanding our many disagreements with the PRC in the trade, human rights, proliferation, Taiwan, and other areas, America has a symbiotic relationship with the PRC—we need each other. Beijing needs the jobs, technology, markets, and the relatively secure external environment that the United States can provide. The United States needs cooperation on issues like the Global War on Terror and on the North Korean nuclear problem, and huge numbers of American families benefit from the low interest rates that Beijing helps provide through its purchase of U.S. debt instruments. More broadly, there now are three locomotives to the world economy—the United States, Europe, and China. Stalled growth or widespread disorder in the PRC spilling out into the international system would be harmful to everyone. The challenge is to manage all aspects of our relationship with Beijing in a way that maximizes the benefits and minimizes the costs. As we think about China's interaction with Latin America our policy should be devised against this larger backdrop.

Second, China's growing involvement in Latin America is not a crisis for U.S. foreign policy. To the degree that it is a subject of concern the focus generally should be on increasing U.S. influence and positive sway in the region rather than trying to offset what Beijing is perceived to be doing.

And finally, if Washington takes a broad, future-oriented perspective on PRC involvement in the region we may be surprised at some of the common interests we share. That list of shared or broadly compatible interests includes the following:

- If China invests in oil and energy resources in Latin America when others are not prepared to do so, the PRC is contributing to a larger global pool of available energy. Latin American oil brought to the surface by Chinese interests probably will end up in the United States the same way that Asian oil brought to the surface by American interests probably will end up in Japan or China.
- With respect to possible U.N. Security Council reform (expansion), while current members of the P–5 may each have their own favorites (among India, Argentina, Germany, Brazil, South Africa, and Japan) for some form of permanent membership on the Security Council, the United States and China actually agree that reform of that body should be premised on making it more effective. Truth be told, neither Beijing nor Washington wants its veto in the Security Council diluted by additional veto-wielding members, nor its efficiency diminished by too many more members.
- The United States is China's most important export market (including re-exports from Hong Kong, SAR) and getting to the entire eastern half of the U.S. market depends considerably on the Panama Canal. As China builds resource and food relations with the big eastern seaboard nations of Brazil and Argentina, the Canal and free passage through it, assumes ever more importance to Beijing. The idea that the PRC would somehow choose to impair passage through the Canal strikes me as very unrealistic.
- While China's (and Latin America's) interests in reduced tariffs and subsidies for agricultural exports are not identical to Washington's, Washington's preference for low-developed country barriers to most developing countries' agricultural exports is close to that of China and stands in stark contrast to the protectionist policies of Europe and Japan that contribute to poverty among the poorer agricultural nations.
- The 2005 annual Pentagon report to Congress on "The Military Power of the People's Republic of China" makes clear that China still possesses very limited long-distance conventional power projection capacity and this will remain true for a considerable period of time, though improvements are occurring. It was only in July 2002 that a Chinese naval ship first circumnavigated the globe. There is no Sino-American military competition for influence in Latin America now, nor will there be for the foreseeable future.
- And finally, the United States has an interest in an economically advancing Latin America. As long as the trade flows are dictated by free negotiations between buyers and sellers, there will be mutual benefit and this generally should foster development and welfare to America's south. This, in turn, creates wealthier citizens in Latin America who will have more money to buy what the United States has to sell.

In short, a zero-sum view in a globalized world is no longer appropriate and the Chinese-United States-Latin American interaction is a good example of this reality. The broad policy implications are twofold. Washington and the U.S. private sector

should get more involved in Latin America and U.S. observers and policymakers generally should be relatively relaxed about Chinese activity there.

Senator COLEMAN. Thank you very much, Dr. Lampton.

Dr. Luft.

STATEMENT OF DR. GAL LUFT, PH.D., CODIRECTOR, INSTITUTE FOR THE ANALYSIS OF GLOBAL SECURITY, WASHINGTON, DC

Dr. LUFT. Thank you, Mr. Chairman.

Since we are facing a major challenge with regards to energy, I will limit my remarks to the field of energy security and how China's activities in Latin America affect America's energy security. There is no doubt that China's robust economic growth has already been felt on the global energy scene and contributed substantially to this year's hike in oil prices. But no less important is the impact of China's energy activities on its relations with the United States and the international community at large.

Energy is today perhaps the main driver of China's recent international behavior. Many of China's foreign policies in the Middle East, East China Sea, Central Asia, and Africa are shaped by its energy expediencies, often at the detriment of the United States. China's recent effort to drive the United States out of Central Asia and in support of terrorist-sponsor regimes like Iran and Sudan just because it needs their oil are the latest testimonies of this trend.

With global reserves of cheaply recoverable oil and gas being depleted, China is already competing with the United States over the same oil reserves in some of the world's most unstable areas.

When it comes to Latin America, China's demand for oil has resulted in a series of deals with a number of countries, primarily Peru, Cuba, Ecuador, Bolivia, Argentina, Brazil, Mexico, and Venezuela, which is America's fourth largest oil supplier.

Though this hearing focuses on Latin America, I want to mention here that there is also a lot of activity going on in Canada, our top petroleum supplier.

I will not go into the full roster of activities. It is all in the written testimony. But the main point I want to make here is that the single most important thing to remember about China's energy acquisitions in the Western Hemisphere is that they will eventually make the United States more dependent on the Middle East and other volatile areas, and I would like to explain why.

The Western Hemisphere is estimated to hold 13.5 percent of the world's proven conventional oil reserves. This amounts to about 160 billion barrels of oil, of which 101 billion barrels are concentrated in Central and South America, particularly in Venezuela, Brazil, Colombia, Ecuador, Argentina, and Peru. These countries accounted for 8 percent of total world output in 2004. Of the region's largest producers, only Brazil and Ecuador still experience production growth. Conventional oil production in the rest, namely Peru, Colombia, Argentina, and Venezuela, has been declining. The same goes for Mexico.

According to a study by PFC Energy, non-OPEC Latin America—that is excluding Venezuela, of course—will peak around 2007 and decline steeply thereafter. Considering the projection that in the

next 20 years the region's own need for oil will nearly double, it seems that Latin America's long-term ability to satisfy the needs of the growing United States market will be increasingly compromised.

China's pursuit of Latin American oil will only make matters worse. With half of its oil imports coming from the Western Hemisphere and with oil imports in the United States projected to surge 60 percent during the next two decades, the United States cannot afford to lose chunks of Western hemispheric crude. Every barrel of oil China buys in the Americas means one less barrel of Western hemispheric oil available to the United States market. This means that China will have to—the United States will have to look for this oil elsewhere, and that will be particularly in the Middle East, which is contrary to President Bush's pledge to make the United States less dependent on, "places that don't particularly like us." So when it comes to oil, Mr. Chairman, this is a zero-sum game.

I must add that I am talking about conventional crude. There are a lot of reserves of nonconventional crude. I can address that, too, and that is part of the reason that China is very interested in Venezuela, which holds a vast endowment of extra-heavy crude.

As consumer of a quarter of the world's oil supply, and holder of merely 3 percent of global reserves, the United States cannot afford to ignore the implications of 1.3 billion people who are gradually relinquishing their bicycles in exchange for passenger cars. In addition, with its current consumption habits the United States lacks the moral authority to preach to the Chinese about the need to address their oil problems, nor can it ask them to deny their people the high standard of living that Americans have been enjoying for decades.

