

# EXECUTIVE SUMMARY

This Report sets forth the Commission's analysis of the U.S.-China relationship in the topical areas designated by the Commission's Congressional mandate; these are the areas the Commission is to consider, and about which it is to make recommendations to the Congress. These include China's proliferation practices; the qualitative and quantitative nature of economic transfers of United States production activities to China; the effect of China's development on world energy supplies; the access to and use of U.S. capital markets by China; China's regional economic and security impacts; U.S.-China bilateral programs and agreements; China's compliance with its accession agreement to the World Trade Organization; and the implications of China's restrictions on freedom of expression. Our analysis, along with recommendations to the Congress for addressing identified concerns, is chronicled in the Report and summarized herein.

## COMMISSION ASSESSMENT OF U.S.-CHINA ECONOMIC AND SECURITY RELATIONS

Congress gave the Commission the mission of evaluating "the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China," and reporting its evaluation to Congress annually together with its findings concerning the topical areas listed above. The Commission adopts a broad interpretation of "national security" in making its review and its evaluation of how the U.S.-China relationship affects the economic health and industrial base of the United States, the military and proliferation risks China poses to the United States, and China's threat to U.S. economic and security interests and influence in Asia.

In its four previous major reports to Congress, the Commission outlined several trends in the economic and security relationship between the United States and China. The Commission's assessment for 2007 is consistent with those past analyses. This year the Commission has focused on identifying the specific commitments that China has made and laws that its government consequently has promulgated, while evaluating the extent to which China has fulfilled or failed to fulfill those commitments.

## COMMISSION CONCLUSIONS

This Report presents its conclusions, analyses, and recommendations to Congress in 15 segments organized in five chapters in response to the requirements of the Commission's Congressional mandate. However, the Commission has attempted to take an integrated approach to its assessments, believing that economic, security, and other issues are interrelated. The intersections of U.S. geopolitical, economic, security, diplomatic, and cultural interests form a complex web of concerns that comprise the overall relationship between the United States of America and the People's Republic of China.

The Commission's conclusions are included in this Executive Summary. At the end of this Summary, the Commission's ten key recommendations are listed. The Commission makes a total of 42 recommendations to the Congress in this Report. Those pertaining to each of the five Report chapters appear at the conclusion of the chapter, and a comprehensive list is provided beginning on page 285.

## **The United States-China Trade and Economic Relationship**

China made progress toward economic reforms in 2007, but only with great hesitancy and, even then, only with the prodding of other nations and the World Trade Organization. China is unwilling to embrace market-oriented mechanisms, such as a freely traded currency, because it maintains a preference for authoritarian controls over its economy. It has not yet, for example, allowed its citizens to freely invest their savings abroad or even in Hong Kong's stock market. Yet China also avoids effective controls where it fears that government intervention might limit economic growth. China continues to refuse, despite repeated promises, to crack down effectively on trademark and copyright piracy of foreign goods sold within China. The central government has also repeatedly resisted calls for it to rein in the extensive government subsidies it provides to favored industries, also a violation of free-market principles. Worse still, China formally has adopted a policy of retaining large amounts of the economy—encompassing a dozen industries from information technology and telecommunications to shipping and civil aviation—under direct government ownership and control. As China has adopted and maintained policies designed to support an export-driven growth model, it has amassed the world's largest foreign currency reserves of \$1.43 trillion.

### **Conclusions**

#### *The Relationship's Current Status and Significant Changes During 2007*

- China's trade surplus with the United States is growing dramatically, due in large part to its financial and economic policies that stimulate exports and discourage imports. China's trade surplus with the United States in goods through August 2007 rose to \$163.8 billion, an increase of 14 percent over the \$143.3 billion surplus during the equivalent period in 2006. By mid-2007, China had accumulated \$1.43 trillion in foreign currency reserves, up from \$1.2 trillion in 2006. An estimated 70 percent of those reserves, or about \$1 trillion, are invested in dollar denominated assets, mostly U.S. government and corporate bonds.
- Following a five-year phase-in period, China is largely complying with the World Trade Organization's procedures, rules, and regulations, at least on paper. While China has rewritten thousands of laws and regulations, major improvements are still needed in implementation and enforcement. China's performance is notably weak in the areas of intellectual property protection, maintenance of a market-based currency regime, and compliance with the WTO's prohibitions on export subsidies.
- China's economy remains heavily dependent on manufactured exports to sustain its rapid economic growth and to provide jobs for a rural population moving to urban areas in search of higher pay and benefits. Chinese authorities have not been willing to alter this pattern, even if pushing exports means violating WTO rules or free market principles.
- China's trade relationship with the United States is severely out of balance, with its exports to the United States exceeding its imports by a ratio of more than five to one.
- Beijing has been slow to translate three decades of record economic growth into a better life for all its citizens by enhancing government programs for education, pensions, and health care. Nor has China encouraged financial services reform to allow its citizens to enjoy the benefits of consumer credit and affordable insurance. As a result, Chinese workers save

