

RECOMMENDATIONS TO CONGRESS

CHAPTER 1—CHINA’S INDUSTRIAL, INVESTMENT, AND EXCHANGE RATE POLICIES

Recommendations for Dealing with China’s Currency Manipulation

- The 1988 Omnibus Trade and Competitiveness Act requires the Treasury Department to examine whether countries are manipulating their exchange rates for purposes of gaining international competitive advantage. The Treasury is to arrive at its finding in consultation with the IMF, which defines manipulation as “protracted large-scale intervention in one direction in the exchange market.” The Treasury has repeatedly evaded reporting on this test. The Commission recommends that Congress require the Treasury to explicitly address this test in its required report to Congress. Furthermore, a condition for taking action against a country that manipulates its currency is that an offending country be running a material global current account surplus in addition to a bilateral surplus. The Commission recommends that Congress amend this provision so that a material global current account surplus is not a required condition.
- The administration should use all appropriate and available tools at its disposal to address and correct the problem of currency manipulation by China and other East Asian countries. With regard to China, this means bringing about a substantial upward revaluation of the yuan against the dollar. Thereafter, the yuan should be pegged to a trade-weighted basket of currencies, and provisions should be established to guide future adjustments if needed. As part of this process, the Treasury Department should engage in meaningful bilateral negotiation with the Chinese government, and it should also engage in meaningful bilateral negotiations with Japan, Taiwan, and South Korea regarding ending their long-standing exchange rate manipulation. The administration should concurrently encourage our trading partners with similar interests to join in this effort. The Commission recommends that Congress pursue legislative measures that direct the administration to take action—through the WTO or otherwise—to combat China’s exchange rate practices in the event that no concrete progress is forthcoming.

Recommendations for Addressing China’s Mercantilist Industrial and FDI Policies

- The Commission recommends that Congress direct the United States Trade Representative (USTR) and the Department of Commerce to undertake immediately a comprehensive investigation of China’s system of government subsidies for manufacturing, including tax incentives, preferential access to credit and

capital from state-owned financial institutions, subsidized utilities, and investment conditions requiring technology transfers. The investigation should also examine discriminatory consumption credits that shift demand toward Chinese goods, Chinese state-owned banks' practice of noncommercial-based policy lending to state-owned and other enterprises, and China's dual pricing system for coal and other energy sources. USTR and Commerce should provide the results of this investigation in a report to Congress that assesses whether any of these practices may be actionable subsidies under the WTO and lays out specific steps the U.S. government can take to address these practices.

- The Commission recommends that Congress direct the administration to undertake a comprehensive review and reformation of the government's trade enforcement infrastructure in light of the limited efforts that have been directed at enforcing our trade laws. Such a review should include consideration of a proposal by Senator Ernest Hollings (D-SC) to establish an assistant attorney general for international trade enforcement in the Department of Justice to enhance our capacity to enforce our trade laws. Moreover, the U.S. government needs to place an emphasis on enforcement of international labor standards and appropriate environmental standards.
- The Commission recommends that Congress direct the administration to work with other interested WTO members to convene an emergency session of the WTO governing body to extend the MFA at least through 2008 to provide additional time for impacted industries to adjust to surges in imports from China.

CHAPTER 2—CHINA IN THE WORLD TRADE ORGANIZATION: COMPLIANCE, MONITORING, AND ENFORCEMENT

- The Commission recommends that Congress press the administration to make more use of the WTO dispute settlement mechanism and/or U.S. trade laws to redress unfair Chinese trade practices. In particular, the administration should act promptly to address China's exchange rate manipulation, denial of trading and distribution rights, lack of IPR protection, objectionable labor standards, and subsidies to export industries. In pursuing these cases, Congress should encourage USTR to consult with trading partners who have mutual interests at the outset of each new trade dispute with China.
- The Commission recommends that Congress press the administration to make better use of the China-specific section 421 and textile safeguards negotiated as part of China's WTO accession agreement to give relief to U.S. industries especially hard hit by surges in imports from China.
- Notwithstanding China's commitments at the April 2004 JCCT meeting, the Commission recommends that Congress press the administration to file a WTO dispute on the matter of China's failure to protect intellectual property rights. China's WTO obligation to protect intellectual property rights demands not only that China promulgate appropriate legislation and regulations, including enacting credible criminal penalties, but also that these rules be enforced. China has repeatedly promised, over many years, to take significant action. Follow-through and action have

been limited and, therefore, the Commission believes that immediate U.S. action is warranted.