The United States should look inward and begin to seriously address its growing addiction to oil and, more broadly, assign a large role for energy policy in its global strategy. This can only be done through multinational cooperation on energy and a joint commitment by the United States, China, and other consuming countries to work toward reducing oil dependence through efficiency and development of alternative energy sources.

China's interests in Latin America are not restricted to petroleum, but also to the continent's alternative fuel market. In response to its growing need for fuel, China has decided to dive into the alcohol market. Its main focus is sugar-based ethanol coming from Brazil and the Caribbean. China is now in the process of developing a fleet of flexible-fuel vehicles that can run on any combination of gasoline and alcohols and is showing strong interest in emerging sugar markets in Central and Latin America. I must add that Latin America is for sugar what the Middle East is for oil.

Should oil prices continue to stay high, the United States will have no other option but to do the same. Ramping up ethanol supply requires incentives for domestic producers, as you have done as part of the energy bill, Mr. Chairman. But more importantly, it entails opening the biofuels market to imports from our neighbors in the Western Hemisphere. Today such imports are prevented due to protectionist policies enacted by Congress which impose a stiff tariff on ethanol imports. Oddly, Mr. Chairman, we are willing to import petroleum from Saudi Arabia, but not ethanol from Brazil.

Blocking ethanol imports to the United States not only undermines U.S. energy security, but also has geopolitical consequences that this committee should be aware of. While the United States could encourage sugargrowers in Latin America and Central America to increase their output and become fuel suppliers, creating economic interdependence with its neighbors, it is China that is doing exactly that.

This is likely to make our neighbors in the Western Hemisphere increasingly dependent on China with regards to the agricultural sector, hence strengthening China's foothold in America's backyard. Needless to say that such development would undermine U.S. energy security in the Western Hemisphere.

So I urge this committee to take a serious look at how we can shift our energy imports from regions that are increasingly hostile to the United States to those that have the strongest likelihood of being our true allies.

Thank you.

[The prepared statement of Dr. Luft follows:]

PREPARE STATEMENT OF DR. GAL LUFT, EXECUTIVE DIRECTOR, INSTITUTE FOR THE ANALYSIS OF GLOBAL SECURITY (IAGS), WASHINGTON, DC

Mr. Chairman, members of the committee, I would like to thank you for inviting me to brief you on China's foreign, economic, and security policies, which stem from its growing energy consumption and their effects on U.S. interests in Latin America.

Since it became a net oil importer in 1993, China has traversed the globe in a relentless quest for energy sources to fuel its booming economy. In recent years its state-owned energy companies concluded oil and gas deals in close to 30 countries, many of them in Latin and Central America. There is no doubt that China's robust economic growth has already been felt on the global energy scene and contributed substantially to this year's spike in oil prices that brought oil prices to reach the $70 a barrel mark. But no less important is the impact of China's energy activities on its relations with the United States and the international community at large.

Energy is the main driver of China's recent international behavior. In a lecture at Beijing University in March 2004, its Deputy Foreign Minister, Wang Yi, admitted that Chinese foreign policies are "at the service of China's economic development." And indeed, many of China's foreign policies in the Middle East, the East China Sea, Central Asia, and Africa are shaped by its energy expediencies, often to the detriment of the United States. China's recent effort to drive the United States out of Central Asia and its support of unsavory regimes like Iran, Sudan, and Uzbekistan just because it needs their oil, are the latest testimonies of this trend.

China's pursuit of energy resources comes at a time that the world is finally waking up to the idea that oil and natural gas are finite commodities and that world demand currently and for the foreseeable future will exceed world supplies. This reality is becoming increasingly accepted by the major oil companies. Earlier this year David O'Reilly, chairman and CEO of Chevron Corporation, admitted in an open letter that "the era of easy oil is over. Many of the world's oil and gas fields are maturing," he wrote, "and new energy discoveries are mainly occurring in places where resources are difficult to extract—physically, technically, economically, and politically. When growing demand meets tighter supplies, the result is more competition for the same resources." And indeed, with global reserves of cheaply recoverable oil and gas being depleted China is already competing with the United States over the same oil reserves in some of the world's most unstable areas.

Former Secretary of State, Henry Kissinger, warned recently that the global battle for control of energy resources could become the modern equivalent of the colonial disputes of the 19th century.

CHINA'S ACTIVITIES IN THE WESTERN HEMISPHERE

Of all the regions of the world where China competes with the United States over access to oil, the Westem Hemisphere is perhaps the one where the direct impact on U.S. energy security is likely to be felt most in the long run. At the moment most of China's oil imports come from the Middle East. In 2004 the Western Hemisphere supplied only 2 percent of the 2.9 million barrels per day China imported. But just

like the United States, China seeks to diversify its supply sources and reduce its dependence on the Middle East. Latin America is, therefore, one of the most sought after domains. China's oil thirst has already resulted in a series of deals stretching from the southern tip of South America to the Caribbean, areas which constitute America's backyard.

- In January 2005, China and Peru signed a memorandum of understanding allowing China to promote investments and technical cooperation in the exploration and export of oil and gas.
- In the same month China Petroleum & Chemical Corporation, or Sinopec signed a production contract with Cuba.
- While U.S. energy companies have grown increasingly disenchanted with the corruption and volatile politics of Ecuador and its energy company Petroecuador, the Chinese seem to be undeterred from investing in drilling and exploration work there. This month EnCana, Canadian Natural Gas Company, agreed to sell oil and pipeline holdings in Ecuador to a Chinese venture for $1.42 billion to fund debt reduction and stock buybacks.
- In Bolivia, Shengli International Petroleum Development has opened an office in the gas-rich eastern region and announced plans to invest up to $1.5 billion.
- Argentina and China signed cooperation deals that could lead to up to $5 billion in investments over the next decade in oil and gas exploration.
- In Brazil, the Chinese President signed 11 bilateral agreements, including planned investment of $10 billion in energy and transportation in the next 2 years. Brazil's state-owned Petrobras and China National Offshore Oil have been studying the viability of joint operations in refining, pipelines and exploration in their two countries and in other parts of the world. This comes after a $1 billion Brazilian agreement with another Chinese company, Sinopec, to build a gas pipeline that will run across Brazil.
- Last, but not least, is Venezuela, United States' fourth largest oil supplier. Since April 2002, U.S. relations with Venezuela have become increasingly acrimonious. Venezuela's President Hugo Chavez warned the United States against any interference with Venezuela's internal affairs threatening that Venezuela "has enough allies on this continent to start a 100-year war," and that "U.S. citizens could forget about ever getting Venezuelan oil." This threat is not being ignored. Secretary of State Condoleezza Rice remarked in her confirmation hearing that two of her chief worries with regards to Venezuela are U.S. dependence on Venezuelan oil and whether Chavez will continue to supply it. The fissure in the relations enables China to step in and reduce Venezuela's dependence on selling oil to the United States, which currently buys 60 percent of Venezuela's crude. A series of oil agreements signed in early 2005 allow Chinese companies to explore for oil and gas and set up refineries in Venezuela. Venezuela's state-run oil company PDVSA opened a marketing office in Beijing and has a target of selling to China 300,000 barrels per day by 2012. But for now Venezuela's oil exports to China are much more limited. The majority of Venezuela's exports to China as of now consist of Orimulsion, a boiler fuel alternative which is burned by powerplants to generate electricity. China's refineries are not equipped to refine Venezuela's crude. Geography is also a constraint. Venezuela has no access to the Pacific shore and the Panama Canal cannot accommodate the biggest tankers. A tanker trip from Venezuela to China takes 45 days. But China and Venezuela are trying to resolve these problems. In July 2004 Venezuela signed a contract with Colombia to build a crude oil pipeline connecting its oil fields with a port on Colombia's Pacific coast sparing Chinese tankers the need to traverse the Panama Canal. This could reduce the travel time by half.