much of their income to enable them to contend with life's vicissitudes and they purchase few imported goods.

- The artificially low value of the renminbi provides a subsidy for Chinese exporters and serves as a hindrance to Chinese importers and consumers.
- China's mercantilist policies are taking a huge toll on small and medium sized manufacturing facilities and their workers in the United States. While U.S.-based multinationals can transfer and have transferred much of their production to China to serve that market, small and medium-sized manufacturers in the United States are not as mobile. They face the full brunt of China's unfair trade practices, including currency manipulation and illegal subsidies for Chinese exports. This is significant because small and medium enterprises (SMEs) represent 60 percent of the manufacturing jobs in America.

#### *The Control of China's Economy by its Government, and the Effect on the United States*

- The push for reform in China's economy in the 1980's and 1990's appears in some cases to have reversed with a renewed use of industrial policies combined with a new class of super state-owned enterprises.
- China's 11<sup>th</sup> Five-Year Plan emphasizes industrial policy planning for the state-owned sector. The plan heavily promotes the development of value-added industries of a technical nature. The Chinese Communist Party employs a range of tools to accomplish these goals, including the use of subsidies and state-funded R&D centers, promoting foreign direct investment from Western high-tech firms, employing strategies to maximize technology transfers from more-developed economies, infant-industry protection, and directed use of China's state-owned enterprises.
- China's state-owned sector is evolving in a way that challenges American firms. The Chinese government provides state-owned enterprises a combination of subsidies, access to cheap capital, industrial coordination, and foreign policy support that U.S. firms do not have.
- China's consolidation of its state-owned enterprises (SOEs) is guided by a new policy announced in December 2006. The State-Owned Assets Supervision and Administration Commission (SASAC) and China's State Council identified seven strategic industries in which the state must maintain "absolute control through state-owned enterprises," and five heavyweight industries in which the state will remain heavily involved. The strategic industries are armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, civil aviation, and shipping. The heavyweights are machinery; automobiles; information technology; construction; and iron, steel, and non-ferrous metals. It is estimated that forty to fifty of SASAC's 155 central SOEs fall in the strategic category and account for 75 percent of SASAC's total assets.<sup>1</sup>
- China has created a new institution to invest part of its \$1.43 trillion foreign exchange holdings. The new sovereign wealth fund, managed by the China Investment Corporation (CIC), initially has been allotted \$200 billion to invest, according to some estimates.<sup>2</sup> It is

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<sup>1</sup> "Beijing Tightens Grip on Critical Sectors," *Asia Times*, December 20, 2006

<sup>2</sup> China's trillion-dollar kitty is ready," *Asia Times*, October 2, 2007, [www.atimes.com/atimes/China\\_Business/IJ02Cb01.html](http://www.atimes.com/atimes/China_Business/IJ02Cb01.html).

expected that the fund will diversify by exchanging some investments in American debt securities for investments in international equity markets. Recently the CIC purchased a \$3 billion stake in the private equity firm The Blackstone Group.

- China's economic policies violate the spirit and the letter of World Trade Organization membership requirements. The United States is not limited to countering China's industrial policy tactics through the WTO, however. It can use other WTO-sanctioned trade remedies to protect itself, such as Countervailing Duties (CVDs) and antidumping cases.