- The Commission recommends that Congress urge the Department of Commerce to make countervailing duty laws applicable to nonmarket economies. If Commerce does not do so, Congress should pass legislation to achieve the same effect. U.S. policy currently prevents application of countervailing duty laws to nonmarket economy countries such as China. This limits the ability of the United States to combat China's extensive use of subsidies that give Chinese companies an unfair competitive advantage.
- The Commission recommends that Congress encourage the administration to make a priority of obtaining and ensuring China's compliance with its WTO commitments to refrain from forced technology transfers that are used as a condition of doing business. The transfer of technology by U.S. investors in China as a direct or indirect government-imposed condition of doing business with Chinese partners remains an enduring U.S. security concern as well as a violation of China's WTO agreement. A WTO complaint should be filed when instances occur.
- The Commission recommends that Congress encourage USTR and other appropriate U.S. government officials to take action to ensure that the WTO's Transitional Review Mechanism process is a meaningful multilateral review that measures China's compliance with its WTO commitments. If China continues to frustrate the TRM process, the U.S. government should initiate a parallel process that includes a specific and comprehensive measurement system. The United States should work with the European Union, Japan, and other major trading partners to produce a separate, unified annual report that measures and reports on China's progress toward compliance and coordinates a plan of action to address shortcomings. This report should be provided to Congress. In addition, independent assessments of China's WTO compliance conducted by the U.S. government, such as USTR's annual report, should be used as inputs in the multilateral forum evaluating China's compliance, whether that forum is a reinvigorated and effective TRM or a new process.
- The Commission recommends that Congress consider options to assist small- and medium-sized business in pursuing trade remedies under U.S. law, such as through section 421 cases.

CHAPTER 3—CHINA'S PRESENCE IN THE GLOBAL CAPITAL MARKETS

- The Commission recommends that Congress reinstate the reporting provision of the 2003 Intelligence Authorization Act [P.L. 107–306, Sec. 827] directing the director of central intelligence (DCI) to prepare an annual report identifying Chinese or other foreign companies determined to be engaged or involved in the proliferation of weapons of mass destruction or their delivery systems that have raised, or attempted to raise, funds in the U.S. capital markets. The Commission further recommends that Congress expand this provision to require the DCI to undertake a broader review of the security-related concerns of Chinese firms accessing, or seeking to access, the U.S. capital markets. This should include the establishment of a new interagency process of

consultations and coordination among the National Security Council, the Treasury Department, the State Department, the SEC, the Federal Bureau of Investigation (FBI), and the intelligence community regarding Chinese companies listing or seeking to list in the U.S. capital markets. The aim of such an inter-agency process should be to improve collection management and assign a higher priority to assessing any linkages between proliferation and other security-related concerns and Chinese companies, including their parents and subsidiaries, with a presence in the U.S. capital markets.

- The Commission recommends that Congress require mutual funds to more fully disclose the specific risks of investments in China. This should include disclosure to investors of the identities of any local firms subcontracted by funds to perform due diligence on Chinese firms held in their portfolios. Subcontractors' principal researchers, location, experience, and potential conflicts of interest should all be disclosed.
- The Commission recommends that Congress direct the Commerce Department and USTR to evaluate whether Chinese state-owned banks' practice of noncommercial-based policy lending to state-owned and other enterprises constitutes an actionable WTO-inconsistent government subsidy and include this evaluation in the report on subsidies recommended in Chapter 1.
- In its 2002 Report, the Commission recommended that Congress prohibit debt or equity offerings in U.S. capital markets by any Chinese or foreign entity upon which the State Department has imposed sanctions for engaging in the proliferation of weapons of mass destruction (WMD) or ballistic missile delivery systems. The Commission further believes that Congress should bar U.S. institutional or private investors from making debt or equity investments, directly or indirectly, in firms identified and sanctioned by the U.S. government for weapons proliferation-related activities, whether they are listed and traded in the United States or in the Chinese or other international capital markets. For example, NORINCO, a company sanctioned by the U.S. government, is currently available for purchase on the Chinese A share market. U.S.-based qualified foreign institutional investors that have rights to trade on this exchange should not be permitted to invest in NORINCO or any other firm officially determined to have engaged in the proliferation of WMD or ballistic missiles.