Though this hearing focuses on Latin America it is important to note that China has also set its sights on North American oil. In January 2005 the Wall Street Journal reported that trade officials in Mexico said they see China as a potential growth market for their oil exports.

Chinese state-owned oil companies pursue ambitious deals in Canada, the top petroleum supplier to the United States. Canada has emerged as the second largest oil reserve in the world due to the drop in price in the recovery of crude from the vast reserve of Alberta's tar sands. Chinese companies are negotiating the acquisition of Canadian tar sands companies and have already bought stakes in a few of them. The Chinese PetroChina International signed an agreement with Canada's giant pipeline company, Enbridge, to build a $2.5 billion pipeline from Alberta to the Pacific coast from where 200,000 barrels of crude a day will be shipped to China. The two countries signed the Canada-China Statement on Energy Cooperation in the 21st century, promising to work closely in the areas of oil, gas, oil sands,

energy efficiency, environment, and related ventures. Analysis conducted by Institute for the Analysis of Global Security shows that if China succeeds in acquiring portions of Canada's energy industry up to a third of Canada's potential exports to the United States could eventually be lost to China.

IMPLICATIONS OF CHINA'S PURSUIT OF WESTERN HEMISPHERIC OIL

The single most important thing to remember about China's energy acquisitions in the Western Hemisphere is that they will eventually make the United States more dependent on the Middle East and other volatile areas.

The Western Hemisphere is estimated to hold 13.5 percent of the world's proven conventional oil reserves. This amounts to 162 billion barrels of which 101 billion barrels are concentrated in Central and Latin America particularly in Venezuela, Brazil, Colombia, Ecuador, Argentina, and Peru. These countries accounted for 8 percent of total world output in 2004. Of the region's largest producers only Brazil and Ecuador still experience production growth. Conventional oil production in the rest—Peru, Colombia, Argentina, and Venezuela—has been declining. According to a study by the Washington-based energy consulting firm PFC Energy, non-OPEC Latin America will peak around 2007 at 4 million barrels per day and will decline steeply thereafter. Considering the projection that in the next 20 years the region's own need for oil will nearly double, it seems that Latin America's long-term ability to satisfy the needs of the growing U.S. market will be increasingly compromised. China's pursuit of Latin American oil will only make matters worse.

With half of its oil imports coming from the Western Hemisphere, and with oil imports projected to surge 60 percent during the next two decades due to demand growth and a decline in domestic crude production, the United States cannot afford to lose chunks of Western Hemispheric crude.

Venezuela stated recently that its aim is to supply 20 percent of China's oil imports. What does this mean? According to the Energy Information Administration China's oil demand in 2025 will stand on 15mbd with net imports of nearly 11mbd. For Venezuela to provide 20 percent of China's imports means loss to the U.S. market of 2.2mbd. In essence, every barrel of oil China buys in the Americas means one less barrel of Western hemispheric oil available for the U.S. market. This means that the United States will have to look for this oil elsewhere and become more reliant on oil from more remote and less stable regions, primarily West Africa, the Caspian and, above all, the tumultuous Middle East. This is contrary to President Bush's pledge to make the United States less dependent on "countries that don't particularly like us." There is also a cost issue. Western hemispheric oil is more attractive to the U.S. market because shipping costs are low relative to the Middle East and other places. The less we have of it, the more we will have to pay as a nation for our oil.

If the Western Hemisphere has any future in oil production it is in the field of nonconventional sources of petroleum such as extra heavy oil, tar sands, and oil shale. By 2010 only 4 percent of the world's oil will come from nonconventional sources, but clearly the next several decades will show an increasing role of these energy sources. About 1.2 trillion barrels of extra heavy oil are in place in Venezuela. At current technology and prices only 2–3 percent of this endowment is economically recoverable but it is likely that 100–270 billion barrels will eventually be economically recoverable. In Canada, there are close to 180 billion barrels which can be derived from Alberta's tar sands. Of this endowment, about 20 percent are economically recoverable at current market conditions. But shifting to nonconventional oil requires enormous investment and a long lead time. Furthermore, the energy required for the extraction of such nonconventional sources of crude is so huge as to offset the amount of energy the extracted oil ultimately yields. Also the cost of production is high and there are severe environmental problems. Even if production of nonconventional oil increased in proportion to the world's growing demand, China and India will seek to buy ever-increasing shares of this oil, hence limiting its availability to the U.S. market.

IMPLICATIONS FOR THE SPREAD OF DEMOCRACY AND THE RULE OF LAW

Latin America may not become a focus of China's diplomacy. But as long as it can offer China's booming economy raw materials and energy sources, China's foothold in the region will continue to grow and could reach a stage in which it infringes on the longstanding principle in U.S. foreign policy of nonintervention in the Western Hemisphere by foreign powers. Furthermore, control of energy assets by a Communist government could expose U.S. neighbors to Chinese pressure to part ways from the United States on issues regarding China, like human rights abuses, arms sales, and mainland's relations with Taiwan. Chinese penetration into Latin and

Central America could also strengthen the voices of Marxism and anti-Americanism in a part of the world critical to U.S. national security. But perhaps the biggest problem associated with China entry into Latin America is impact on America's effort to promote democracy and good governance in this part of the world. In countries like Sudan, Iran, Myanmar, and Uzbekistan, China's energy deals have already undermined U.S. efforts to promote freedom and democracy and force improvement in these countries' human rights. Unlike the United States, China typically does not address democracy, human rights, and nonproliferation issues in its relations with other countries. Its state-controlled oil companies are in a position to offer large packages of development aid which help secure them access to oil and gas assets in many cash-starved developing countries. China's penetration into Latin America could create similar problems, strengthening the region's nondemocratic regimes. Chinese energy companies have another competitive advantage when dealing with the Third World, where under-the-table payments can ease the way to a deal: They do not have to contend with transparency initiatives nor comply with a Foreign Corrupt Practices Act.

OPTIONS FOR THE UNITED STATES

To spare China the need to seek Western hemispheric oil, the United States should encourage China to source its energy from countries that are geographically closer to it and that are not under the U.S. sphere of influence. Russia and Kazakhstan are two oil rich countries which share a border with China. Russia is today the world's second largest oil producer and supplier of 9 percent of China's oil imports. Earlier this month Russia's President, Vladimir Putin, announced that the long bidding war between China and Japan on the construction of a pipeline to carry oil from eastern Siberia, had been decided in favor of China. The pipeline, scheduled to be completed in 2008, will run from Taishet to Daqing near the Russia-China border. Kazakhstan supplies only 1.1 percent of China's oil imports but is capable of doing much more. The two countries are soon to be connected by an 1,800-mile pipeline. China has acquired oil assets in Kazakhstan and will continue to invest heavily in the country over the next two decades. Such energy deals will create interdependence between China and its neighbors while reducing China's need to seek for energy resources in the Western Hemisphere.