#### *The Impact of Trade with China on the U.S. Defense Industrial Base*

- As the globalization of supply chains continues, elements of the U.S. defense industrial base are being moved overseas, thus lengthening the supply chains of U.S. weapons and defense equipment. U.S. defense contractors have merged and moved some manufacturing outside the United States. Sources of defense components are becoming scarcer in the United States, and the supply of American workers skilled in manufacturing these components is diminishing.
- DoD is not a sufficiently large customer to many of its suppliers to be able to influence their supply chain decisions.
- Some of the items DoD purchases contain foreign-made components, the origin of which, in most cases, is unknown. There potentially are substantial security risks to the United States from using foreign-made parts and components in weapon systems or other equipment important to U.S. defense. These can result from—
  - tampering with or specially engineering foreign-manufactured parts and components.
  - inadequate quality that leads to failure or substandard performance.
  - interruption of the supply chains, thus depriving U.S. forces of the weapons and equipment on which they depend to defend U.S. interests.
- At the present time, U.S. officials are neither carefully tracking the persistent attrition of the U.S. defense industrial base as more and more manufacturing is outsourced offshore, nor identifying and justifying on national security grounds an irreducible minimum defense industrial base that the United States should retain regardless of the cost or effort required to do so.
- Specifically with respect to the impact of trade with China on the U.S. defense industrial base, U.S. officials are neither—
  - methodically tracking what parts and components are obtained from China that are used in significant and/or unique systems important to the nation's defense; nor
  - identifying based on specific national security considerations (1) particular parts and components that, if obtained from China, contractors and subcontractors should be prohibited from using in any such systems, and (2) a subset of key defense systems in which contractors and subcontractors are prohibited from using *any* parts or components from China; nor
  - developing effective means to implement, monitor adherence to, and enforce such policies and restrictions.

- The United States currently is a world leader in R&D, which greatly benefits its defense industrial base. As the quality of R&D in China continues to improve, and China's research capabilities continue to expand, it is becoming an increasingly attractive destination for American companies to outsource their R&D

*A Case Study of the Local Impact of Trade with China: North Carolina*

- The accelerating decline in North Carolina's manufacturing employment is due in large measure to increasing competition from imports, mostly from China. Manufacturing employment in the United States has declined for 50 years although the dollar value of manufacturing production has increased as a result of rising productivity.
- During this same period, the number and proportion of jobs in the North Carolina services sector have been increasing. This shift has put downward pressure on wages because manufacturing historically has paid substantially higher wages than the services sector. The shift also has reduced the number of workers receiving such fringe benefits as retirement and health insurance, in part because some of the displaced workers were able to find only part-time jobs that often do not offer benefits.
- Because a greater proportion of North Carolina's workforce held manufacturing employment than held such employment in any other state, North Carolina's workforce was more vulnerable to competition from imports than the workforces of other states. North Carolina's manufacturing economy was made even more vulnerable by its concentration in the import-sensitive sectors of textiles, apparel, and furniture.
- Trade agreements can profoundly affect state and regional economies and particular industries. The combination of China's 2001 admission to the World Trade Organization (WTO), which gave it quota-free access to U.S. markets for its textile and clothing exports, and the subsequent U.S. grant of Most Favored [Trading] Nation status that lowered most tariffs on Chinese imports,<sup>3</sup> battered North Carolina's textile and apparel industries, and they never recovered. While trade agreements that lower import barriers among America's trading partners have the potential to benefit American exporters, North Carolina appears to have realized few if any substantial benefits from China's admission to the WTO, and the net effect of trade with China since its accession appears to be negative overall for North Carolina's economy.
- Two provisions in trade laws and agreements proved crucial to sustaining what remained of North Carolina's textile, apparel, and furniture industries after China's admission to the World Trade Organization. The first authorized the U.S. Department of Commerce to levy "dumping" duties on below-cost imports of Chinese wooden bedroom furniture in July 2004. The second authorized imposition in 2005 of temporary import quotas on Chinese clothing imports.
- North Carolina has been a global leader in establishing a local base for research and science, leveraging the state's best universities and an innovative industrial policy to fashion the 700-acre Research Triangle Park, now almost 50 years old. It has been successful by almost any measure, attracting 157 tenants and creating its own job-creating momentum.

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<sup>3</sup> The provision was renamed Permanent Normal Trade Relations in legislation granting new trade privileges to China. The legislation lowered tariffs on China's imports to the lowest levels levied on imports from all other WTO members.

This center has enabled North Carolina to compete successfully for facilities of many companies and has substantially increased the number of higher paying jobs in the state.

- North Carolina has worked diligently to make user friendly the system of benefits for dislocated workers that has been established and funded largely by the Federal Government. This has greatly benefited its workers who have been dislocated by the effects of trade, and has helped salvage the state's economy and place it on a firmer footing.