CHAPTER 4—CHINA'S REGIONAL ECONOMIC AND SECURITY IMPACTS AND THE CHALLENGES OF HONG KONG AND TAIWAN

Regional Engagement

- The Commission recommends that Congress revitalize U.S. engagement with China's Asian neighbors by encouraging U.S. diplomatic efforts to identify and pursue initiatives to demonstrate the United States' firm commitment to facilitating the economic and security needs of the region. These initiatives should have a regional focus and complement bilateral efforts. The Asia-Pacific Economic Cooperation forum (APEC) offers a ready mechanism for pursuit of such initiatives. The United States should consider

further avenues of cooperation by associating with regional forums of which it is not a member.

Hong Kong

- The Commission recommends that Congress consult with the administration to assess jointly whether the PRC's recent interventions impacting Hong Kong's autonomy constitute grounds for invoking the terms of the U.S.-Hong Kong Policy Act with regard to Hong Kong's separate treatment. This includes U.S. bilateral relations with Hong Kong in areas such as air services, customs treatment, immigration quotas, visa issuance, and export controls. In this context, Congress should assess the implications of the National People's Congress Standing Committee's intrusive interventions with regard to matters of universal suffrage and direct elections. Congress and the administration should continue to keep Hong Kong issues on the U.S.-PRC bilateral agenda and work closely with the United Kingdom on Hong Kong issues.

Cross-Strait Issues

- The Commission recommends that Congress enhance its oversight role in the implementation of the Taiwan Relations Act. Executive branch officials should be invited to consult on intentions and report on actions taken to implement the TRA through the regular committee hearing process of the Congress, thereby allowing for appropriate public debate on these important matters. This should include, at a minimum, an annual report on Taiwan's request for any military equipment and technology and a review of U.S.-Taiwan policy in light of the growing importance of this issue in U.S.-China relations.
- The Commission recommends that the Congress and the administration conduct a fresh assessment of the one China policy, given the changing realities in China and Taiwan. This should include a review of:
 - The policy's successes, failures, and continued viability;
 - Whether changes may be needed in the way the U.S. government coordinates its defense assistance to Taiwan, including the need for an enhanced operating relationship between U.S. and Taiwan defense officials and the establishment of a U.S.-Taiwan hotline for dealing with crisis situations;
 - How U.S. policy can better support Taiwan's breaking out of the international economic isolation that the PRC seeks to impose on it and whether this issue should be higher on the agenda in U.S.-China relations. Economic and trade policy measures that could help ameliorate Taiwan's marginalization in the Asian regional economy should also be reviewed. These should include enhanced U.S.-Taiwan bilateral trade arrangements that would include protections for labor rights, the environment, and other important U.S. interests.
- To support this policy review, the Commission recommends that the appropriate committees of Congress request that the executive branch make available to them a comprehensive catalogue and copies of all the principal formal understandings and other communications between the United States and both China and

Taiwan as well as other key historical documents clarifying U.S. policy toward Taiwan.

- The Commission recommends that Congress consult with the administration on developing appropriate ways for the United States to facilitate actively cross-Strait dialogue that could promote the long-term, peaceful resolution of differences between the two sides and could lead to direct trade and transport links and/or other cross-Strait confidence-building measures. The administration should be directed to report to Congress on the status of cross-Strait dialogue, the current obstacles to such dialogue, and, if appropriate, efforts that the United States could undertake to promote such a dialogue.