Additionally, the United States should offer to help the Chinese to boost their domestic energy supplies, support energy market reforms, encourage regional energy cooperation, integrate China into the International Energy Agency and make it a key participant in the international dialogue on global energy policy. It should also invite China to participate in joint research and development aimed at displacing imported petroleum with energy sources that both China and the United States have available domestically, via utilization of clean coal technology, waste-to-liquid-fuels, and advanced nuclear power stations. Such cooperation will not only help prevent future conflict but it will also foster Sino-American collaboration with significant economic benefits for both countries.

While there is an urgent need for a comprehensive energy strategy to deal with China's energy needs such a strategy cannot be based on seeking ways to block China's access to oil throughout the world including the Western Hemisphere. As a consumer of a quarter of the world's oil supply and holder of merely 3 percent of global reserves, the United States cannot afford to sit on its hands and hope that the world's energy problem resolves itself. In addition, with one of the worst fuel efficiency standards in the industrialized world the United States lacks the moral authority to preach to the Chinese about the need to address their oil problem. Nor can it ask them to deny their people the high standard of living that Americans have been enjoying for decades. The United States should look inward and begin to seriously address its growing addiction to oil and more broadly assign a larger role for energy policy in its global strategy.

This can only be done through multinational cooperation on energy and a joint commitment by the United States, China, and the other consuming countries to work toward reducing global oil dependence through efficiency and development of alternative energy sources.

Both the United States and China are not rich in oil but they are both well endowed with a wealth of other energy sources that can be used to displace petroleum in the transportation sector, which accounts for two-thirds of U.S. oil consumption and the bulk of the growth in oil consumption in the developing world. Both China and the United States are rich in coal; both have large cities that generate huge amounts of garbage and both have massive agricultural sectors that generate billions of tons of biomass. Technology can convert all of these resources into transportation fuel. Next generation hybrid electric vehicles that can be optionally plugged

in, can utilize electricity from the grid as a transportation fuel. Just as in the United States, less than 3 percent of grid electricity in China is generated from oil, so using electricity as a transportation fuel would dramatically displace petroleum consumption with coal, natural gas, nuclear power, and renewables.

Were the United States and China to collaborate on advancing such technologies and improving efficiency they could gradually curb their demand for oil and hence reduce the likelihood of conflict.

SEEKING LATIN AMERICA'S SUGAR ALCOHOL

The Chinese understand what we unfortunately haven't. The answer to the energy predicament is manifestly not increased reliance on the Saudis and other members of the Organization of Petroleum Exporting Countries. Rather, it is to diversify of sources of transportation fuels. China's interests in Latin America are, therefore, not restricted to petroleum but also to the region's alternative fuel market. In response to its growing need for fuel China has decided to dive into the alcohol market and its main focus is sugar-based ethanol coming from Brazil and the Caribbean. Brazil is the world's leading ethanol producer and exporter, distilling nearly 4 billion gallons in 2004. The country exported half a billion gallons last year but has indicated its ability to ramp up ethanol production to meet the market's need. China is already the world's third largest ethanol producer and is now in the process of developing a fleet of flexible-fuel vehicles that can run on any combination of gasoline and alcohols.

El Salvador, Guatemala, Paraguay, Honduras, Colombia, Peru, Nicaragua, and Costa Rica have all increased the cultivation of sugarcane for ethanol production. China has shown strong interest in these markets. The Brazilian energy company Petrobras has already started negotiations with the Chinese Government to promote trade in fuel alcohol.

Should oil prices continue to soar, the United States will have no other option but to create a fuel choice economy, as Brazil did, in which automobiles can run on fuels other than petroleum; ethanol would probably be among the most readily available of all alternative fuels. Ramping up ethanol supply requires incentives for domestic producers but more importantly it entails opening the biofuels market to imports from our neighbors in the Western Hemisphere. Today such imports are prevented due to a protectionist policy enacted by Congress which imposes stiff tariffs on ethanol imports. Oddly, we are willing to import petroleum from Saudi Arabia but not ethanol from Brazil. Blocking ethanol imports to the United States to protect corn growers not only undermines U.S. energy security but also has geopolitical consequences. While the United States could encourage sugar growers in Latin and Central America to increase their output and become fuel suppliers, creating economic interdependence with its neighbors, it is China that is doing just that.

This is likely to make our neighbors in the Western Hemisphere increasingly dependent on China hence strengthening China's foothold in America's backyard.

As anti-Americanism spreads across the world it is critical that the United States maintain its strategic posture and popular support in the Western Hemisphere. This can only be done through increased effort to promote democracy, economic reforms, and good governance and, not less importantly, by enriching our neighbors and promoting economic interconnectedness with them. Energy is one of the areas in which such mutually beneficial relations can be easily established.

Senator COLEMAN. Thank you. Thank you, Dr. Luft.

I am going to just touch a little bit on the renewables. Representing the largest sugargrowing region in the country, I just want to raise that issue. Then I want to get into a range of others.

When I was in Brazil recently, 60 percent of the new cars in Brazil are now flex-fuel engines, which means they can run on pure ethanol or pure petroleum. I think there are sensors in the gas lines that allow them to measure the oxygen content, which then changes the compression ratio in the engine, so you can run either way. As I understand it, Brazil is not going to be importing any foreign oil at the end of 2006.

Here in the United States, we have doubled the production of ethanol in this country in the last energy bill, as you made reference to, from 3.87 billion gallons to 7.5. But that is still just a

drop in the bucket. We have not yet gotten sugar into the energy business, and I think the future is there.

Brazil is using its ethanol domestically. I have not done an in-depth study of Brazil, but is Brazil in a situation to export ethanol to China and also then to be competitive in the United States?

Dr. LUFT. First of all, let me say that there is no reason, Mr. Chairman, why every new car sold in the United States should not be a flexible-fuel car. This is a very, very cheap feature. It costs about $150 a car. There are 4 million cars like this already on the road, including Ford Taurus, Mercedes C320's, Chevrolet Silverado, Dodge Caravan. People do not even know that they have flexible-fuel cars.

Since it is a very cheap feature and it is very easily produced by auto manufacturers, we ought to have a situation that all our new cars are capable of running on alternative fuels. That includes ethanol and also methanol, that can be made also from agricultural products through gasification. This is exactly what the Brazilians are doing and their fleet will be almost—all their fleet will be running on, or capable of running on, ethanol in the next several years.

Today they already run on 25 percent ethanol in the blend, which is great and that really puts them in a situation that they are very, very well insulated against shocks. Significantly, only 20 percent of Brazil's arable land is cultivated. They have said that they can—are in a position to produce—and I quote their Minister of Agriculture—"rivers of ethanol."

The Chinese have set their sights on this. They are already building the largest ethanol plants in the world and they are building, as I mentioned before, a large fleet of flexible-fuel cars. And if we will not preempt them in being in this market, they will be there and most of the ethanol will be diverted to Asia.

By the way, Japan is doing the same thing. So I think we are missing the boat here and that is very unfortunate because every gallon of ethanol can replace a gallon of fuel that we are importing from the Middle East.