## **China's Security-Related Activities**

The pace and success of China's military modernization continue to exceed U.S. government estimates. Indeed, on occasion the U.S. defense and intelligence communities have been taken by surprise, as in the case of the launching of the Jin class submarine by the navy of the People's Liberation Army. China's defense industry is producing new generations of weapon platforms with impressive speed and quality, and these advancements are due in part to the highly effective manner in which Chinese defense companies are integrating commercial technologies into military systems. Additionally, industrial espionage provides Chinese companies an added source of new technology without the necessity of investing time or money to perform research. Chinese espionage in the United States, which now comprises the single greatest threat to U.S. technology, is straining the U.S. counterintelligence establishment. This illicit activity significantly contributes to China's military modernization and acquisition of new capabilities.

Since the 1990s, China's nonproliferation record has improved. However, the United States continues to have concerns about China's willingness to invest in, sell weapons and military equipment to, and offer diplomatic support to regimes such as Iran's that are suspected of developing nuclear weapons, and regimes such as Sudan's that perpetuate human rights abuses. Additional commitment and political will in the Chinese government is needed to strengthen China's enforcement of its export controls, especially to ensure that state-controlled companies and private entities in China do not proliferate outside government policy and regulation.

## **Conclusions**

### *China's Military Modernization*

- Several Chinese advances have surprised U.S. defense and intelligence officials, and raised questions about the quality of our assessments of China's military capabilities.
- Chinese military strategists have embraced disruptive warfare techniques, including the use of cyber attacks, and incorporated them in China's military doctrine. Such attacks, if carried out strategically on a large scale, could have catastrophic effects on the target country's critical infrastructure.
- China has developed an advanced anti-satellite program consisting of an array of weapons that could destroy, damage, or temporarily incapacitate an adversary's satellites. The use of high energy lasers to temporarily blind U.S. satellites in late 2006 and the use of a direct-ascent anti-satellite kinetic weapon to destroy an aging Chinese satellite in early 2007 demonstrate that China now has this capacity.

- The Chinese defense industry, while still lagging far behind that of the United States, has begun achieving noteworthy progress over the past ten years. New generations of warships, fighter aircraft, spacecraft, submarines, missiles, and other sophisticated weapon platforms are coming off production lines at an impressive pace and with impressive quality.
- The pace at which each of China's defense industrial sectors is modernizing varies in direct proportion to its degree of integration in the globalized production and R&D chains, because such integration provides access to the most up-to-date technologies and manufacturing expertise.
- China is supplementing the technologies that its defense industry obtains through commercial transfers and direct production partnerships with an aggressive and large-scale industrial espionage campaign. Chinese espionage activities in the United States are so extensive that they comprise the single greatest risk to the security of American technologies.

#### *China's Proliferation*

- Since the 1990s, China's nonproliferation record has improved, especially after it established and expanded the reach of its domestic export control system. However, serious concerns remain about the continued transfer of weapons and technology to nations of concern and nonstate actors by Chinese state-controlled and private companies.
- Because of the opacity of China's government, when incidents of proliferation occur, it generally is difficult or impossible to know whether (1) the government objects to the incidents but is either unaware of them or powerless to stop them; (2) the transactions result from government acquiescence fostered by entrenched corruption; or (3) the government approves of the transactions in direct contravention of its official policy and commitments. Regardless, there is evidence that many illicit transactions are not accidental, and that all three of these explanations may have some validity in various cases.
- It is vital for U.S. national security that China ensure it is not the source of proliferation that is contrary to its commitments, and it is equally vital for other nations committed to nonproliferation to monitor China's adherence to its commitments and insist that China honor them.
- If China wants to be perceived as a responsible stakeholder, it must stop providing trade and diplomatic cover to countries such as North Korea and Iran that are under international pressure to end their WMD programs.
- Continued United States cooperation with China, and U.S. technical assistance to China, on export controls, border security, customs procedures, and port and shipping security can contribute significantly to China's capacity to play a positive role in reducing proliferation and consequently to increasing the world's security from terrorism and the destructive acts of irresponsible states.
- In order for China to eliminate its proliferating activity, it must couple sufficient technical capacity with strong and unmistakable political commitment, and ensure that its government,

its military, and its state-controlled companies and other organizations adhere to both the letter and the spirit of China's multilateral and bilateral nonproliferation commitments.

