



U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

Opening Remarks of Chairman Dan Slane and Vice Chairman Carolyn Bartholomew on the 2010 Annual Report

November 17, 2010

Good morning. Thank you for coming. My name is Dan Slane. I am Chairman of the U.S.-China Economic and Security Review Commission. Today we are releasing the Commission's Annual Report to Congress. This is the Commission's eighth major report since it was established in 2000. It is the work of our 12 member, bipartisan Commission, which was created to advise Congress on policy toward China. I am pleased to note that once again this report was adopted unanimously.

This year the Commission conducted numerous activities in support of its Congressional mandate to "monitor, investigate and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." The Commission held eight hearings, including a field hearing in Toledo, Ohio. We also traveled to Taiwan and Vietnam and to four cities in China. During these trips we met with local government officials, business leaders, scholars, and American diplomats. Our findings from these trips are contained in this report. In addition, the Commissioners attended a series of classified briefings at the U.S. Air Force's National Air and Space Intelligence Center. The Commission contracted with outside firms for research in specific areas, such as the bilateral investment treaty negotiations with China, and the Chinese pharmaceuticals and telecommunications industries. Some of those reports have been posted on our website.

The 2010 Annual Report reflects the Commission's conclusions that China has failed in some notable areas to fulfill the promises it made nine years ago when it joined the World Trade Organization. Specifically, China is adopting a highly discriminatory policy of favoring domestic producers over foreign manufacturers. Under the guise of fostering "indigenous innovation" in its economy, the government of China appears determined to exclude foreigners from bidding on government contracts at the central, provincial, and local levels. In addition, China has proposed that its many state-owned corporations be exempt from WTO rules on procurement. The Chinese government quite simply intends to wall off a majority of its economy from international competition.

The Commission also examined China's policy on fostering a green technology industry. China has devoted a significant amount of money to promote domestic green energy use. China certainly needs to address its environmental problems, which include severe air and water contamination. However, the goal of maintaining eight percent GDP growth per year hinders China's ability to enact effective environmental policies. China may be more interested in developing a world class green technology export sector rather than cleaning up its environment. For example, although China is the world's largest producer of photovoltaic solar panels, 90 percent are exported.

We also investigated China's aviation industrial base and found that it has substantially improved. Once almost entirely dependent upon imports, China is now capable of producing both

advanced commercial and military aircraft. Unfortunately this improvement is primarily due to strong Chinese government support which often excludes foreign firms, and a requirement for technology offsets from Boeing and Airbus, in return for market access in China. Two days ago China announced its first 100 orders for its large commercial aircraft, an aircraft expressly designed to compete with Boeing and Airbus. Alarming, China appears to be directly transferring improvements in commercial aviation to its defense aviation sector.

The Commission also examined the sale of U.S. Treasury securities to China. We considered whether America's growing debt implies that China, as America's largest foreign creditor, has gained political leverage over the U.S. government. We found that there is no economic justification to believe that China has gained political leverage over the United States or that a decision by China to scale back or even to cease its purchases of U.S. Treasuries should be viewed with alarm.

In fact, the United States would welcome a decision by China to abandon its system of strict capital controls that prohibit Chinese citizens and businesses to hold or to spend or to invest dollars. Instead of allowing those dollars to circulate freely, the Chinese government requires its citizens to trade dollars for renminbi at state-owned banks. This is part of the mechanism by which China strictly controls and undervalues its currency. The United States and Chinese citizens would no doubt welcome a more free market approach by the Chinese government.

China is increasing its efforts to utilize its vast hoard of accumulated capital—built up through its protectionist policies—to promote its interests overseas. Its state-controlled or connected enterprises are seeking to access new markets—especially in the United States—to ensure that its export-led growth model continues. Huawei's efforts here in the United States are a perfect example of that.

As more Chinese companies seek to list their shares on U.S. stock exchanges, it is important that regulations from the Security and Exchange Commission reflect the fact that many large Chinese companies are either government-owned or controlled. The Commission believes that Chinese government or Communist Party involvement in the ownership and control of Chinese companies is a material fact that warrants public disclosure in official SEC filings.

During one of our hearings this year, we heard how the Chinese government refined its state and trade secrets regime in 2010. In some areas Beijing clarified its expectations, but many laws and regulations still contain broad language that allows for ambiguous interpretation. In recent years, the selective enforcement of these laws has affected U.S. citizens doing business in China, such as Xue Feng, an American geologist sentenced in July for possession of geological surveys available on the open market yet retroactively deemed to be state secrets.

Finally, China's currency manipulation continues to harm U.S. manufacturing and employment. There appears to be no real motivation by the Chinese to adopt market-based approaches with regard to its currency.