Senator COLEMAN. But one of the things that Brazil did is they began this transformation 30 years ago. They developed an infrastructure for the delivery of ethanol. I represent a State in which I go to my neighborhood gas station. I have a standard lease 2005 Ford Explorer that is a flex-fuel engine. They did not advertise that. I just looked through the book and there it was. I can buy E–85 at the neighborhood gas station at the corner of Grand Avenue and Milton in St. Paul, MN. But that is pretty unusual.

Does China have the infrastructure for the delivery of ethanol into its auto market?

Dr. LUFT. Well, they are building now. As we are talking, there are a number of representatives now from the Republic of China here addressing this. They are building refueling stations that are capable of handling alcohol fuels. They have developed a large fleet of buses that run on methanol, that can be made, by the way, also from coal as well as biomass.

So they are investing in domestic production as well as exploring opportunities to import alcohols into their country, because we need to remember that China itself is the Saudi Arabia of biomass.

They have a tremendous endowment of agricultural waste that can be converted into fuel.

Senator COLEMAN. Let me shift—Dr. Lampton.

Dr. LAMPTON. I just wanted to say, this suggests an area for cooperation with China that would seem to be in our mutual interest. That is energy cooperation, alternative fuels. I have looked at what has been said about ethanol and China's interest in that to be a very positive thing. If we are competing over oil, the more diversified energy sources we can get the better.

I also should point out that China has just raised its fuel efficiency standards for its cars quite substantially. Now, car ownership and economic growth are growing so fast that it is still generating a huge demand for crude and refined product, but China is moving in that way. This is another area of cooperation, if we want. Rather than fighting over a finite pie, we ought to all be trying to make this pie bigger.

Senator COLEMAN. Dr. Lampton, to shift gears a little bit, you indicated in your testimony you did not see any Sino-American military competition in Latin America. Does everyone else on the panel agree with that? Mr. Johnson.

Mr. JOHNSON. I am not sure that I do not see any competition. I think that there is some, that there is an effort to establish some ties with Latin American countries, and it is what any rising power would want to do around the world, because military-to-military relations are a component of normal diplomatic ties. They also imply some arms sales and the possibility for sales of heavy equipment, such as transport aircraft and jet fighters.

Now, whether or not China is particularly competitive in that way is another question altogether. Up until Europe's Airbus consortium came on the scene, the United States was the preeminent nation on Earth in terms of developing and marketing military and commercial aircraft, and, in many ways, it still is. I think China is behind the times, but there may be some areas in which Chinese arms may be appealing to countries that do not have particularly big budgets.

Senator COLEMAN. Dr. Lampton.

Dr. LAMPTON. Just to add a little, I do not particularly disagree with what was just said. What I meant is that China is trying to use, particularly in Southeast Asia, South Asia, and in Latin America, its military less as a military instrument than a diplomatic instrument. I think it is trying to use it to reassure. Not only is China increasing its military exchanges with Latin American countries, it has just had joint exchanges with Britain and France. So I think this is more to be looked at almost as diplomacy.

That gets to the repetitive question that you raised about IMET. I think that is where we ought to be competing.

Senator COLEMAN. That was my next question to you, actually. I wanted to get back to the IMET question. Again, I fully understand the intent of the American Service Members Protection Act. My concern is that it has had a disproportionate effect on Latin America. Anyone on the panel want to respond as to why they believe Congress should exempt Latin American countries from IMET sanctions? Is the negative impact of losing relations exceeding whatever the benefits have been?

Dr. Lampton.

Dr. LAMPTON. I am certainly not an expert on that, but it seems that we have 30-some countries in Latin America and the Caribbean and there might be something other than just a blanket policy. I am prepared to believe there are some governments we would want to do that with—IMET relations—and others we might not wish to. But my general predisposition is in the general direction of doing so.

Senator COLEMAN. Mr. Johnson.

Mr. JOHNSON. Mr. Chairman, I would just like to relate a conversation that I had with, I believe, the chief national security advisor for Costa Rica's Police and Public Security Forces, who told me that because Costa Rica is not a signatory of the article 98 letter that it could not receive any IMET training, nor could it receive any particularly specialized equipment from the United States that would help scan containers coming into their ports.

A lot of arms, drugs, and even people are being found in these containers, some of the ones that are being opened. And ironically enough, a lot of the people coming out of them are Chinese. So this is one of the areas in which it would be in our best interest to wield a scalpel instead of a bludgeon.

Senator COLEMAN. Let me turn to Venezuela, about which my colleague, Senator Nelson, raised some concerns, and I will address a question to everybody on the panel. First, if I can, a technical question to you, Dr. Luft. You talked about Venezuela having a heavy crude. It is my understanding, though, that the technical capacity to turn that heavy crude into lighter crude is now a lot better than it ever was. Can you explain the implications of your comments about heavy crude? Is that a limitation on Venezuelans actually strengthening their relationship with China?

Dr. LUFT. In the Western Hemisphere there are two large reservoirs of heavy crude. One is in Canada in Alberta in the form of tar sands. The other one is in Venezuela in the form of extra-heavy crude. There is also quite a large endowment of oil shale in the United States.

Now, all of these nonconventional sources of crude will amount, by the end of the decade, to about 4 percent of the world's oil output. So this is not a lot, and most of it will actually come from Canada, the reason being that these are very, very expensive and energy-intensive processes.

If we stay with oil, Mr. Chairman, if the world remains with oil as a primary energy currency, we will have to tap into these reserves and invest a lot of money, a lot of money in infrastructure and conversion processes and refining. The refining process is completely different. We have no choice because we are running out of conventional crude.

China is aware of this. They are looking into this market. They want to be there as it happens. They want to make sure that they are on top of this because they realize that—and by the way, their projection for the future of the oil industry are pretty dire. Unlike our oil companies that tend to project oil to be back at the $27 a barrel, they are talking about much higher figures, and that affects their long-term planning.

That is why they are willing to invest in places and areas that we are not willing to invest. Maybe they are right, maybe they are wrong. We do not know. But if they are right and we are wrong, then we are going to pay a very heavy price.

Senator COLEMAN. Continuing on the Venezuelan discussion, I get a feeling, as I listened to the earlier panel and some of the testimony that has been presented here, that Venezuela does not have the capacity to simply cut off its flow to Citgo. Economically, it would suffer great consequences.

And I am wondering if discussions of Venezuela diverting oil to China is simply a way of needling the United States. Is it one of those ways of taking advantage of competing influences in the region? Is there a sense that China's interest in the region can be exploited by those who wish to confront the United States? I am trying to understand the nature of the danger. Is it a verbal thing or is there a real threat here that those who wish to hurt United States interests in Latin America will use China's interest as a way to further their own objectives?

Dr. LAMPTON. Let me take an initial stab at your question.

Senator COLEMAN. Dr. Lampton, then Mr. Johnson.

Dr. LAMPTON. Not so much on the technical side, but I said that Latin America——

Senator COLEMAN. Is your microphone on?

Dr. LAMPTON. I said that this is not so much a comment on the technical side as the political side, and I said in my testimony that I did not think Latin America was the most important foreign policy focus for China. If I had been asked what is the most important foreign policy focus for China, it is the United States and then China's own region.