#### *China's Science and Technology Activities and Accomplishments*

- China's Fifteen-Year Plan for science and technology incorporates elements of previous similar plans, but also takes into account important social factors such as needed institutional and cultural reforms. It also places new emphasis on the importance of indigenous innovation rather than reliance on imported high-tech products.
- China no longer seeks only to attain parity with Western S&T, but instead is working to surpass the technological prowess of the West.
- On the whole, Chinese S&T capabilities still are not world-class. In some key specialties such as nanotechnology, however, Chinese scientists and engineers are among the world's most advanced.
- Chinese policies promote "leapfrogging," whereby the development of Chinese technologies improves on established foreign technologies and bypasses intermediate domestic R&D steps. This speeds product development and saves China the time and cost of accomplishing the intermediate steps. Industrial espionage contributes to this process.
- A major objective of Chinese S&T policy is to acquire technology that will strengthen the PLA while it also realizes commercial benefits.

### **China's Energy and Environmental Policies and Activities**

China's rapid pace of development has led to increasing energy consumption that has global environmental and energy security effects. China's demand for oil and reliance on oil imports are growing, but it has maintained an overall dependence on coal as a leading energy resource, especially for production of electricity. Dependence on coal, a lack of energy efficiency, and poor enforcement of energy and environmental regulations are creating devastating environmental effects that extend throughout the region and beyond to the United States. Additionally, China's strategy for acquiring energy resources has created concern that China is not willing to act as a responsible player in the international energy market, where it continues to invest in countries whose governments perpetuate human rights abuses and conflict such as Sudan, Iran, and Burma. China's actions in this regard affect U.S. national security interests in the Middle East and Asia.

United States-China cooperation on energy and energy-related environmental concerns occurs on several different levels in both the private and public realm, and has produced new opportunities for the development and application of clean energy technology to address China's energy and environmental situation.

### **Conclusions**

#### *China's Energy Policies and Activities*

- The lack of policy coordination and implementation between the central government and local or provincial levels of government is hindering China from achieving greater gains in energy efficiency, promoting greater use of alternative fuels, and mitigating the environmental consequences that result from China's dependence on coal. If this structure is not reformed, the Chinese government will not have, for the foreseeable future, the administrative tools necessary to reform China's domestic energy consumption patterns, and also will be limited in its ability to address global energy problems proactively.
- As incomes rise in China and the economy becomes more consumption-oriented, effective conservation programs will be essential if energy demand growth is to be limited. China will have to pay close attention to mitigating the effects of energy-intensive and heavily polluting consumer items such as automobiles and air conditioners, which will require government regulation or market-based incentives that influence consumer choices on such items. Changing consumer demand also will affect the composition of China's fuel needs, likely increasing China's use of oil and natural gas, which will increase global demand for oil.
- China is pursuing an energy diversification strategy that seeks to find cleaner alternatives to coal. However, as long as the environmental costs of burning coal are not built into coal's price, the degree of diversification into natural gas, nuclear power, and renewable energy sources will have little impact on the complexion of the fuel supply, and China will continue to rely on coal as its primary energy source and increase its reliance on oil. This has long-term negative environmental and strategic consequences for the United States, but also raises opportunities for U.S.-China collaboration on clean coal technologies.

#### *China's Environmental Situation*

- China's national leaders recognize that a failure to enforce environmental controls on pollution has significant economic and social costs. However, the government has not yet taken steps to ascribe value to environmental compliance that equals or exceeds the value placed on economic growth. Continued lax enforcement may have consequences for the sustainability of China's economic growth.
- If China's underlying environmental problems are not addressed effectively, this could become another source of unrest that could challenge the Chinese Communist Party's control of the country.
- China soon will overtake the United States as the largest emitter of greenhouse gases in the world if it has not already done so. China currently is the largest national source of coal mine methane and is poised to become the largest national source of carbon dioxide. Global climate change initiatives will not work without China's participation.
- The effects of China's energy-related pollution are far-reaching, extending to the United States and beyond. China lacks adequate data and public information to assess accurately changes in its energy consumption and resulting environmental consequences, especially at the provincial and local levels. Greater availability and transparency of data can improve the central government's ability to make and implement sound energy policy, and assist the United States in understanding more clearly the mutual energy and environmental challenges

facing both countries. Additionally, more accurate data can facilitate deployment of green energy technology, much of which is developed in the United States.