The Commission makes 45 recommendations to Congress. Among them, the Commission urges steps to press China to allow the renminbi to become flexible and responsive to market forces, thereby contributing to the correction of global economic imbalances. The Commission also recommends that Congress consider legislation that has the effect of offsetting the impact on the U.S. economy of China's currency manipulation.

I'd like to thank Senator Ben Nelson, Chairman of the Rules Committee for graciously offering this hearing room for our press conference today. Now I would like to introduce my colleague on the Commission, Carolyn Bartholomew, who has served ably during this past year as the vice chairman.

[Begin Vice Chairman Bartholomew's Opening Statement]

Thank you, Chairman Slane, and good morning ladies and gentlemen. I would like to echo the Chairman in thanking you all for coming today. I will focus on a few broad security-related themes in this year's Annual Report.

We looked into China's efforts to modernize its air and missile capabilities. Over the past decade, the Chinese Air Force has acquired both foreign and indigenously produced advanced aircraft, weapons, and equipment. For example, since 2000, the Air Force has increased its number of 4th generation combat fighters by over 500 percent. In addition, China has fielded one of the world's best ground-based air defense systems in the world, comprised of highly-capable surface-to-air missile systems and a new nation-wide air defense network, providing China with an "offensive" air defense capability. To better operate its new weapons and equipment, Beijing has implemented a series of deep institutional reforms: it has increased the rigor of its military training exercises, and has improved the quality of its officer and enlisted forces.

Complementing its improved air capabilities is an increase in China's ability to conduct conventional missile strikes throughout the region. Since 2000, China has increased its arsenal of short-range ballistic missile launchers sevenfold. Over the past year, China has also increased its number of land-attack cruise missiles by 30 percent. Of import, China appears to be on the cusp of deploying an anti-ship medium-range ballistic missile that will be used to target large ships at sea up to 1,000 miles away.

As a result of China's improved offensive air and missile capabilities, the Chinese military has strengthened its capacity to threaten U.S. forces and bases in the region. Currently, China's conventional missile capabilities alone may be sufficient to temporarily knock out five of the six U.S. air bases in East Asia. Saturation missile strikes could destroy U.S. air defenses, runways, parked aircraft, and fuel and maintenance facilities. Complicating this scenario is the future deployment of China's anti-ship ballistic missile, which could hold U.S. aircraft carriers at bay outside their normal operating range.

In Southeast Asia, China has aggressively asserted its disputed territorial claims to the South China Sea, leading to tensions with many countries in the region. For example, earlier this year China began referring to the South China Sea as a "core interest," on par with Taiwan and Tibet. China has also pushed forward with the construction of a number of dams along the upper Mekong River which may give China control of downstream river flows and could severely impact the food and human security of Burma, Cambodia, Laos, Thailand, and Vietnam; with potential global ramifications.

The overall relationship between Taiwan and China has seen an unbalanced improvement over the past year. The two sides signed an historic free trade agreement that will further integrate their two economies. They have continued to institutionalize their diplomatic relations as well. Yet despite these improvements, the security situation in the Taiwan Strait remains a concern. China continues its military buildup across from Taiwan and has refused to renounce the use of force to reclaim the island. Current estimates maintain that China deploys between 1,050 and 1,150 short-range ballistic missiles opposite the island. Further complicating the matter is the decreasing capability of Taiwan to adequately defend itself from a Chinese air and missile assault.

Our report this year also addresses how Chinese individuals and organizations continue to penetrate American computer systems and networks as well as those of foreign entities and governments. The methods used during these activities appear to be more sophisticated than techniques used in the past. The massive scale and the extensive intelligence and reconnaissance components of recent high-profile, China-based computer exploitations suggest that there continues to be some level of state support for these activities. In addition, for a brief period in April, Chinese Internet service providers "hijacked," or inappropriately gained access to,

U.S. Internet traffic. This incident affected numerous government sites, including those for the Senate and the Office of the Secretary of Defense.

Finally, our report notes that over the past year China has continued to tighten its control on the Internet, dashing hopes for the Internet to act as a means to liberalize Chinese society. China's approach to the Internet is best explained by the concept of "networked authoritarianism," where the authorities skillfully balance the need to limit speech and information on the Internet against the Chinese public's desire to participate in discourse about the country's social conditions. The Chinese government delegates the responsibility for its Internet censorship activities to private firms in China, some of which, like Baidu, are heavily funded by American investors. These issues have implications for the United States. For example, in a report released this week, Google persuasively argues that Internet censorship acts as an impediment to free trade. The report suggests that, as a corollary, the WTO should evaluate states' censorship practices. This is particularly important in light of the proliferation of state-based Internet censorship, now employed by some 40 countries—a tenfold increase over the past decade.

For those of you who wish to pursue these issues further, I urge you to read our Annual Report. It will be posted on the Commission's website at www.USCC.gov. And with that, we will be happy to take your questions. Please identify yourselves as you ask your questions.

#