Quite frankly, I think the Chinese are probably somewhat embarrassed by some of the anti-American bombast from Mr. Chavez. They are trying to make relations with the United States smoother. In the earlier panel the secretary pointed out that indeed the Chinese had said their purpose was not to divert oil from Venezuela to China, and I think that is just one reflection of this effort.

So my reading of it would be that we are listening to rhetoric designed for a domestic political audience in Venezuela and not designed for action, and the people that they are proposing to act with—China—do not want to act with them.

Senator COLEMAN. Mr. Johnson.

Mr. JOHNSON. My sense goes kind of along those lines. I would agree that I think the United States is China's priority. But in looking at the patterns of Chinese commerce with Latin America, I would have to say that the Chinese seem to be equal opportunity consumers. They will buy from whomever they can get their product from, and it does not matter if it is somebody who may be disagreeable or somebody who may not be necessarily a friend of the United States. We have two countries in Latin America, Cuba, and Venezuela, that are openly hostile, that are openly adversaries of the United States. That does not stop China from dealing with them and obviously trying to have relations that work to their advantage. They see things differently.

Another thing I would keep my eye on is whether or not there may ever be a Chinese role, not in Venezuela but in Bolivia, in the

future. Right now the interests there seem to be more Brazilian and Spanish and European, and of course the United States is interested in what happens to the gas fields in Tarika. But at the same time, if you look at the declining interest that socialist leaders in Latin America have in terms of commerce with Western nations, China might be a more acceptable foreign buyer for Bolivian gas, to say, a future (socialist) President Morales.

Those are things that are difficult to predict. But, obviously, there is an ideological component that may not be present necessarily with China, but is certainly there with potential adversaries that we have in our own backyard.

Senator COLEMAN. Dr. Luft.

Dr. LUFT. I just want to focus on, not on the statement by Hugo Chavez, but on the work plan of Venezuela's oil industry, Minister of Energy, et cetera. They are talking about sending 300,000 barrels to China by 2012. More importantly, they are talking very, very openly, and have said so in numerous occasions, that they would like to see, by the end of the day, Venezuela being the source of 20 percent of China's imported oil.

Now, let's look what it means. If we look at the trajectory of China's demand for oil, we see that by 2025 they will need 15 million barrels a day, out of which about 11 million barrels a day will be imported. Twenty percent, Mr. Chairman, of 11 million barrels a day, that is 2.2 million barrels; 2.2 million barrels a day that Venezuela is telling us that they would like to see them sending to China.

Now, question number one: Can our economy afford to, considering our growth rate, considering our growing demand for it, can we afford to lose 2.2 million barrels a day? I do not think so.

Another question is: Can those extra-heavy processes, all those things, meet the rising demand? Can they fill in the gap? That is the issue here. That is the question. I am not so sure that we can do it on time.

Senator COLEMAN. Dr. Lampton.

Dr. LAMPTON. Several times you have said that oil is zero-sum, and if Venezuelan oil was the only oil in the world, I would agree. But, in fact, there are many suppliers and they are going to have to move that Venezuelan oil at a pretty heavy transportation cost, and that was explained in terms of days of transport, and that is going to cost the Chinese more. They can buy oil out of Burma, which presents its own problems to our foreign policy; they can buy from Indonesia. They are going to liquefied natural gas.

So, I just do not see it as zero-sum. In the end, we want to keep the prices as low as possible and certainly we do not want it higher cost. But the United States has plenty of choices about where to buy oil and everybody else does. So, I do not see it as zero-sum. I think that is a misconception.

Dr. LUFT. Well, our policy is that we want to reduce our dependence on countries that do not like us. If that is the purpose, then we have a problem here. If we do not care who we buy our oil from, then it is a different debate. But I believe that this administration's policy is to reduce our dependence on the Middle East.

Senator COLEMAN. I would be remiss if we concluded this hearing and did not talk about IPR. China is ground zero when it comes

to the piracy of intellectual property. I believe two-thirds of Brazil's counterfeit goods apparently come from China. There is concern that a lot of that is transited over the lawless triborder region between Brazil and Paraguay and Argentina.

When I was in Brazil not too long ago, I attended a conference on IPR, and after years of looking the other way it seems that Brazil is making an effort to turn the corner with regard to IPR protections.

So my question is, how does the growing Chinese relationship and influence, particularly in Brazil but in Latin America, how does that impact the IPR issue? Do we have any leverage in dealing with China regarding IPR issues in our neighborhood? I will open it up. Dr. Lampton.

Dr. LAMPTON. This is really one of the core issues. This is a global issue with China. We have got a problem with IPR violation as it pertains to the sale of products in China. But what is even more distressing is the production of counterfeit items in China and then the contamination in third markets that we would otherwise have.

So I think this is really a key. The United States as I would understand the State Department's policy and the Special Trade Representative and so on, have placed this very high on our priority list, and I think this is really one of the major issues. We ought to not only target China itself, but those criminal syndicates and governments that are cooperating or turning a blind eye to this.

This strikes me as the key to the United States moving up the value-added chain—our intellectual property. That is what is going to make us competitive. We are not going to compete with the Chinese on low labor costs. I sure hope we are not. So the key is intellectual property. I think that ought to be right up there in the number one category of our concerns, both with China directly and its operation in third countries.

Senator COLEMAN. What kind of leverage so we have? I would like to hear from everyone and then I will do a followup question. Mr. Johnson.

Mr. JOHNSON. Just on top of that, I would just like to commend the Senate and the House of Representatives and the administration for the work it has done in its relations with Paraguay in helping make our relationship with that country more comprehensive, because that has helped in some measure to try and close down some of the contraband activities in the triborder area. If we did not have that kind of a comprehensive relationship with them, recent progress would not have happened.

Senator COLEMAN. Let us just get back to one more approach to this question. Maybe it is not a Latin America problem, it is simply a problem. It is a problem all over. But in regard to Latin America, is there anything that we can do vis-a-vis piracy in Brazil that is being fed by Chinese product, any steps America can take to deal with that issue?

Dr. LAMPTON. Well, your question probably calls for a level of expertise I do not have. But I know what we are doing with respect to China itself and maybe this has applicability. Many of the customs services around the world lack, and immigration and border control and so on, lack a lot of tools; training, legal advice, and so forth. So once again, we end up in the realm of exchange. But our

government has very active exchanges in intellectual property with many countries around the world, and I would look for those particular offenders in South America and Latin America that are particular problems where we can cooperate with their law enforcement and border control and so forth.

So to the degree that knowledge is the problem, as opposed to something else, I would like to see us cooperate more there.

Senator COLEMAN. Thank you.

Mr. Johnson, and I will end on this note, I appreciate your comment about the more comprehensive relationship with Paraguay. The government there is trying to make a difference. You keep coming back to this phrase, "comprehensive." Maybe that is a good note to end on, that in our relationships with Latin America it is about comprehensive relationships. In Colombia, it is about drugs, but it is not just about drugs. We have a direct interest in the economic vitality of Colombia and business coming back. Obviously, that is dependent upon security, and so, in what we have done with Plan Colombia and now Plan Colombia II, we have to keep in mind this comprehensive approach.

I would suspect that with our other neighbors in Latin America it is the same concept. To us, Latin America is not just a market for resources. I wonder with the Chinese whether that resource market is at the core. But for a whole range of other reasons—the first panel talked about the longstanding relationships, the shared culture, the heritage—we have some tremendous opportunities and advantages in Latin America if we work on them and we develop them. We should not worry about China as our "competitor"; we should keep an eye on what is going on, and realize that there are aspects to the relationship that we need to develop.