#### *The Geostrategic Impact of China's Energy Policies and Activities*

- China's pursuit of equity oil acquisitions is contrary to international commercial practices related to energy that support use of the market, and allocation of available petroleum supplies through international cooperation in the event of an emergency.
- In pursuing some of its global energy interests, China aids regimes operating contrary to U.S. foreign policy interests, such as the genocidal government in Sudan and Iran's government that is attempting to develop its own nuclear capability.
- The bilateral relationships China is building around the world—many if not most of them largely motivated by its quest for energy supplies and other resources—have resulted in an increase of its global economic, political, diplomatic, and cultural influence that has the potential to challenge U.S. interests.
- China's naval modernization is targeted not only on a Taiwan scenario but also on protecting China's economic resource supply chains. As Chinese overseas investment grows, the government will have a greater stake in protecting these investments and the ability to transport to China the resources the investments are producing and its economy requires. This is a major determinant of China's naval modernization.

#### *Prospects for Addressing the Effects of China's Energy Consumption*

- Success in addressing China's energy challenges will require the Chinese government to focus on correcting the structural weaknesses within its energy policymaking apparatus.
- Cooperative projects that promote and support the collection and reporting of sufficiently detailed energy and environmental data will contribute substantially to China's ability to address challenges in these fields and to the ability of the United States and other nations to provide real encouragement and targeted assistance to those efforts.
- U.S.-China cooperation on energy and the environment is a crucial component for addressing the energy challenges that both countries face.
- China presents an opportunity to develop and apply U.S. energy technologies on a large commercial scale that will increase the viability of these technologies on the market.

## **China in Asia**

During 2007 Commission delegations conducted fact-finding visits to China, Hong Kong, Taiwan, and India in fulfillment of its mandate to assess the U.S.-China relationship, the triangular U.S.-China-Taiwan relationship, and China's regional economic and security impacts. The U.S. commitment to the 1979 Taiwan Relations Act remains strong. American leaders are committed to helping Taiwan's people maintain international visibility, continue to upgrade their self-defense

capabilities, and further strengthen their democracy. Politically, Taiwan's relationship with the PRC remains tense, with leaders on both sides of the Taiwan Strait relying on rhetoric to advance their respective positions vis-à-vis the status of Taiwan.

In Hong Kong, the transition to a government elected by universal suffrage has yet to occur, although this is guaranteed in Hong Kong's Basic Law that establishes the political system for the Hong Kong Special Administrative Region. Hong Kong's Chief Executive, Donald Tsang, has promised to resolve the question of universal suffrage before the end of his term in 2012, but democracy supporters are skeptical that any real progress toward an equal and universal right-to-vote will occur in the near future.

While India and China have grown to become Asia's leading emerging economies, India has become both a competitor and a partner with China in Asia. The unresolved border conflict between India and China could act as a destabilizing factor in the region, and so far, negotiations to resolve this conflict remain stalled. U.S.-India economic and security cooperation possibly could serve as a counterweight to growing Chinese influence in Asia.

## **Conclusions**

### *Taiwan*

- Taiwan's 2008 Presidential and legislative elections raise a number of significant issues in cross-Strait and U.S.-Taiwan relations.
- Tensions between Taiwan and China have created an emotionally-charged stand-off that risks armed conflict if not carefully managed by both sides. Such a conflict could involve the United States.
- Economic links between Taiwan and China have grown significantly over the last several decades. Currently, it is estimated that Taiwan businesses have between US\$150 billion and US\$250 billion invested in the PRC, accounting for one-tenth of China's total foreign direct investment and making Taiwan China's largest investor. Some think these economic links act as a stabilizing force, while others are concerned that they strengthen China's military-industrial complex to the potential detriment of Taiwan.
- Although Taiwan's defense spending has declined as a percentage of GDP, it has continued to enhance its self-defense capabilities in meaningful ways. The United States has been encouraging Taiwan to enhance its ability to engage in joint and combined operations, and to expand and improve its C4ISR abilities, naval operations, and missile defense. Taiwan has made notable progress in some of these areas.
- Partisan politics in Taiwan have prevented the achievement of a consensus concerning which steps it needs to take and what weapon systems it needs to acquire to give it optimum defensive capability. This weakens its ability to deter Chinese aggression.
- Taiwan desires to establish a Free Trade Agreement (FTA) with the United States. It sees such an agreement as offering not only economic benefits but also diplomatic leverage it believes will be crucial to preventing the PRC from further isolating the island. For a number

of reasons, the Administration has indicated it currently is unable to move forward on an FTA with Taiwan.