CHAPTER 5—CHINA’S PROLIFERATION PRACTICES AND THE CHALLENGE OF NORTH KOREA

- Should the current stalemate in the Six Party Talks continue, the Commission recommends that Congress press the administration to work with its regional partners, intensify its diplomacy, and ascertain North Korean and Chinese intentions with a detailed and staged proposal beginning with a freeze of all North Korea’s nuclear weapons programs, followed by a verifiable and irreversible dismantlement of those programs. Further work in this respect needs to be done to determine whether a true consensus on goals and process can be achieved with China. If this fails, the United States must confer with its regional partners to develop new options to resolve expeditiously the standoff with North Korea, particularly in light of public assessments that the likely North Korean uranium enrichment program might reach a stage of producing weapons by 2007.
- The Commission recommends that Congress press the administration to renew efforts to secure China’s agreement to curtail North Korea’s commercial export of ballistic missiles and to encourage China to provide alternative economic incentives for the North Koreans to substitute for the foreign exchange that would be forgone as a result of that curtailment.
- As recommended in the Commission’s 2002 Report, and now similarly proposed by President Bush and the U.N. Secretary General, the Commission reiterates that Congress should support U.S. efforts to work with the U.N. Security Council to create a new U.N. framework for monitoring the proliferation of weapons of mass destruction and their delivery systems in conformance with member nations’ obligations under the Nuclear Non-Proliferation Treaty, the Biological Weapons Convention, and the Chemical Weapons Convention. This new monitoring body would be delegated authority to apply sanctions to countries violating these treaties in a timely manner or, alternatively, would be required to report all violations in a timely manner to the Security Council for discussion and sanctions.¹
- As recommended in the Commission’s 2002 Report, the Commission reiterates that Congress should act to broaden and harmonize proliferation sanctions by amending all current statutes that pertain to proliferation to include a new section authorizing the president to invoke economic sanctions against foreign nations that proliferate WMD and technologies associated with

WMD and their delivery systems. These economic sanctions would include import and export limitations, restrictions on access to U.S. capital markets, restrictions on foreign direct investment into an offending country, restrictions on transfers by the U.S. government of economic resources, and restrictions on science and technology cooperation or transfers. The new authority should require the president to report to Congress the rationale and proposed duration of the sanctions within seventy-two hours of imposing them. Although the president now has the authority to select from the full range of economic and security-related sanctions, these sanctions are case specific and relate to designated activities within a narrow set of options available on a case-by-case basis.²

CHAPTER 6—CHINA’S ENERGY NEEDS AND STRATEGIES

- The Commission recommends that Congress direct the secretaries of State and Energy to consult with the International Energy Agency with the objective of upgrading the current loose experience-sharing arrangement, whereby China engages in some limited exchanges with the organization, to a more structured arrangement whereby the PRC would be obligated to develop a meaningful strategic reserve, and coordinate release of stocks in supply disruption crises or speculator-driven price spikes.³
- The Commission recommends that Congress encourage work that increases bilateral cooperation in improving China’s energy efficiency and environmental performance, such as further cooperation in Clean Coal Technology and waste-to-liquid-fuels programs, subject to any overriding concerns regarding technology transfers. Further, the Commission recommends that Congress direct the State and Energy departments, and the intelligence community, to conduct an annual review of China’s international energy relationships and its energy practices during times of global energy crises to determine whether such U.S. assistance continues to be justified.
- The Commission recommends that the Commerce Department and USTR investigate whether China’s dual pricing system for coal and any other energy sources constitutes a prohibited subsidy under the WTO and include this assessment in the Commerce/USTR report on subsidies recommended in Chapter 1.

CHAPTER 7—CHINA’S HIGH-TECHNOLOGY DEVELOPMENT AND U.S.-CHINA SCIENCE AND TECHNOLOGY COOPERATION

- The U.S. government must develop a coordinated, comprehensive national policy and strategy designed to meet China’s challenge to the maintenance of our scientific and technological leadership. America’s economic competitiveness, standard of living, and national security are dependent on such leadership. The Commission therefore recommends that Congress charge the administration to develop and publish such a strategy in the same way it is presently required to develop and publish a national security strategy that deals with our military and political challenges around the world. In developing this strategy, the administration should utilize data presently compiled by the Department of

Commerce to track our nation's technological competitiveness in comparison with other countries.