Is that a fair summation of what you mentioned when you talked about comprehensive relationships?

Mr. JOHNSON. Yes; that is exactly it. And we went through a period in the 1990s where we shrank back, and understandably so, because, looking at the other priorities that we had in the world, we had the collapse of the Soviet Union, we had problems at the end of the 1990s that were beginning to happen in the Middle East.

So it is hard to say that one region should be more important than the other. But in Central and South America, we pulled a lot of our programs that were of a comprehensive nature when it was important to try and go beyond the inactivity that we had for decades and try to encourage democracy and open markets and better relations with these countries.

So in doing so, in turning—in reducing the programs that we had, we tended to concentrate solely on counternarcotics. That was a big issue. That was sellable at home. American constituents understood it a lot better than such concepts as why rule of law is something that is in our interest in Ecuador, for interest.

But now I think that the model that we have in Colombia—perhaps we cannot do it on that scale in other countries, investing that amount of money, but certainly we can try to replicate the extent to which we engage different areas of society and government and institutions to be a kind of a helping hand, because to the extent that we repeat that elsewhere, then the rising tide may lift more boats.

Senator COLEMAN. And in many ways the concern about China in the hemisphere is actually fostering that more comprehensive discussion. If you look at the debate about CAFTA, I think there were some people who say that if we did not pass CAFTA it would benefit China, that we would be giving away market opportunities.

As we look to the possibility of an Andean trade agreement and an agreement with Panama, I think the same discussion comes into play: Do we want to just give away market opportunities or do we want to develop them? Yet, to develop them, we, in addition, have to see things like commitment to rule of law. We have to see respect for intellectual property rights, we have to see issues dealing with labor agreements and other things that need to be part of our treaty arrangements. So in many ways the Chinese relationship is actually spurring perhaps a greater unity.

This has been a very, very informative hearing, very helpful to me. I will share this with other members of the committee. The testimony has been much more optimistic than I, perhaps, would have anticipated. Prior to coming into this, the sense I had was that those involved in the business community see China and its development and the role it is playing in Latin America as presenting opportunity. For those focused on foreign policy and defense issues, I think there is some question of fear and concern. My take on this hearing is that the opportunity is there. It is always good to be concerned, but on the other hand, hopefully, if done right, the opportunity can trump the fear.

So with that, I will leave the record open for 7 days, so if there are any additional questions my colleagues have, gentlemen, I will make sure they contact you. But if not, this hearing is now adjourned.

[Whereupon, at 4:37 p.m., the subcommittee was adjourned.]

ADDITIONAL STATEMENT SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF DAVID HALE, HALE ADVISERS, LLC, CHICAGO, IL

There is now growing concern in Washington about the rise of China as an economic power in Latin America. China has been announcing major investments in the region's natural resource industries. The Chinese Government has promised to spend billions helping to upgrade the region's infrastructure in order to facilitate trade. China has applied for membership in the Inter-American Development Bank. China has been lobbying countries in the Caribbean to end their traditional relationship with Taiwan and recognize the Beijing government instead.

China's new focus on Latin America is the result of the transformation which has occurred in her economic status during the past few years. China has displaced the United States as the world's largest consumer of most industrial raw materials, including copper, aluminum, nickel, platinum, and iron ore. China's steel industry now generates more output than the United States and Japan combined. The market capitalization of China's steel industry is over $40 billion compared to $11 billion for the U.S. steel industry. In 2003 China produced 40 percent of the world's cement compared to 6 percent for the United States. While China now consumes 22 percent of global copper output and 11 percent of nickel output, its per capita consumption of most materials is still equal to only about 20 percent of U.S. per capita consumption. As a result, China's continuing economic development could cause her share of global metals consumption to rise to the 35- to 40-percent range during the next two decades. At current growth rates, there can be little doubt that China will be the dominant price setter for most commodities in the future, not America and Europe.

There are several factors driving China's explosive demand for raw materials. During the past decade, China has attracted over $500 billion of foreign direct in-

vestment. Foreign firms are turning China into an export powerhouse. The country now generates 6 percent of global exports and could become the world's largest exporter within 3 years. Foreign firms produce over 55 percent of China's exports. China is also going through a process of urbanization which will generate huge construction activity. At present, the country is 38 percent urban and 62 percent rural. In 30 years, this ratio could reverse. When the United States urbanized during the first half of the 20th century, its per capita steel consumption increased sixfold.

China's emergence as the world's largest commodity importer has profound implications for her relationship with Latin America. The continent still depends heavily upon raw materials for export income, so China's demand for raw materials will have an important influence on Latin America's terms of trade. The emergence of a country which could rival the dominance of the American economy will also have long-term consequences for foreign policy and other strategic concerns.

During the second quarter of 2004, both Brazilian President Lulu and Argentine President Kirchner paid visits to China in order to promote closer economic and political relations. These visits provide useful insights into how the future relationship is likely to evolve.

President Lula said that he wanted to create a "strategic partnership" with China as an offset to American power. Mr. Lula is anxious to create a more multipolar world in which leading developing countries, such as Brazil, India, and South Africa, could play a prominent role. He views China as a successful developing country which could bolster his proposed coalition. China, by contrast, no longer regards itself as just a regional power or emerging market country. It increasingly perceives itself on a fast track to great power status. As a result, it views Brazil as less of a foreign policy partner and more as a potential source of critical raw materials.

Trade between Brazil and China is growing rapidly. Five years ago, China was Brazil's 15th largest trading partner. It will soon be number two. In 2003, bilateral trade was $7.8 billion, with Brazil exporting $4.3 billion of goods to China. China has emerged as a major market for Brazilian soybeans and steel. China also recently announced plans for a $2 billion investment in the Brazilian aluminum industry and $1.5 billion in the steel sector. Sinopec is looking for a partner to build an oil refinery as well. During the recent visit, President Lula asked China to consider large investments in the development of Brazil's infrastructure, including rail links to the Pacific and new highways. As a result of the need for raw materials. Chinese firms are now making investments in countries as diverse as Angola, Algeria, Papua New Guinea, Australia, and Indonesia. Brazil's great endowment of mineral resources and agricultural land make her a natural partner for Chinese foreign investment.

President Kirchner visited Brazil 6 weeks after President Lula. He focused less on foreign policy themes and more on economic cooperation. In 2003, Argentine exports to China grew 143 percent to $2.5 billion. The dominant export was soybeans and soya oil ($2.1 billion) followed by metallurgy products. President Kirchner proposed new forms of bilateral cooperation in agriculture, civil aviation, investment, culture, and health. As an immediate result, Aerolinas Argentinas announced that it will begin operating flights between Beijing and Buenos Aires. At the same time Argentine Planning Minister Julio De Vido announced that China had committed to $275 million of infrastructure investment, including $25 million for a grain port in Sante Fe and $250 million to construct a road from San Juan Province through Chile, facilitating exports from Chile's Pacific Port of Comquimbo.