#### *India*

- The United States and India share similar concerns about the rise of China, the spread of its influence in Asia and elsewhere around the world, and the security implications of an emboldened China willing to assert its military power in areas outside its borders and territorial waters.
- Although India does not want to be perceived as “ganging up” against China, it will seek to expand its multilateral relationships to hedge against China’s growing influence and military strength. In part because of this, opportunities exist for U.S.-India cooperation on economic and security matters and in the promotion of democratic values and governance throughout Asia.

#### *Hong Kong*

- The United States and other democracies, especially in Asia, have a strong interest in the development of democratic freedoms in Hong Kong. Progress toward universal suffrage not only is guaranteed by the Basic Law, but is an important indicator of Beijing’s willingness to fully implement its “one country, two systems” principle. The delay in implementing universal suffrage, and the possibility that the definition of universal suffrage will be altered to include options other than “one person, one vote,” lead to significant concerns that Hong Kong will not achieve the universal suffrage guaranteed in its Basic Law.
- The March 2007 elections for Chief Executive set an important precedent for holding public debates, articulation by candidates of policy positions and goals, and the desire of the people of Hong Kong to have multiple candidates.
- The linkages between China’s energy consumption and the pollution affecting Hong Kong provide both incentives and opportunities for increasing investments in clean energy production on the mainland. This can provide an opening for American firms offering clean energy technologies.
- Maintaining an independent, free press in Hong Kong and preventing the causes of self-censorship are necessary for democracy in Hong Kong.

### **China’s Media and Information Controls – The Impact in China and the United States**

The Chinese government’s policies on information control have grown more rigid since Beijing’s adoption of President Hu Jintao’s “Harmonious Society” socio-economic policy, which intends to mitigate sources of internal domestic conflict and criticism of the government and maintain the Communist Party’s hold on power. Directed by China’s Central Propaganda Department, a variety of other government agencies collectively censor domestic media sources and information that Chinese citizens can access on the Internet. Using sophisticated technologies, stiff penalties

for dissent, and incentives for those who “play by the rules,” Chinese authorities have created one of the most effective information control regimes in the world.

China uses its controls to manage and manipulate the perceptions of the Chinese people, often promoting nationalism and xenophobia. Additionally, Beijing uses these controls to influence the way it is perceived by foreign populations such as in the United States. By manipulating international media reports written about China and denying pertinent information to the outside world on salient issues including food and product safety and the outbreak of diseases, China’s actions have the potential to endanger the welfare of U.S. citizens.

## **Conclusions**

- Over the decades China has built one of the world’s most effective information control systems. The Chinese government controls the content of newspapers, magazines, television, radio, and the Internet. Chinese journalists have been demoted, fired, imprisoned and beaten for violating restrictions on media content. Internet users face similar restrictions and violators may be imprisoned.
- China censors information and communications pertaining to some broad issues like democracy, human rights, and the Falun Gong as well as to more subtle issues related to domestic current affairs and political developments. Strict penalties for addressing forbidden topics, and the uncertainties of where the fine lines fall at any moment, have created an environment of strict self-censorship among Chinese journalists. These self-imposed restrictions effectively stifle information Beijing deems undesirable.
- China’s information controls are designed to perpetuate the existence of the Chinese political structure and the Chinese Communist Party’s control of the nation, and also to maintain a stable environment for China’s new “rising power class,” the primary beneficiaries of the developing two-tiered society who are seeking to maintain their favored status.
- Through its media control regime, the Chinese government has been able to manipulate and influence the perspectives of many Chinese citizens. While the majority of the Chinese people understand that the information provided by Chinese state-owned media organizations may not be free of censorship and propaganda, they have little choice but to rely on it when forming their opinions about the outside world. Beijing has used this capacity to create deep feelings of nationalism inside China and can use it to incite strong anti-foreigner sentiments among the Chinese people when it wishes to do so.
- The strong nationalism Beijing has fostered may constrain its options to respond to international incidents. This could result in exacerbating tensions in a sensitive situation and turning a misunderstanding into a conflict. The media organizations supervised by the U.S. Broadcasting Board of Governors struggle in the face of Chinese censorship to provide accurate news and information to the people of China through radio and television broadcasts and the Internet. In violation of international laws the Chinese government successfully jams or blocks access to many of these broadcasts and Internet messages and content.