- The Commission recommends that Congress revise the law governing the CFIUS process (Title VII of the Defense Production Act)—which gives the president authority to investigate mergers, acquisitions, or takeovers of U.S. firms by foreign persons if such activities pose a threat to national security—to expand the definition of national security to include the potential impact on national economic security as a criterion to be reviewed. In this regard, the term national economic security should be defined broadly without limitation to particular industries.
- The Commission recommends that Congress direct the administration to transfer chairmanship of CFIUS from the Secretary of the Treasury to the Secretary of Commerce.

CHAPTER 8—CHINA'S MILITARY MODERNIZATION AND THE CROSS-STRAIT BALANCE

- The annual report to Congress recommended in Chapter 4 on Taiwan's requests for military equipment and technology should include an assessment of the new military systems required by Taiwan to defend against advanced PRC offensive capabilities.
- As recommended in Chapter 4, Congress and the administration should review the need for a direct communications hotline between the United States and Taiwan for dealing with crisis situations. This is important in light of the short time frame of potential military scenarios in the Strait, together with Chinese strategic doctrine emphasizing surprise and deception.
- The Commission recommends that Congress urge the president and the secretaries of State and Defense to press strongly their European Union counterparts to maintain the EU arms embargo on China.
- The Commission recommends that Congress direct the administration to restrict foreign defense contractors who sell sensitive military-use technology or weapons systems to China from participating in U.S. defense-related cooperative research, development, and production programs. This restriction can be targeted to cover only those technology areas involved in the transfer to China.
- The Commission recommends that Congress request the Department of Defense to provide a comprehensive annual report to the appropriate committees of Congress on the nature and scope of foreign military sales to China, particularly from Russia and Israel.

CHAPTER 9—MEDIA AND INFORMATION CONTROL IN CHINA

- On June 30, 2003, the Commission recommended that Congress direct the Broadcasting Board of Governors to target funds for efforts aimed at circumventing China's Internet firewall through the development of anticensorship technologies and methods. Congress approved such funding as part of the 2004 Omnibus Appropriations Act. The Commission recommends that Congress continue this program with enhanced resources, pending successful results for the current fiscal year.

- As recommended in the Commission's 2002 Report, the Commission reiterates that Congress should direct the Department of Commerce and other relevant agencies to conduct a review of export administration regulations to determine whether specific measures should be put in place to restrict the export of U.S. equipment, software, and technologies that permit the Chinese government to surveil its own people or censor free speech.
- The Commission recommends that Congress approve legislation to establish an Office of Global Internet Freedom within the executive branch, tasked with implementing a comprehensive global strategy to combat state-sponsored blocking of the Internet and persecution of users. The strategy should include the development of anticensorship technologies.
- The Commission recommends that Congress encourage the administration to press China to freely admit U.S. government-sponsored journalists, such as those representing the Voice of America and Radio Free Asia. China frequently denies visas for such journalists, despite the fact that China's state-sponsored journalists are freely admitted in the United States. Options should be considered for linking Chinese cooperation to concrete consequences, including the possible use of U.S. visas for Chinese government journalists as leverage to gain admission of more U.S. government-supported journalists to China.

ENDNOTES

1. Recognizing deficiencies and loopholes in the current nuclear nonproliferation regime, President Bush has made several new proposals. First, that the Nuclear Suppliers Group nations (forty members) "refuse to sell enrichment and reprocessing equipment and technologies to any state that does not already possess full-scale, functioning enrichment and reprocessing plants." Second, an "Additional Protocol" has been submitted to the Senate for ratification. This protocol requires members of the NSG to declare a wide range of nuclear activities and facilities and for these to be open to IAEA inspectors. Only those countries that agree to the protocol would be allowed to import equipment for civilian nuclear programs. And third, the president proposed a new IAEA committee to focus on safeguards and verification and that IAEA members would be precluded from serving on the board of governors or the special committee if they are under investigation for violations of the NPT.

2. Under the International Economic Emergency Powers Act (IEEPA), the president does have the authority to select from the range of sanctions, but this implementation is an unlikely remedy as the IEEPA is to be invoked only in the event of a national economic emergency.

3. The IEA is an autonomous body within the OECD. OECD membership is limited to countries that can demonstrate its attachment to the basic values shared by all OECD members: an open market economy, democratic pluralism, and respect for human rights.