President Hu Jintao used his visit to Latin America during November to announce several new initiatives. He told the Brazilians China would be willing to invest $8.5 billion in their railways, ports, and highways. He announced a major infrastructure investment program for Argentina, including $8 billion for railways, $6 billion for low-cost housing, $5 billion for hydrocarbons, $450 billion for communications, and $260 million for satellite technology. Mr. Hu also announced plans to open China's market to exports of Brazilian beef, chicken, and pork, and Argentine beef and fruit. Mr. Hu announced as well that China would recognize Brazil and Argentina as official tourist destinations, opening up both countries to China's 20 million international tourists. Argentina offered to open 140 tourist offices in China to facilitate the growth of tourism. Brazil and Argentina responded to the Chinese initiatives by agreeing to recognize China as a market economy. This was a major development for China because it is striving to get recognition as a market economy in order to lessen the risk of protectionist trade policies against its exports. At present fewer than 10 countries recognize China as a market economy. Brazilian and Argentine manufacturers were concerned about this decision because they fear it could open their domestic markets to a flood of cheap imports in sectors such as textiles and consumer electronics. There are currently 15 antidumping measures in place against Chinese goods in Argentina; under the terms of the new agreement,

only barriers on sensitive products such as toys and textiles will be permitted. The Brazilians are also concerned about the fact that China invoked concerns about fungicide contamination to block imports of Brazilian soybeans at a time when market prices were falling rapidly. The Brazilians perceive that China used this excuse to block imports in order to get a lower price.

Now that China is the world's largest oil consumer, she is striving to obtain new oil supplies all over the world. As a result of the Hu Jintao visit, China will make new investments in the Brazilian and Argentine energy sectors. China's National Petroleum Company will develop a gas pipeline linking the northeast of Brazil to Rio with Petrobas and the National Development Bank. In Argentina, China's oil companies will engage in exploration and development activities with Enarsa, Argentina's new state oil company.

In January, President Hugo Chavez of Venezuela visited Beijing to promote more Chinese investment in his country. Chavez has a bad relationship with the United States and is anxious to diversify his country's trade. In August, China National Petroleum Corporation announced plans to develop Venezuela Zumano oilfields. The field has large reserves of both oil and natural gas. The Venezuelan Government says that it hopes to supply 15–20 percent of China's petroleum needs in 10 years. As Venezuela produces primarily heavy oil, it is not clear that China will be an easy market for the Venezuelan output but Hugo Chavez will take every step necessary to promote trade with China.

Chile is also anxious to promote new trade and investment links with China. The two countries announced plans to create a joint commission to promote more investment and trade in the mining sector. At the APEC summit, Chile and China formally announced they would launch negotiations to create a free trade area during the next 2 years. China currently produces 4.9 million tonnes of copper and exports 850,000 tonnes to China. If the two countries could sign an FTA, it would help to bolster exports of noncommodity products such as Chilean wine to China. In 2003, China exported $1.28 billion of goods to Chile and imported commodities worth $2.24 billion. It is widely estimated that two-way trade could reach $10 billion in 5 years if the two countries had an FTA.

The recent interaction between China and Latin America is a natural outgrowth of China's need for imports of soybeans, steel, copper, and other raw materials. What remains to be seen is how China will adjust its long-term foreign policy agenda to reflect its new status as the world's leading consumer of commodities.

China is now pursuing potential free trade agreements with several countries to enhance its access to raw materials, including Australia, New Zealand, South Africa, and the Persian Gulf countries, as well as Chile. In the 1990s, the U.S. Government lobbied hard to prevent China from selling nuclear weapons to Iran and other Middle Eastern countries in return for oil and natural gas. China recently signed a nonproliferation treaty which will prevent her from selling nuclear weapons to all countries, but she could still use her military power to promote improved access to raw materials. China, for example, now has 4,000 troops in the Sudan to protect an oil pipeline which her companies built there 5 years ago. Sudan has been in the midst of a civil war for several years, so China wants to use its own troops to guarantee the safety of the pipeline. As China promotes new investment in other developing countries, such as Zambia, Zimbabwe, Papua New Guinea, and Angola, it is not difficult to imagine some governments seeking military alliances in order to enhance their domestic political positions.

The United States and other major industrial countries have not recognized the potential consequences of China's new status in the commodity markets. Japan is aware of it because she has been competing with China for the right to control a pipeline carrying Russian oil to the Pacific coast. The Chinese made the mistake of signing a joint venture agreement with Yukos while Japan focused on the government controlled pipeline monopoly, so Japan is likely to control this new $10 billion project. But President Putin has suggested that he will build an auxiliary pipeline to northern China as well. The Chinese recently beat the Americans in obtaining new oil exploration rights in Saudi Arabia but the relationship between the United States and the Saudis is under pressure because of other concerns, such as the war against terrorism. The issue of oil reserves is less dominant than it might have been during the 1990s.

At the start of the decade, some Asian countries were alarmed about China's rise because they perceived that China would gobble up all the foreign direct investment in the region. While they are still concerned about China's FDI boom, they have enjoyed such robust export growth to China that they now regard China as a partner rather than a threat. Latin America is going through the same evolution.

The Latin American country which is most alarmed about the rise of China is Mexico. The Mexicans fear that China's FDI boom is drawing both capital and jobs

from their country. During the past 4 years, the Maquiladoras zone has lost about 250,000 jobs in part because of firms moving to Asia. In 2003, China displaced Mexico as the number two trading partner of the United States. In 2005, Mexico will probably account for 11–12 percent of U.S. imports while China could be exceeding 13 percent. Mexico was the last country to sign the treaty for China's membership of the WTO because of concerns about the competitive challenge which China poses. Mexico's problem is that it does not have a natural resource endowment conducive to the kind of export boom which Brazil and Argentina are now enjoying. It is not a major exporter of soybeans, copper, or steel. It instead competes with China in sectors such as textiles, furniture, and auto parts.

Some Mexican textile companies have moved factories to China. What remains to be seen is whether Mexican companies will be able to form joint ventures with Chinese companies to penetrate both the domestic market of China as well as to re-export goods back to North America. At present, about 60 percent of China's imports are goods used for developing products which are re-exported. Most of these imports come from other Asian countries. Mexican firms should also strive to get into the global supply chain which now runs through China.

China has recently applied to join the Inter-American Development Bank. If she joins the group, her construction companies will be eligible to participate in projects funded by the bank. Membership would also provide China with a new channel for playing a role in the region. The United States is cautious about allowing China to join but other Latin American countries are supporting the Chinese bid because of their rapidly growing trade with China.

In the 16th, 17th, and 18th centuries, China emerged as a major market for Latin America silver. During that era, the countries of Europe were anxious to import Chinese silk, porcelain, and tea but had few products to sell in return. The result was that they exported silver from the mines of Mexico, Peru, and Bolivia. At the end of the 18th century, China had over one-third of the world's silver reserves. When the supply of silver declined, the British substituted opium and fought a war to guarantee their access to the Chinese market.

At the dawn of the 21st century, there are no constraints on trade between China and other countries. China has an insatiable appetite for commodities as well as many industrial capital goods for developing her economy. Latin America is rapidly emerging as an important source of raw materials for China's booming economy. The challenge for Latin America will be developing opportunities for broadening its trade to include more exports of manufactured goods as well as to promote services such as tourism. The governments of Latin America have taken initial steps to capitalize on the China opportunity. But they, along with other countries, are still at only the early stages of coming to terms with a historic transformation.

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