- Some U.S. technology firms have cooperated with and contributed to the Chinese government's censorship and propaganda systems by supplying hardware and software. In some but not all these cases, their cooperation may be a Chinese legal requirement.
- Chinese leaders are seeking an international reputation that is benign if not benevolent, and are using every available state resource in their effort. Chinese Communist Party news outlets such as *Xinhua* are employed in a concerted perception management campaign that is directed not only at domestic audiences but also at foreign populations.
- China's control and manipulation of information make it difficult or impossible for officials responsible for food and product safety in the United States and other nations to identify potential safety problems in Chinese imports on a timely basis and intervene to protect the health and safety of consumers.

## THE COMMISSION'S KEY RECOMMENDATIONS

The Commission believes that 10 of its 42 recommendations to Congress are of particular significance. These are presented below in the order in which they appear in the Report. The complete list of 42 recommendations appears at the Report's conclusion on page [xx](#).

- ***Treating currency manipulation as an illegal export subsidy:*** The Commission recommends that Congress enact legislation to define currency manipulation as an illegal export subsidy and allow the subsidy to be taken into account when determining penalty tariffs. In addition, Congress should amend the law to allow currency manipulation to be added to other prohibited subsidies when calculating antidumping and countervailing duty penalties.
- ***Determining the country of origin of U.S. weapon systems components:*** The Commission recommends that Congress require the Department of Defense to prepare a complete list of the country of origin of each component in every U.S. weapon system to the bottom tier.
- ***Ensuring adequate support for U.S. export control enforcement and counterintelligence efforts:*** In order to slow or stop the outflow of protected U.S. technologies and manufacturing expertise to China, the Commission recommends that Congress assess the adequacy of and, if needed, provide additional funding for U.S. export control enforcement and counterintelligence efforts, specifically those tasked with detecting and preventing illicit technology transfers to China and Chinese state-sponsored industrial espionage operations.
- ***Ensuring adequate support for protecting critical American computer networks and data:*** The Commission recommends that Congress assess the adequacy of and, if needed, provide additional funding for military, intelligence, and homeland security programs that monitor and protect critical American computer networks and sensitive information, specifically those tasked with protecting networks from damage caused by cyber attacks.
- ***Ensuring U.S. access to and ability to use space:*** The Commission recommends that Congress ensure that the U.S. Department of Defense and the National Aeronautics and Space Administration have programs to provide access to space, protect space-based assets, and maintain adequate defense measures such as those required for rapid replacement of destroyed assets in space (the Operational Responsive Space framework).

- ***Addressing weaknesses in U.S. intelligence capabilities focused on China's military:*** The Commission recommends that Congress instruct the director of national intelligence to conduct a full assessment of U.S. intelligence capabilities vis-à-vis the PRC's military, and identify strategies for addressing any U.S. weaknesses that may be discovered as part of the assessment
- ***Assessing potential Chinese military applications of R&D conducted in China by U.S. companies:*** The Commission recommends that Congress direct the U.S. Department of Defense to evaluate, and, in its *Annual Report to Congress on the Military Power of the People's Republic of China*, to report on, potential Chinese military applications of R&D conducted in China by U.S. companies.
- ***Engaging China to address global climate change/environmental degradation:*** The Commission recommends that Congress urge the Administration to engage China to address global climate change/environmental degradation and identify opportunities for further U.S.-China cooperation.
- ***Establishing joint efforts with China to monitor, determine the costs of, and prevent pollution:*** The Commission recommends that Congress encourage the Administration to seek opportunities with China (1) for joint study of the economic and social costs of environmental pollution, (2) for joint projects to monitor more effectively and transparently relevant environmental pollutants, and (3) for joint projects to prevent pollution by use of nonpolluting energy sources and technologies and application of technologies to reduce pollution from carbon fuel combustion (such as carbon capture and sequestration techniques).
- ***Assisting Taiwan to strengthen its military:*** The Commission recommends that Congress encourage the Administration to continue to work with Taiwan to modernize its military, enhance Taiwan's capabilities for operating jointly with U.S. and allied forces, and make available to Taiwan the defensive weapons it needs for its military forces.